BANK FOR
INTERNATIONAL SETTLEMENTS

FORTY-THIRD ANNUAL REPORT

1st APRIL 1972 – 31st MARCH 1973

BASLE

18th June 1973

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FORTY-THIRD ANNUAL REPORT

submitted to the

ANNUAL GENERAL MEETING

of the

BANK FOR INTERNATIONAL SETTLEMENTS

held in

Basle on 18th June 1973

Gentlemen,

I have the honour to submit herewith the forty-third Annual Report of the Bank for International Settlements for the financial year which began on 1st April 1972 and ended on 31st March 1973.

After deduction of 3,984,995 gold francs transferred to the Provision for Exceptional Costs of Administration and 10,000,000 gold francs transferred to the Provision for Building Purposes, the net profit for the year amounted to 122,063,281 gold francs, compared with 148,832,656 gold francs for the preceding year and 99,448,906 gold francs for the financial year 1970–71.

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 18,042,187 gold francs in payment of the preferential dividend of 6 per cent. per annum, or 37.50 gold francs per share, and that from the remainder of the net profit it should appropriate 9,021,094 gold francs — a sum falling within the statutory limit of 20 per cent. — in payment of the maximum further dividend of 3 per cent. per annum, or 18.75 gold francs per share.

The Board further recommends that 47,500,000 gold francs be transferred to the General Reserve Fund, 13,967,817 gold francs to the Special Dividend Reserve Fund (thereby increasing the amount in that Fund to the statutory maximum of one-quarter of the paid-up capital) and the remainder of 33,532,183 gold francs to the Free Reserve Fund.

If these proposals are approved, the Bank's total dividend for the financial year 1972–73 will amount to 56.25 gold francs per share. This will be payable to shareholders on 1st July 1973 in Swiss francs.

Chapter I of this Report gives a survey of economic developments and policies in 1972–73, dealing in particular with the problem of inflation, the expansion of money and credit, the monetary crises and the prospects of reform of the international monetary system. The second chapter analyses developments in individual countries in respect of production, prices and monetary and fiscal policies. The following two chapters review the events of last year in the fields of foreign trade and payments, gold production, global reserves and foreign exchange markets. The fifth chapter examines developments in the Euro-currency and Euro-bond markets and the sixth deals with the operations of the European Monetary Agreement and its termination. Chapter VII concerns the Bank's activities during the financial year, the Balance Sheet and the financial results.

I. SURVEY OF ECONOMIC DEVELOPMENTS AND POLICIES, 1972-73.

The dramatic aspect of international economic developments in the past year was the breakdown of the exchange rate structure that had been put together at the Smithsonian Institute in December 1971. By the third quarter of last year it was already clear that the realignment of currencies would not bring about an adequate adjustment of payments imbalances — if it brought about one at all. The exchange crisis, when it came, was acute and market confidence was so far undermined that a new devaluation of the dollar was of no avail; floating and controls were the new order of the day.

Soon after the exchange rate structure first gave way in August 1971 there began to be signs of business uncertainty and of possible adverse effects on trade and production. This time, however, no such signs have as yet appeared and the upswing of the business cycle, which was general by the second half of 1972, has accelerated sharply in the past six to eight months. The movement has been so rapid that the authorities in several countries have already taken steps against the threat of excess demand.

Excess demand or not, inflation remained acute in most countries, becoming generally more intense in the second half of 1972. Only by using price and wage freezes followed by statutory controls were the United States and the United Kingdom able to achieve some success in dampening the spiral. In addition to the steady pressure of wage-push inflation, the trend in prices was aggravated by considerable increases in basic commodity prices. The dilemma of the situation was that this speeding-up came when the economies of many countries were not at full-employment levels.

Production and demand.

The cyclical upswing in economic activity that began in the United States and Canada in early 1971 gradually showed itself in most other industrial countries in the course of 1972. The expansion of output in the United States was particularly fast throughout all of last year and into the first half of 1973, and in Canada too a high rate of growth has continued. For the other countries, however, developments were for a time quite mixed, even though renewed expansion has been the dominant tendency. A few countries, including France and Switzerland, had been little affected by the 1971 recession and over the past year experienced fairly steady growth at rates comparing favourably with longer-term trends. It was in the others, where output had been sluggish in 1971, that the turn-round in the cycle was evident last year.

In Japan, for example, activity showed new stirrings early last year and has moved ahead at an accelerated pace since the autumn; the economy seems clearly headed for one of its super-star performances in 1973. In the United Kingdom the second quarter of

1972 signalled a new expansionary phase and production has increased quite fast since — if at a more staid pace than in Japan. In Belgium and Spain production was clearly accelerating from early in 1972, or even perhaps from late 1971, and the gains have been substantial into the first half of this year. In Germany, the Netherlands and Sweden, on the other hand, the recovery had a late start, without many signs of strength until about the last quarter of 1972; in Germany, in particular, it has moved ahead with a burst of vigour since then. In Italy, too, output has been picking up somewhat since about last October, but it has a long way to go before the earlier growth rates of the economy are reached.

In consequence of the realignment of currencies in December 1971, export demand was not the mainspring of renewed expansion of output that it had been in earlier economic cycles. Although Belgium, Germany, Norway and Spain provide exceptions, exports in the first half of 1972 did not generally show their accustomed bounce. Thereafter, however, a sharp upturn of exports occurred in many countries, including Canada, France, Japan, Sweden, the United Kingdom and the United States. In the Netherlands, where the increase in real product in 1972 was about the same as in the previous year, the rise in exports was a sustaining factor. In a number of cases the differences in the timing of the cyclical upturns and in the speed of domestic expansion ran counter to the needs of external adjustment. This was conspicuously true of the United States and the United Kingdom, where imports rose much faster than exports.

As to domestic demand forces, personal consumption played a key rôle in the advance or recovery of economic activity. Particularly in the United Kingdom, but also in the United States and Canada, the increase in real consumption in 1972 was much higher than the 1961–70 average and reflected a return of consumer confidence, rising disposable incomes and relatively easy credit conditions. It is evident, too, that in some cases consumers were motivated to beat rising prices. In Japan consumption growth recovered to about its long-term average. Among the continental European countries, consumption in Austria, Belgium, Finland and Switzerland advanced at a high rate in terms of earlier standards, and in France it continued to go up fairly steadily. In other countries, including Italy, the Netherlands, Sweden and Spain, consumption rebounded last year from the earlier recessed levels, but the rate of increase remained noticeably below that of the sixties.

So far in the cyclical upswing business plant and equipment outlays have not generally been a dynamic force. An exception has been the United States where such investment showed a sharp upturn last year and where a larger rate of increase is likely this year. The momentum of the expansion as a whole, the shrinking margin of spare capacity and the improvement in operating results have all helped to strengthen business confidence. In Japan, on the other hand, fixed investment in manufacturing industry actually declined, but that in non-manufacturing industry showed a strong increase. In western Europe the only countries to show a fair gain in industrial investment were France, Sweden and Switzerland. Elsewhere such increases as occurred were modest, and in the Netherlands there was a sizable decline. Investment in stocks also lagged in the upswing, remaining generally weak or, as in the case of the United Kingdom and Sweden, even negative.

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			
		annual average or annual volume changes, in percentages							
Austria	1961-70	4.4	3.0	6.0	.	.	8.5	8.4	4.7
	1971	6.6	2.6	12.9	.	.	4.8	5.9	5.6
	1972	7.3	6.0	4.4	.	.	10.3	11.2	6.4
Belgium	1961-70	4.0	5.7	5.3	6.1	2.9	9.4	8.6	4.9
	1971	4.6	4.8	-2.8	-2.6	-4.9	8.1	6.2	3.7
	1972	4.7	7.4	-0.6	.	.	9.2	8.3	4.1
Canada	1961-70	4.5	5.9	5.2	5.6	3.4	9.1	7.2	5.2
	1971	5.5	5.3	5.7	3.3	16.1	5.2	8.2	5.5
	1972	7.6	5.0	4.1	2.6	9.6	6.2	10.9	5.5
Denmark	1961-70	4.8	6.1	7.4	7.2	8.0	7.1	8.2	4.8
	1971	1.9	6.9	1.9	2.0	1.7	4.2	1.0	3.1
	1972	3.0	7.2	9.0	.	.	7.0	4.5	4.6
Finland	1961-70	4.9	5.6	4.0	3.3	6.4	7.6	8.3	5.1
	1971	3.0	4.5	2.7	4.2	1.1	-1.1	-0.4	2.3
	1972	5.2	5.4	2.9	1.3	8.0	15.1	4.1	4.9
France	1961-70	5.7	3.6	8.9	9.2	8.3	9.6	10.8	5.8
	1971	6.0	3.5	5.9	5.9	5.8	11.7	11.6	5.0
	1972	5.4	2.4	8.1	7.0	11.0	12.5	12.4	5.3
Germany	1961-70	5.0	4.3	5.7	6.6	3.1	8.5	9.9	4.8
	1971	5.6	7.3	4.5	3.7	8.3	6.5	9.8	2.7
	1972	3.5	4.4	1.9	-0.6	12.8	7.6	8.1	2.9
Italy	1961-70	6.1	4.0	5.0	4.6	5.9	12.1	11.9	5.7
	1971	2.8	6.2	-3.5	-0.1	-11.7	6.2	1.7	1.6
	1972	3.8	4.2	-0.2	-1.0	2.0	11.2	13.2	3.2
Japan	1961-70	9.1	6.6	14.9	14.8	15.4	15.3	14.8	11.1
	1971	7.1	8.1	7.7	8.6	3.9	17.9	3.4	6.2
	1972	9.3	7.8	10.7	10.0	14.3	7.4	8.5	9.2
Netherlands. . .	1961-70	5.9	3.2	7.0	7.1	6.4	8.9	10.1	5.1
	1971	3.1	3.5	1.7	0.1	8.6	11.1	6.8	4.3
	1972	4.0	1.3	-5.0	-8.6	10.2	9.1	5.7	4.2
Norway	1961-70	4.1	6.4	5.4	5.1	6.6	7.8	8.0	5.0
	1971	5.0	7.5	18.6	20.2	11.5	2.6	6.1	5.4
	1972	1.6	5.3	-5.7	-7.4	2.5	14.1	1.5	4.2
Spain	1961-70	7.2	5.5	10.3	12.2	4.1	12.3	17.4	7.5
	1971	3.4	6.4	-6.1	-6.2	-5.7	14.5	0.6	4.6
	1972	6.5	4.5	13.6	.	.	12.2	18.6	7.3
Sweden.	1961-70	3.7	5.4	5.0	5.0	5.2	7.6	7.3	4.4
	1971	-0.9	4.0	-2.1	-1.8	-3.2	6.4	-2.3	0.0
	1972	2.3	1.0	5.5	6.3	2.7	5.8	4.7	2.2
Switzerland . . .	1961-70	4.7	4.6	6.0	6.8	3.9	7.7	9.0	4.5
	1971	5.5	3.7	7.8	8.3	6.7	3.7	6.9	3.9
	1972	5.7	4.5	7.5	7.1	9.0	4.5	6.8	4.7
United Kingdom.	1961-70	2.4	2.1	4.5	5.0	2.9	4.9	4.0	2.7
	1971	2.6	3.9	-0.6	-1.0	1.8	5.7	5.8	1.6
	1972	6.8	3.5	0.7	-0.6	7.2	2.9	9.3	2.2
United States . .	1961-70	4.2	4.2	3.7	4.4	0.2	6.9	8.1	4.0
	1971	3.9	-1.6	5.2	-0.4	29.6	0.8	5.0	2.7
	1972	5.9	4.9	10.0	7.2	19.5	8.0	11.8	6.4

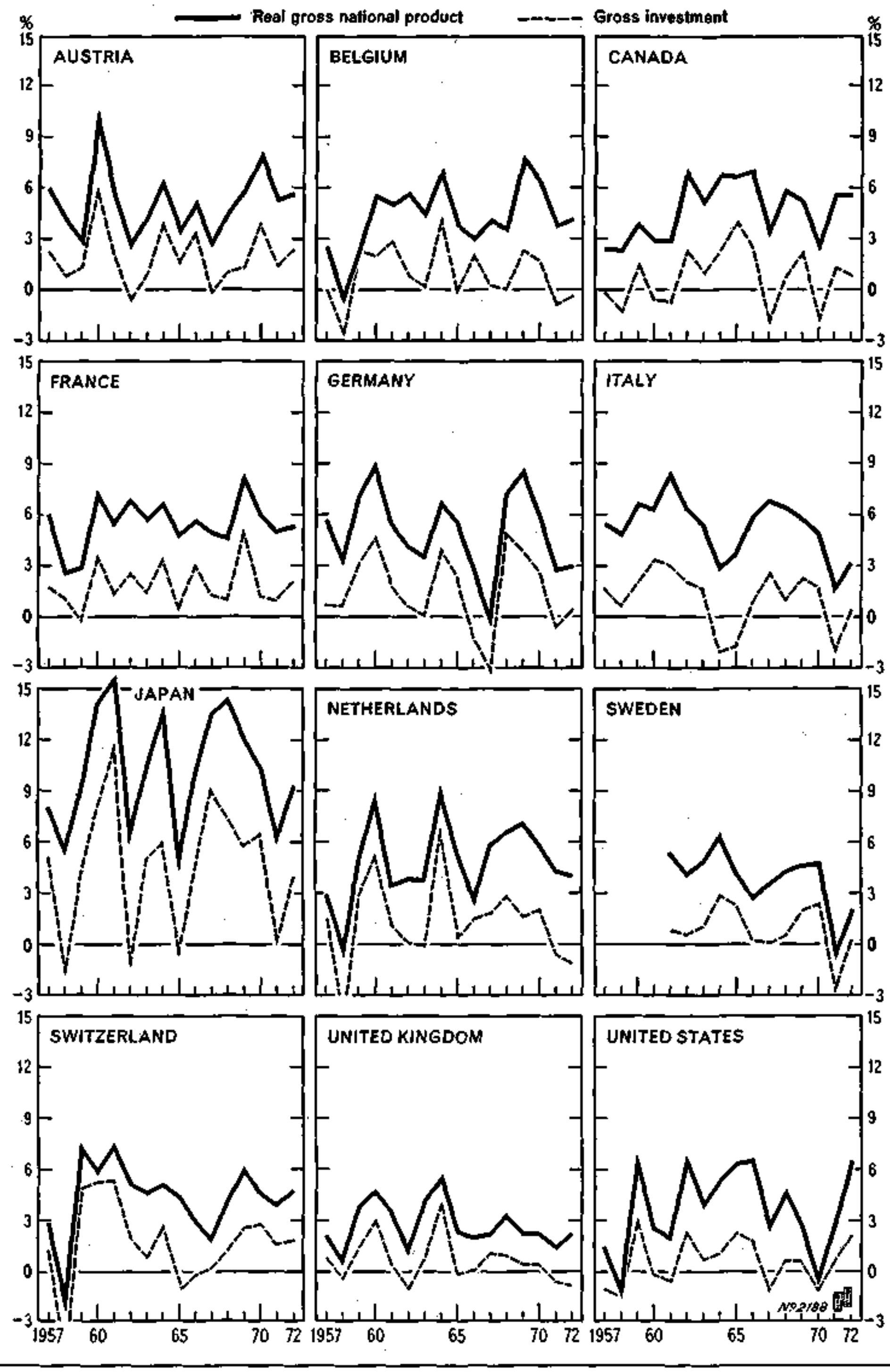
The situation in residential construction, however, was quite different. Boom conditions prevailed in many countries, reflecting strong demand for housing, relative credit ease during most of 1972 and also, to some extent, a flight from money into real assets. In the United States house-building rose by 20 per cent. in 1972, after a 30 per cent. gain the year before, and in Canada the same pattern occurred on a reduced scale. In Japan a vigorous housing boom got under way following the negligible growth recorded in 1971, with an increase in construction of 14 per cent. last year. In western Europe housing construction showed the largest acceleration in the United Kingdom, but it also advanced at a high or more rapid rate in the Netherlands, Germany, Denmark, France and Switzerland. On the other hand, the recession in house-building in Italy continued into its third year, reflecting largely legal and administrative impediments, while in Sweden, where the market for new housing had become temporarily saturated, only a gentle recovery occurred after two years of decline. More recently, new construction appears to have accelerated in Sweden and Belgium, while levelling off in the United States and Canada.

Official attitudes towards capital formation have been undergoing some change of emphasis. In Japan the authorities are aiming at a de-emphasis of manufacturing investment, with which the overly-large exports of recent years have been associated, in favour of investment in social infrastructure, housing and service industries. For both domestic and external reasons certain countries, particularly Italy, Sweden and the United Kingdom, but apparently also the United States, would like to see a distinctly higher rate of productive investment over the long term. Other countries, such as Belgium and the Netherlands, have also evinced concern about manufacturing investment, though less because of balance-of-payments implications than because of constraints being imposed by cost inflation and the earlier squeeze on profit margins. In France, on the other hand, official efforts over recent years to maintain a high rate of industrial investment have met with fairly consistent success.

In view of these changing attitudes, as well as of differences in cyclical positions, it is interesting to look at last year's investment results against a longer-term perspective. Gross capital formation (that is, plant and equipment outlays, housing construction and stock accumulation) has traditionally been the most volatile component of demand, which has at times exercised a dominant influence on the cyclical shifts in total output. The accompanying graph shows the contribution of gross investment, in terms of percentage points, to the annual percentage change in real gross national product for the major industrial countries since 1957.

The graph clearly reveals the close association between the rates of growth of real output and gross investment. It also indicates the diversity in the patterns of cyclical fluctuation between countries, for example the wide swings in activity in Japan, the relatively stable growth in France and the comparatively stagnant trend in recent years in the United Kingdom. With regard to 1972, it can be seen that gross investment made a moderate-to-substantial contribution to real product in Austria, Canada, France, Japan, Switzerland and the United States and that overall real growth in these countries, though in some cases in an early phase of upswing, compared favourably with average performances over the longer term. In other countries, including Belgium, Germany, Italy, the Netherlands, Sweden and the United Kingdom, the contribution of gross investment, though in most cases better than in 1971, was either quite low, as in

Contribution of gross investment to changes in real gross national product.*



* The figures for gross investment represent the contribution in terms of percentage points to the annual percentage change in real gross national product.

Germany, or still negative. Almost all countries expect a further recovery or continued advance in fixed investment, together with a substantial pick-up in inventory investment, in the course of 1973.

In the past year or two it seems that many industrial firms have been shifting the emphasis in new investment away from capacity expansion towards productivity improvement. The reason, of course, has been the burden of rising wage costs, and one result has been some sluggishness in the fall of unemployment. This was the case in the United States and even more in Canada, but in most western European countries, too, a similar lag was evident before unemployment began to ease off late in 1972. Almost all countries, with the main exception of Italy, have continued in this phase of the cycle to experience large productivity gains ranging from about 5 to 10 per cent., though closer to 15 per cent. in the case of Japan. In view of the persistent problems of cost inflation, firms in most countries are bound to continue the search for productivity-orientated capital outlays.

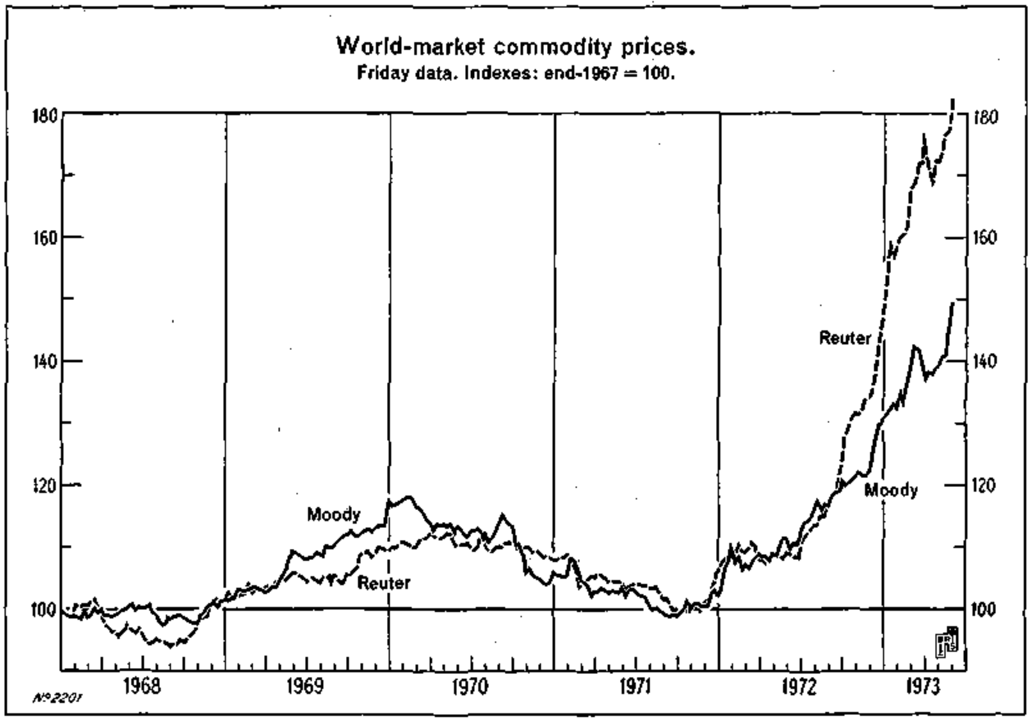
Data becoming available in the late spring of this year confirm the strength and broad sweep of the economic expansion. While in many countries demand is not yet pressing heavily against resources, the rate of increase is now so rapid that a generalised state of excess demand no longer seems far off. For this reason a number of countries have been turning to restrictive measures so as to temper the rate of expansion. The country reviews in the next chapter bring out the shifting policy attitudes.

The problem of inflation.

A high rate of price inflation was again a feature of the world economy over the past year. While the pace of the advance in prices generally eased marginally during the first half of 1972, this gave way later in the year to a distinct and widespread acceleration, which has continued into 1973. By April of this year consumer prices were mostly rising at annual rates of between 6 and 10 per cent. A major factor in this acceleration was soaring prices of primary products throughout the world. This was reflected directly in the surge of wholesale prices which began around mid-1972. Almost everywhere wholesale prices have been going up considerably faster than consumer prices — an unfamiliar situation which threatens a further twist to consumer prices as the effect feeds through more fully.

Among European countries the similarity of rates of price inflation reflects not only the common influence of world commodity prices but also the high degree of economic interdependence that has developed. Price rises for internationally traded goods affect prices of competing goods in both domestic and international markets. A key rôle in this transmission has been played by high wage settlements in export industries. Price levels in smaller countries with relatively large external sectors are especially subject to these external influences.

The advance in commodity prices has been of an order of magnitude not experienced since the Korean war period in the early fifties. In the fifteen months to end-March 1973 Moody's index of dollar prices in the United States rose by 35 per cent., while Reuter's index of UK sterling prices (covering a somewhat different



basket of commodities) rose by 65 per cent. And the trend over the last two months has remained, on balance, upward. While the depreciations of the dollar and the pound sterling affected commodity prices in the United States and the United Kingdom, the price experience of other countries was not greatly different. The rise in these indexes was concentrated on foodstuffs and industrial agricultural products. Food prices moved up very rapidly from the middle of 1972, since when they have accounted for about half of the rise in consumer price indexes.

Cereals and meat have been key cases of steep price increases. The rise in cereal prices was the more or less direct market effect of bad harvests in the USSR, together with poor yields in Australia and, to a lesser extent, Canada; but the short-term impact of reduced supplies was exacerbated somewhat by the programmes in recent years to cut back surplus acreage, and by the inadequate incentive for meat production under the EEC's Common Agricultural Policy. Beef and pork have both shown spectacular price rises. On the supply side, there have been international as well as domestic shortages for structural reasons and because the number of livestock happened to be relatively low; on the demand side a fast-growing upward trend has been evident — in part the effect of high income elasticity in this period of economic re-expansion and large wage increases.

For industrial agricultural commodities, price accelerations were widespread but most marked in the case of wool, hides and, to a lesser extent, rubber. For example, in the fifteen months to March 1973 wool prices in the United Kingdom roughly quadrupled and in the United States they increased almost sixfold. Growing world demand for textiles, embodying a shift in favour of wool, coupled with stockpiling demand from Japan, were the main causal factors. Prices reacted sharply in April this year, however, as Japanese demand fell away. Prices of hides practically doubled over the same period; and natural rubber prices rose on average by some 60 per cent., mostly in the months from October onwards, as demand associated with expanding output and restocking in industrialised countries became heavy.

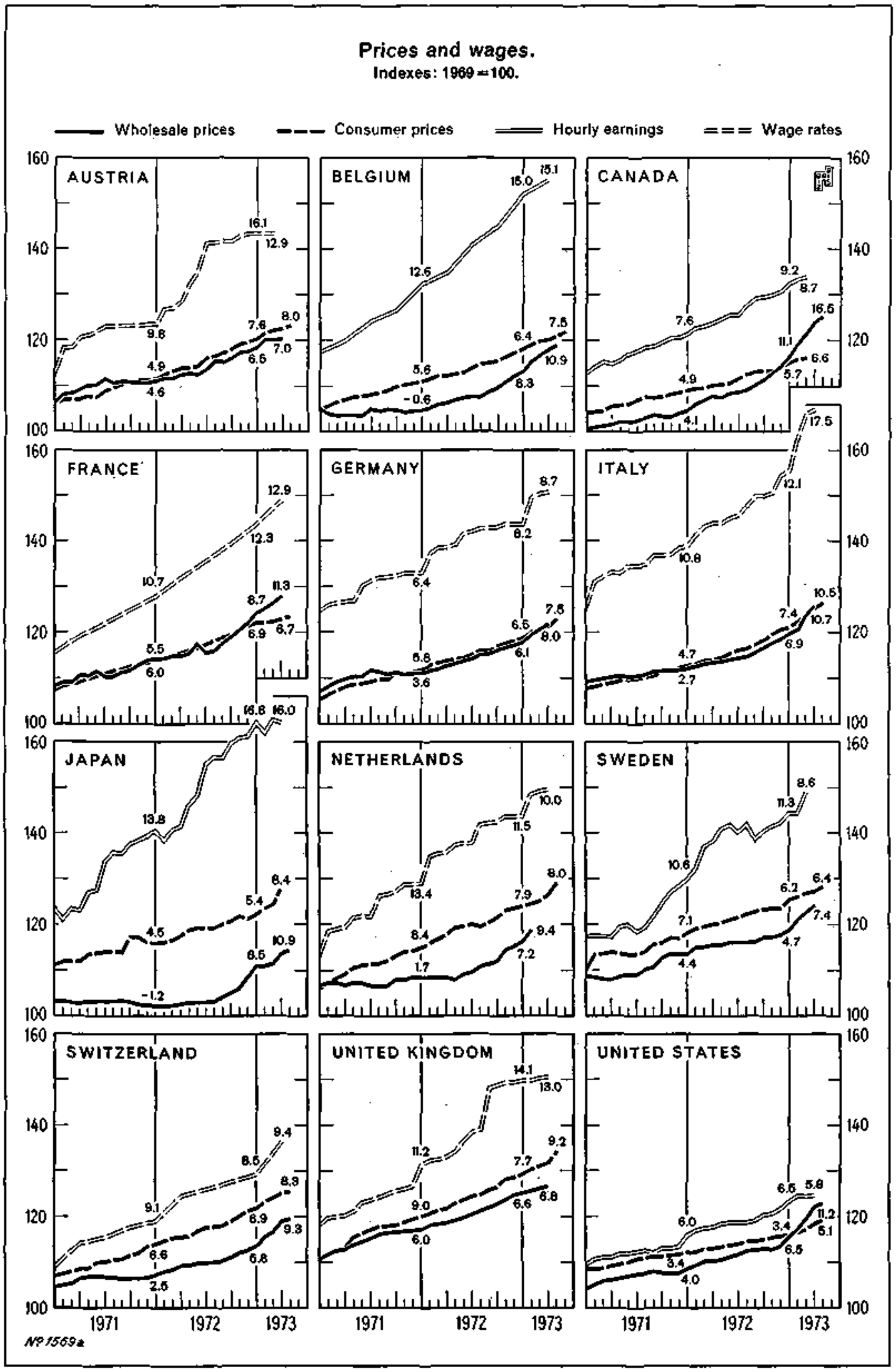
Non-ferrous metal prices did not, on average, show any substantial upturn until about the start of the current year. A significant part of the advance that then occurred was accounted for by a sudden escalation in copper prices — by 50 per cent. in the space of four months in London — brought about, in part, by political uncertainties in the two principal producer countries, Zambia and Chile. Of other non-ferrous metals, zinc may be singled out, its price recording an all-time peak, partly owing to supply shortages associated with cut-backs in US refining capacity.

Mention should also be made of further advances in oil and petroleum prices, although they are not included in either Moody's or Reuter's index. These prices, after remaining comparatively stable during the sixties, when conditions of excess supply and greater supplier competition prevailed, have moved up in recent years owing to ever-soaring demand and tough bargaining by suppliers.

In sum, the exceptional performance of commodity prices over the past year or so may be attributed to the combination of very buoyant demand, as part of the strong cyclical upswing in the world economy, with various unusual political, climatic and structural conditions making for shortages on the supply side. Also, prices quoted in dollars or sterling will have been affected by the depreciations of those currencies. It is too early to assume any long-term shift in the balance between supply of and demand for primary products which would change the trend of the terms of trade of industrial countries. The underlying position is difficult to assess, as the net amount of any stockpiling that has been contributing to demand is not known.

While the acceleration of price increases may be accounted for by developments in commodity markets, there was little visible let-up in the brisk underlying pace of inflation that had already been in evidence during the preceding two years or so. This had broadly been attributed to cost-push pressures, accompanied by the apparent breakdown of earlier relationships between the demand for labour and the rate of wage increase. By the end of 1972 wages in many countries were expanding somewhat faster than twelve months earlier, but this may be ascribed as much to the sensitivity of wage demands to food prices as to a tightening of labour-market conditions. While the recent rates of increase in wages of 17 per cent. in Italy and Japan have been exceptional, they have been around 10 per cent. in the majority of countries. Only in the United States have they been as low as the 6 per cent. level, and the rate there seems likely to rise this year. Meanwhile, in most countries the upswing in economic activity has been accompanied by sufficient productivity gains to have moderated temporarily the pressure of wage costs on prices. Finally, the observed weakness in recent years of demand restraint as an instrument for arresting wage inflation does not imply that wages are correspondingly immune from upward pressures during the later stages of the cyclical upswing.

A hardening of inflationary expectations has probably also helped to sustain the momentum of price rises in the past year or so. A contributory factor in the inflationary psychology, with some signs of a flight out of money, has been the upheavals in the



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

exchange markets. Many investors have not considered the dollar a safe haven, and access to strong currencies has been limited by direct controls. Although personal savings do not appear to have declined in proportion to disposable incomes, an increasing amount of such savings seems to have been directed towards real assets, such as housing, land and works of art. In this context the soaring price of gold is also significant. Consumer durable goods, too, have been in brisk demand in a number of countries. Moreover, currency uncertainties have, through movements of speculative funds, in some instances fuelled monetary expansion, which in turn aggravated inflation.

In a more prosaic way exchange rate changes have also contributed to rising prices. Given an oligopolistic industrial complex and downward inflexibility of prices, the downward adjustments to internal prices (including imports) resulting from currency appreciations seem to be weaker than the upward adjustments following currency depreciations. In general terms, it appears that increased exchange rate flexibility tends to have an inflationary bias, over and above that which may exist if the forces of external adjustment are such as to make currency depreciation a more common phenomenon than appreciation.

Throughout most of 1972 fiscal and monetary policies in many countries were generally aimed at expansion. Governments were not prepared to jeopardise economic recovery in an attempt to cut back inflation. In part this may have been because of the exogenous nature of much of the upward pressure on prices or because of scepticism about the responsiveness of the rate of inflation to such policies. In these circumstances the authorities have given increased attention to the use of direct measures for holding down prices and wages. While the full breadth of policy developments in individual countries over the past year is reviewed in the next chapter, a summary of these more direct actions is given here.

In the United States and the United Kingdom formal and comprehensive controls, which initially marked a significant revision of the attitude of the respective governments towards economic management, have been in operation, the US programme running approximately a year ahead of that in the United Kingdom. The two approaches have been quite similar. Thus, each began with a freeze on prices, wages and certain other incomes. In the United States the freeze ran for ninety days from August to November 1971 and was clearly successful in reducing the rate of inflation significantly. In the United Kingdom it ran from November 1972 to the end of March this year for incomes and for a further four weeks in respect of prices: again, the limited objective of holding down wages was achieved; but this was the period of soaring prices for foods and other raw materials, and since food and imports were exempt from the price freeze the overall price level continued to increase rapidly.

Phase II of the US counter-inflationary programme ran from November 1971 to January 1973. A general limit of 5½ per cent. on annual wage increases and a target of 2½ per cent. for increases in domestic prices other than those for agricultural products were set, as well as a ceiling on dividend increases. Again, the policy, which had statutory support, was broadly successful, and although the overall price level rose by about 1 per cent. more than the target rate, this was entirely due to exempt food prices.

However, Phase II had not been intended to be more than temporary. Apart from arguments concerning the efficiency of resource allocation, the authorities accepted that a more flexible framework was required for the renegotiation of several large long-term wage contracts in 1973, and there were also fears of substantial industrial unrest should the existing controls continue far beyond the turn of the year. Hence, a change to Phase III was made in January this year. While the guide-line for increases in wages remained 5½ per cent., the target for price rises 2½ per cent. and the ceiling on dividend increases 4 per cent., there was some liberalisation of profit margin limitation, the range of exceptions was generally broadened and the programme was to be to some extent self-administered. The switch-over to Phase III came at a time when food and other primary product prices were surging forward. Wages also appeared to be heading for a rate of increase this year in excess of the guide-line, especially in view of the sharp rise in business profits over the past year. With this and the rise in commodity prices that has taken place, it may be doubted whether Phase II controls would have been able to maintain their success. Nevertheless, the introduction of Phase III does appear to have given a fillip to upward price adjustments, which are likely to influence subsequent wage negotiations. But the Administration's reserve powers remain at hand: to quote the President, "The Federal Government will retain the power ... and the responsibility ... to step in and stop action that would be inconsistent with our anti-inflationary goals." At the end of March the government placed a ceiling on meat prices at their prevailing levels, but since these levels were already very high the measure was received as little more than a gesture. More importantly, compulsory advance notification was re-introduced at the beginning of May for price increases in excess of 1.5 per cent. a year planned by larger firms.

The United Kingdom's statutory Phase II came into operation in April of this year. A ceiling averaging about 8 per cent. was fixed on wage rate increases; profits were not normally to exceed the average level of the best two of the previous five years; and price increases were only permitted to reflect increases in certain costs, and not the whole of higher wage costs. The policy seems to be working to plan so far, though the consumer price index has been kept moving ahead by trends in commodity prices. The authorities plan to move over to Phase III later this year, but its content and timing are not yet known.

In continental Europe the EEC Council of Ministers adopted a set of resolutions against inflation in October 1972, aiming to limit the increase of consumer prices in the member countries to 4 per cent. during 1973. Responsibility for supporting action lay with individual countries and it can hardly be said that the goal is likely to be realised. The Netherlands had much experience of controls on incomes and prices some years ago, but controls were eroded in the late sixties. An earnest effort more recently led to a new tripartite agreement last December between labour, employers and the government. Basic contracts are, as before, subject to escalator arrangements which allow eventual compensation, on average, for most of any increase in the cost of living, but labour unrest developed in the spring of this year over the precise apportionment of this compensation. For 1973 most of the increase in real earnings is to be siphoned off by higher taxation and social security contributions, so that the increase in real disposable incomes will be only marginal. On the prices side, prospective increases have been made subject to advance notification and must be justified in accordance with certain formulae relating to allowable costs.

For either practical or political reasons the other original EEC countries have not formalised controls on incomes, though some form of price regulation is not uncommon. In March 1972 the French authorities actually relaxed some price controls, as anti-inflation contracts concluded with the private sector six months earlier expired; but in most cases this was only in return for a slightly less rigid system of planning contracts, whereby firms are granted price freedom in exchange for subjection to a compulsory review procedure. The aim was to limit price rises for industrial products to 3 per cent. and for services to 4 per cent. over the following twelve months. Then in August 1972 a price freeze in the public sector was announced, to last until end-March 1973. Furthermore an anti-inflationary package was introduced in December, which included reductions in VAT, with the aim of lowering certain prices, and a request to industry to limit increases in wages and salaries to 6 per cent. in 1973. The system of planning contracts was extended for a further twelve months from April 1973, along similar lines but with slightly more generous terms for price rises. In Belgium a system of notification of planned price rises to a Price Commission has been in operation for several years, covering most products. The Commission can hold up increases usually for two months, but for proposed increases declared in the period March to June 1973 it is four months, and in July three. Steps have recently been taken to supervise enforcement of its decisions more strictly, though these are not statutorily binding. Moreover, since December 1971 the government has had powers to impose six-month freezes in individual cases. Italy has a system of price surveillance, but maximum prices can legally be set only for energy, certain services and a limited number of industrial products, such as pharmaceuticals, cement and sugar. Finally, in Germany the authorities continue to shy away from direct controls, hopefully relying on severe monetary and fiscal restriction.

The Scandinavian countries have long experience of centralised collective bargaining, with governments remaining as far as possible on the side-lines. Nation-wide agreements on basic wages covering up to three years at a time are normal practice. However, agreed rates of increase are heavily supplemented by wage drift and usually also by cost-of-living indexation. Thus, in Sweden earnings have been rising considerably in excess of the basic 9 per cent. per annum laid down in the three-year agreement dating from mid-1971. In Norway the agreement of April 1972, setting a total addition to wage rates of 5.6 per cent. over two years, must also be judged in conjunction with its further allowances for the low-paid, indexing, fringe benefits and local supplements. In Denmark a new two-year national contract was concluded in April this year after its negotiation — principally regarding the escalator arrangements — had caused three weeks of strikes on a scale not experienced since 1936. The agreement is estimated to add 9 per cent. per annum to wages, exclusive of drift. In the field of prices, Norway and Denmark have long histories of surveillance, and Norway strengthened its system early in 1973 following a four-month price freeze. Sweden introduced a scheme of surveillance early in 1972, following a period of quasi-freeze during which price increases were only permitted if really justifiable. Then the authorities imposed a freeze on all meat and dairy products for the whole of 1973, undertaking to pay subsidies to producers.

Of other European countries, Switzerland inaugurated a monitoring system for wages, prices and profits in December 1972 as part of an anti-inflationary package which otherwise relied on fiscal and monetary restriction; and because of the substantial appreciation of the Swiss franc some easing in the demand for labour is anyway expected. The Austrian Government undertook in November 1972 to hold various prices steady, mainly those for foods and fuels, for varying periods of time, and the following month a voluntary agreement was reached within the private sector to exercise strict restraint on both wages and prices, initially for a period of six months.

Money, credit and interest rates.

Monetary expansion has for the second consecutive year been of large, and at times even startling, proportions. A number of factors have influenced this expansion. Practically all central banks were on a course of monetary ease from early 1972 or before in order to counter the slackness in the economic situation. Yet the rate of cost inflation last year was still high and later in the year the expansion of activity was rapid. These circumstances contributed to private-sector credit demands, as did the need to reconstitute liquidity after the earlier period of monetary restraint. The heavy demand for consumer durable goods and real estate also stimulated bank lending, and there was probably some anticipation of a not-too-distant tightening of credit policy.

Another element in several countries was public-sector deficit financing, which likewise had been undertaken as a means of reactivating the economy. Finally, large international flows of funds helped to flood the credit channels in the surplus countries.

With the economic upswing in full force last year, the growth rate of the broadly-defined money supply rose to over 10 per cent. in the United States, while in most western European countries, Canada and Japan the increase was in the range of 13–28 per cent. In most cases the increase in the money supply far exceeded that of gross national product not only in real but also in current price terms. In almost all countries monetary policies had again to be tightened during the year and short-term interest rates then rose sharply.

Monetary growth came mainly from a remarkable increase in bank credit to the private sector. Business borrowing advanced strongly throughout the year in the United States, and elsewhere it picked up as the recovery gathered momentum. In addition, credit demand for housing construction was generally strong in the major countries and an upsurge in consumer credit was also a feature in most of them. Partly reflecting the spread of inflationary sentiment, there was an increase in borrowing from banks to finance investment in real estate or shares, particularly in the United Kingdom and Japan.

Bank lending to the public sector also rose in most countries last year. A notable exception was the Netherlands, where both the central government and the local authorities reduced their deficits and also increased their borrowing at long term outside the banking system. The French Government kept to a balanced budget and, as in 1971, reduced its net indebtedness to the banking system. On the other hand, the central government in Belgium, Italy, Sweden, Japan and the United

The money supply.

Countries		1969 Dec.	1970 Dec.	1971 Dec.	1972 March	1972 June	1972 Sept.	1972 Dec.	1973 March
		percentage changes over twelve months							
United States	M 1	3.5	6.0	6.6	6.7	5.4	6.5	8.3	6.4
	M 2	2.5	8.3	11.3	10.3	9.3	10.5	10.8	9.0
Canada	M 1	4.4	5.0	19.9	10.8	9.5	13.5	11.8	15.0
	M 2	4.3	10.3	16.4	16.6	16.9	16.6	14.5	12.8
Japan	M 1	20.6	16.8	29.7	27.7	19.9	19.6	24.7	27.4
	M 2	18.5	16.9	24.3	24.0	22.8	22.0	24.7	25.1
Belgium	M 1	2.6	8.3	10.1	13.3	14.5	12.6	14.0	15.1
	M 2	7.7	8.2	12.9	15.3	15.7	14.6	16.1	16.8
France	M 1	0.4	11.0	11.0	11.9	12.9	15.0	15.4	10.4
	M 2	6.1	15.0	17.7	17.5	18.9	19.9	18.5	13.9
Germany	M 1	6.4	8.8	12.3	15.0	14.0	14.1	14.6	13.8
	M 2	10.2	10.5	14.5	13.4	14.4	15.7	17.0	20.5
Italy	M 1	15.7	27.2	18.8	19.0	17.7	16.7	17.2	20.0*
	M 2	11.4	13.6	17.1	18.9	18.4	17.8	18.0	19.3*
Netherlands	M 1	8.1	11.8	15.0	19.0	18.5	20.6	18.7	16.2
	M 2	10.5	10.5	10.2	9.8	11.5	9.8	13.0	16.2
Sweden	M 1	−3.8	9.2	9.3	12.4	11.5	7.8	7.4	11.2
	M 2	2.1	4.6	10.8	12.4	13.5	13.1	13.1	11.8
Switzerland	M 1	6.9	7.3	39.5	40.9	30.4	5.3	3.0	−1.5
	M 2	18.9	8.9	26.6	21.4	20.4	−0.9	0.7	3.3
United Kingdom	M 1	0.3	9.3	15.1	15.2	19.3	16.8	14.9	11.2
	M 2	3.1	9.5	13.0	15.4	23.8	25.9	27.7	27.4

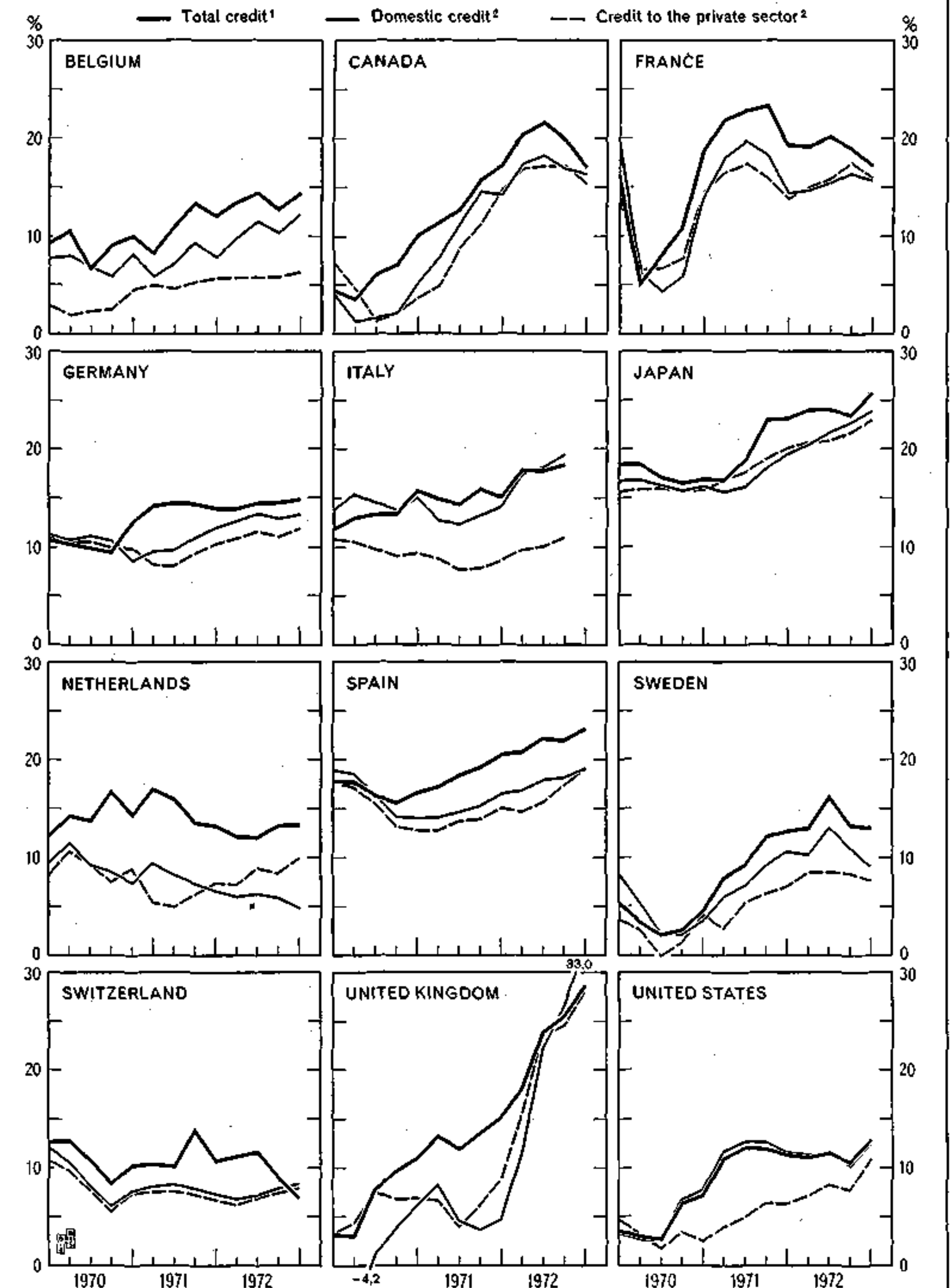
*January.
Note: M 1 = Currency and demand deposits.
M 2 = M 1 plus quasi-money, according to national definitions, which differ from country to country.

Kingdom adopted expansionary budgets and financed these largely by recourse to the banking system. Local-authority borrowing accounted for most of a rise in bank credit to the public sector in Germany and Switzerland. In the United States, too, the commercial banks acquired mainly State and local government securities, while their holdings of Treasury securities remained almost unchanged.

Balance-of-payments surpluses contributed substantially to monetary expansion last year in Belgium, France, Germany, the Netherlands, Sweden and Japan. However, except in Germany and the Netherlands, the increase in official foreign assets was smaller than in 1971 and slowed down appreciably in the second half of the year. Although monetary authorities reduced the effects of inflows on bank liquidity, they felt themselves unable to go beyond certain limits in their offsetting actions. In Italy and the United Kingdom, on the other hand, where there had also been net inflows in 1971, the banking system's net foreign assets declined last year. The new wave of inflows in early 1973 was concentrated on Germany, though it was sizable in a number of other countries.

In the United Kingdom the introduction of the new credit control arrangements in 1971 was followed by a steep rise in liquid balances in the hands of persons and commercial companies. Moreover, in that country, as well as in Canada and the United States, lags in the adjustment of bank lending rates caused prime rates to stand at

Total bank credit and its composition.



[1] Percentage change over twelve months. [2] Contribution in terms of percentage points to the percentage change in total bank credit. Total bank credit equals domestic bank credit plus net foreign assets; domestic bank credit equals credit to the private sector plus credit to the public sector.

times below interest rates on certain of the banks' liabilities, thus increasing the attractiveness of borrowing for liquidity purposes. In the United States the Federal Reserve kept on a mildly expansionary course, operating from February onwards on aggregative targets relating to the growth of bank reserves; however, short-term interest rates were permitted to rise as credit demand strengthened. In Canada the authorities sought to restrain the expansion of bank reserves but at the same time to avoid rises in interest rates which could hinder domestic recovery and encourage inflows of funds. In Italy and Sweden throughout the year, and in the United Kingdom and Japan for the greater part of it, the authorities pursued easy policies with respect to bank reserves.

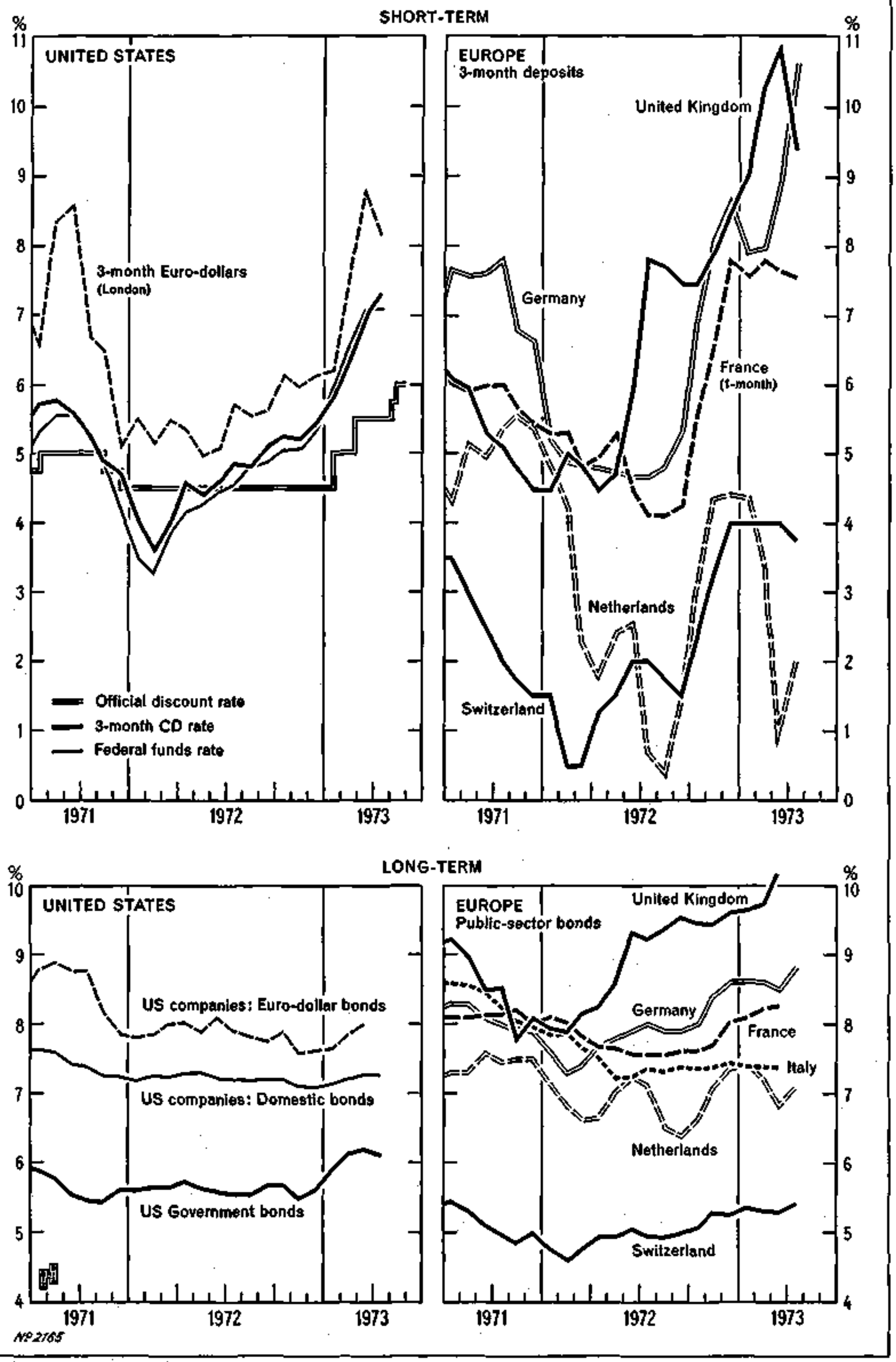
On the other hand, policies to limit bank liquidity were adopted quite early last year in Belgium, France, Germany, the Netherlands and Switzerland, although the authorities were still reluctant to see a steep rise in interest rates for external and, in some cases, domestic reasons. To help insulate domestic monetary conditions selective direct controls were tightened in Germany, the Netherlands and Switzerland, while in Belgium and France reliance was placed largely on the dual exchange-market system. When inflows of funds occurred nevertheless in the spring and summer, liquidity was absorbed mainly through the introduction or raising of compulsory reserve ratios or blocked deposit requirements, or through reductions in banks' rediscount quotas. In Germany measures of this kind were also used to offset the effect on reserves of the reimbursement of the anti-cyclical tax surcharge previously frozen at the Bundesbank. In these countries government debt-management operations were also designed to temper the growth of bank liquidity.

By the autumn accelerating price rises and diminishing margins of unutilised resources emphasised the need for bringing monetary expansion under control. The stability of the dollar late last year, together with quite sharp rises in US short-term interest rates, helped the authorities in other countries to get a grip on bank reserves and gave them more scope for restrictive interest rate policies. An agreement covering 1973 and 1974 was reached in the European Economic Community in late October that member countries should progressively reduce the growth of the money supply to that of the real gross national product plus 4 per cent., the latter being their target for containing consumer price increases.

In late 1972 and early 1973 monetary policy was made more definitely restrictive in almost all of these countries. The change was signalled by a series of increases in central-bank lending rates from October to December 1972 in all EEC countries. In the United Kingdom Bank rate, then at 6 per cent., was replaced in October by a minimum rate for central-bank lending linked to the Treasury bill rate; it was initially set at 7¼ per cent. but rose to 9 per cent. by the end of the year. Apart from a tightening of exchange controls, further measures to curb bank liquidity — increases in compulsory reserve ratios, blocked deposit requirements or a curtailing of rediscount facilities — were introduced in several EEC countries and in Switzerland and Japan.

General limits or guide-lines on bank credit-granting were introduced in France and Japan, and existing ceilings were extended or strengthened in Denmark and Switzerland. Selective measures to restrain consumer credit were introduced in Belgium, France and Switzerland, while in Japan steps were taken to limit lending for

Short and long-term interest rates.



financing investment in stocks and real estate. During January–May 1973 there were increases — in some cases substantial — in central-bank discount rates in Belgium, Canada, Germany, Japan, Switzerland and the United States. In May 1973 the US authorities suspended the Regulation Q ceilings on interest rates payable on large certificates of deposit and equalised the reserve requirements against banks' foreign borrowings and their domestic borrowings in the form of certificates of deposit and bank-related commercial paper. The principal exception to the widespread tightening of monetary policy was Italy, where the authorities still gave priority to stimulating the economy and in December offered the banks privileged currency swap facilities to encourage them to draw in liquidity from abroad. Monetary policy was also kept fairly easy in Sweden and, to some extent, in Canada.

Short-term interest rates rose in the second half of 1972 on both sides of the Atlantic and this movement continued in early 1973. In the United States the Federal funds rate went up at an unprecedented pace, climbing at times in March 1973 to as high as 10 per cent., compared with a trough of 3 per cent. a year earlier. Other short-term rates, however, rose less rapidly and by May 1973 stood in general about 2½ percentage points higher than a year earlier. In the United Kingdom short-term interest rates shot up during the sterling crisis in the summer of 1972, but elsewhere in western Europe money-market rates generally remained fairly stable until the autumn at levels on balance lower than at the beginning of the year. Thereafter, under the influence of monetary restraint, they rose steeply until the new exchange crisis in early 1973. Consequently, in several European countries, and more particularly in Germany, interest rates on commercial-bank lending and the margin by which these exceeded lending rates charged by US banks increased. In Japan the call-money rate continued to fall and it was only in December that this trend was reversed. In Canada short-term rates rose appreciably in early 1973 but in the spring still stood well below comparable US rates.

Post-Smithsonian developments and the 1973 monetary crisis.

Developments during 1972 and the early months of this year in the rather battered international monetary system may be said to come under the heading of unfinished business left over from the upheaval of 1971. In broader perspective, they constituted a further instalment of the more or less permanent crisis which has prevailed since 1967.

The Smithsonian agreement, which attempted to establish a new durable structure of fixed exchange rates, had two objectives, one immediate and the other more long-term. The immediate objective was to restore confidence and orderly conditions in the exchange markets, so as to set in motion a reversal of the previous flight of funds from the United States. The longer-term and more fundamental aim was to bring about an adjustment of the basic payments imbalances between the deficit of the United States and the excessive current-account surpluses of some other countries. In the event, the more immediate aim was not achieved, nor were any real signs evident during 1972 of progress towards the longer-term adjustment process. As a consequence, matters came to a head again in early 1973 and the dollar was devalued further on 13th February.

This was quickly followed, however, by yet another wave of currency unrest, leading in March to the enforced suspension of the fixed exchange rate system. To see how this came about in little more than a year after the Smithsonian agreement one must consider the events of 1972–73 in relation to both the immediate and the longer-term objectives of the 1971 realignment.

Exchange-market developments. When the exchange markets reopened following the Smithsonian agreement, the immediate reaction was a marked strengthening of the dollar. It was at once quoted well above its new central or middle rates against other major currencies and a few of them — sterling, the commercial French franc and the lira — moved to near their lower limits. This reaction, which reflected a somewhat natural reflux of funds to the United States, did not, however, last very long. For that there were various reasons.

In the first place, neither interest rate nor exchange-market conditions at that time favoured a sustained reverse movement of funds. Short-term interest rates in the United States were lower than in other major financial centres, except Switzerland; and with other currencies well below their new central rates against the dollar there was much more scope, within the newly-established 4½ per cent. range of permitted exchange rate fluctuations, for the dollar to become cheaper than for it to become dearer.

More fundamental, however, was the awkward fact that the realignment itself did not generally restore confidence, either in the dollar or, a fortiori, in the monetary system. In relation to the size of the US balance-of-payments problem, the 7.9 per cent. devaluation — even taken together with the revaluation of some other currencies — seemed to many market observers "un peu juste", particularly as it was known that the US authorities themselves believed a larger adjustment to be necessary. In relation to the problem of the dollar's inconvertibility, the devaluation was obviously inadequate. It seemed to make no detectable difference that the price at which the US Treasury did not buy and sell gold had shifted from $35 to $38 per ounce. There was not even the consolation of any narrowing of the gap between the official value and the market price of gold. The latter very soon moved up by $3 and more.

Another factor in the lack of confidence was that the devaluation of the dollar had not been accompanied by any shift to domestic monetary and fiscal restraint. For this there were perfectly valid reasons from an internal economic viewpoint: unlike the usual cases of such currency adjustment, the dollar was devalued at a time of excess unemployment rather than of excess demand. To the market, however, a devaluation unaccompanied by any tightening of belts at home seemed as incomplete as a house with no roof.

Finally, there was the realisation, which was not long in coming, that the benefits to the US basic balance of payments would in any case take considerable time to make themselves felt and that in the meanwhile — unless a sizable reflux of short-term money developed — other countries would have to buy further substantial amounts of inconvertible dollars.

The consequence of all this was that the dollar began to weaken again in the course of January and that during February and early March a new upsurge of currency unrest developed that provided a first test of the new exchange rate pattern. The renewed movement out of the dollar was concentrated on the Benelux currencies, the Deutsche Mark and the yen, i.e. precisely those currencies which had been revalued a few weeks earlier. All of them rose in the markets up to, or very near, their new upper limits against the dollar, with the Bundesbank and the Bank of Japan each having to buy some $700 million from the market during February, while in the space of two days in early March the Nederlandsche Bank bought $400 million of exchange. Besides market intervention, the authorities of these countries also took various measures to block the inflow of funds, the most noteworthy being the application of the "Bardepot" scheme to foreign borrowing by German corporations. Shortly thereafter, in the second week of March, the monthly meeting of central bankers at the BIS in Basle served to emphasise to the market the collective determination to uphold the Smithsonian pattern of exchange rates.

These actions succeeded in calming the markets and pressure on the dollar eased. The three months which followed, to mid-June, were relatively quiet, sentiment being helped both by the legal devaluation of the dollar in April and by some convergence of US and European short-term interest rates — the former rising while the latter were declining. It is true that most other leading currencies continued to be well above their new central rates vis-à-vis the dollar, but no obvious signs of immediate further trouble were to be seen.

In the third week of June, however, strong selling of sterling developed and the authorities decided to float the pound on 23rd June. This first breach in the Smithsonian rate structure at once showed the frailty of confidence in the dollar, for a new outflow of funds from the United States now took place. There was a risk of other exchange rate changes occurring — particularly as the US trade deficit had been consistently running at an annual rate of $7–8 milliard since February. Matters were complicated by the fact that the official support for the pound in the week of the sterling crisis had taken place in the framework of the Common Market arrangements for keeping the spot rates of exchange amongst their currencies within 2¼ per cent. of the cross parities. The United Kingdom, though not yet an EEC member, was already participating in these arrangements; and it so happened that when the sterling crisis broke the pound was nearly 2¼ per cent. below its cross parity with the French franc, at that time the strongest EEC currency, while being just above its central rate vis-à-vis the US dollar. The effect of intervention by EEC members in EEC currencies in support of sterling was to put a brake on the decline of sterling against the dollar and to pull down the stronger EEC currencies vis-à-vis the dollar. In fact, on 22nd June sterling was still well above its lower limit vis-à-vis the dollar, despite a $2.6 milliard outflow from London, while the Belgian franc, the French franc and the Deutsche Mark were respectively 1.3, 1.0 and 0.9 per cent. lower vis-à-vis the dollar than a week earlier. These currencies therefore looked relatively cheap.

As soon as sterling began to float, the commercial Belgian and French francs, the Deutsche Mark and the guilder all went to their upper limits against the dollar, while the Swiss franc at one point was quoted 3 per cent. above its dollar parity. Further restrictions on inflows of funds were then announced by Germany, Japan and the Netherlands and by Switzerland, where a negative interest charge of 2 per cent.

per quarter was imposed on any further increases in non-resident Swiss franc deposits with banks in Switzerland. Despite these moves, by mid-July the reserves of Group of Ten countries other than the United States and the United Kingdom were $8.3 milliard above their end-May level, with Germany accounting for almost $5 milliard and Switzerland for rather over $1 milliard of the rise. A comparison of these figures with the United Kingdom's June/July reserve loss of $3 milliard points to a run on the dollar of some $5 milliard in the three weeks to mid-July.

In addition to the fact that any depreciation of sterling implied some erosion of the effective devaluation achieved by the dollar in December 1971, prevailing uncertainties were aggravated by rumours that the EEC Ministers, due to meet on 17th and 18th July, might announce a joint float of their currencies against the dollar. In the event, they reaffirmed their determination to adhere to the existing rate structure. Their decision was followed, on 19th July, by the resumption — for the first time since August 1971 — of support operations for the dollar by the Federal Reserve System. At the same time it was announced that the August 1971 suspension of the Federal's swap network had been lifted and that the US authorities were prepared to draw on it in case of need. At once the pressure on the dollar eased again. Only the yen remained persistently at its upper limit until almost the end of the year, Japan's reserves going up by a further $2.5 milliard during the remainder of 1972. Otherwise, the last months of 1972 were a period of stability for the dollar in exchange markets.

This was partly, of course, the direct result of the various measures taken in July. In particular, the resumption of Federal Reserve exchange-market operations — small-scale though they were — was taken by the market as an indication that the United States was ready to play its part in upholding the Smithsonian agreement. And this impression was reinforced by the positive approach to international monetary reform adopted by Secretary Schultz at the IMF annual meeting in September. More generally, there were signs during the last months of the year of a fairly marked change in sentiment about the dollar's prospects. Economic developments in the United States seemed promising, since economic expansion was much faster than in western Europe, while the rate of increase in consumer prices was much smaller. Another helpful factor was that US short-term interest rates had risen considerably since early 1972; between February and July the three-month Treasury bill rate had risen from 3.2 to just over 4 per cent. and by December it was slightly over 5 per cent.

These favourable factors were not, however, the whole story. From autumn 1972 interest rates were rising faster in Europe than in the United States, partly because the authorities there saw in the strengthening of the dollar an opportunity to use monetary policy more forcefully against inflation. In addition, though the reserves of European Group of Ten countries declined by nearly $2 milliard during August–December 1972, there was, once again, no substantial reflux of funds to the United States despite the generally lower return available on non-resident investment in other strong currencies. Most of all, there was little progress towards the fundamental Smithsonian objective of a better basic balance in international payments. The situation at the end of the year, therefore, was that one way or another, and sooner or later, the underlying payments situation and the exchange-market situation would have to come closer together.

This turned out to be sooner rather than later. On 22nd January 1973 Italy acted to check its persistently large capital outflow by reducing the scope for leads and lags in its international commercial payments and receipts and by establishing a separate exchange market for financial transactions with a floating exchange rate. On the same day the Swiss franc, which, partly as a consequence of the tight domestic monetary policy, was already the firmest European currency, went to its upper limit against the dollar. After having to buy a fairly substantial amount of dollars from the market that day and the next day, the authorities decided to allow the franc to float so as to stop pouring out Swiss francs against the interests of their anti-inflationary aims. By the end of January the Swiss franc had risen against the US dollar by about a further 3 per cent. and at the same time the dollar had weakened vis-à-vis all other major currencies. On 1st February there began a new wave of speculation against the dollar, larger than any previous one. Among its causes were the recent publication of the enormous US trade deficit for 1972 and fears of less success in holding down inflation under Phase III. More fundamentally, the Italian and Swiss moves were received as further indications of the extent to which countries were prepared to resort to rather greater exchange rate flexibility, and the possibility of other steps in that direction prompted swift movements of funds. During the first seven working days of February Group of Ten monetary authorities bought some $8 milliard in the market, of which Germany accounted for nearly $6 milliard and Japan for half of the rest. By Friday, 9th February, the situation had become untenable and most exchange markets were closed at the beginning of the next week. After a rapid round of international consultations a new devaluation of the dollar, of 10 per cent., was announced on 13th February and on the following day the yen and the commercial lira were set free to float. This action by the United States contrasted with its unrealistic refusal to devalue the dollar after 15th August 1971, when the dollar was formally declared inconvertible.

After the markets had reopened on 14th February, the yen quickly appreciated by 5 per cent. on top of the dollar devaluation. Otherwise the dollar was at first quite firm and the German authorities were able to sell almost $1 milliard out of the previous inflow of funds. It was soon apparent, however, that the crisis was not over. The dollar began to weaken again from 21st February and by 1st March was at its new lower limit vis-à-vis all major currencies with fixed rates. Among the floating currencies, the Swiss franc and the yen were by then showing appreciations over and above the newly devalued dollar of 12 and 7½ per cent. respectively. Following very large official purchases of dollars on 1st March, including $2.7 milliard by the Deutsche Bundesbank, the exchange markets were again closed and yet another round of official consultations got under way.

This time, however, it was believed to be futile to return to fixed rates between the US dollar and other leading currencies. The market was in disarray, the 10 per cent. devaluation of the dollar was thought sufficient to bring about an adequate adjustment of payments positions in the course of time, and it was not considered practicable in the meantime to hold the new central rates by more market intervention until the basic trade and payments imbalances had shown marked improvement. In other words, renewed confidence would have to be based on solid accomplishment.

Rather than accept the complications within the EEC framework of complete floating, six of the EEC countries — Belgium-Luxemburg, Denmark, France, Germany and the Netherlands — decided on 12th March to maintain the exchange rates against one another within a margin of 2¼ per cent. on either side of their nominal cross rates, while leaving the position of their currencies as a whole vis-à-vis the dollar to be determined by the market. At the same time the Deutsche Mark was revalued by a further 3 per cent. The United Kingdom, along with Ireland whose currency remains at par with sterling, and Italy continued to let their currencies float independently, while expressing their intention of taking part in the joint EEC float as soon as circumstances permitted. Canada, Japan and Switzerland also continued to allow their currencies to float. Subsequently, Norway and Sweden decided to participate in the joint float. The Austrian schilling was revalued by 2¼ per cent. and the authorities continue their policy of keeping it stable, on average, relative to the currencies of Austria's main trading partners.

Before the exchange markets reopened on 19th March, a number of countries had announced further reinforcement of their controls against inflows of funds. In the BLEU and the Netherlands new increases in non-resident bank deposits were to be subjected to a negative interest rate of 0.25 per cent. per week, while in France the payment of interest on non-resident French franc deposits was banned. At a meeting of the Group of Ten on 16th March it was agreed that the system of floating would, if judged necessary, be managed by central-bank intervention in which the United States might participate.

For several weeks after 19th March exchange markets were generally calm. The dollar strengthened against most other currencies and there was some movement of funds back to the United States from Japan and Germany, while the currencies participating in the joint European float remained comfortably within what would have been their permitted margins of fluctuation against the dollar had they returned to fixed rates with post-Smithsonian 4½ per cent. bands. For the first three weeks or so the Deutsche Mark was the weakest of the jointly floating currencies, at times receiving support from other participants, all of whose currencies, with the exception of the guilder, at some stage held the position of strongest currency. By the end of April the band of the jointly floating currencies was as a whole more than 1 per cent. lower against the dollar than on 19th March. Meanwhile the Swiss franc and the yen had remained steady, showing appreciations of the order of 6½ and 5 per cent. respectively against the dollar, over and above the February devaluation.

The third week of May opened, however, with the dollar suddenly much weaker, and it then slipped further, recording losses in the range 3¼–4¾ per cent. from its end-April levels against the jointly floating currencies by the end of May: the strongest participant currency was then the Swedish krona, showing an appreciation of almost 5½ per cent. over its nominal central rate, compared with one of some 3½ per cent. for the guilder, which was the weakest. The Swiss franc also moved ahead by a further 4¼ per cent. in May, but the yen by less than ½ per cent. Sterling came to within 2 per cent. of its Smithsonian parity and the lira turned firmer against the dollar after two months of drifting. The sharp deterioration of the dollar has been ascribed in part to political developments in the United States. This episode suggested the potential volatility of exchange markets under a régime of floating, where modest pressures can cause significant shifts in rates.

The adjustment process. The more fundamental objective of the Smithsonian realignment was to correct the long-standing disequilibrium in international payments, centred on the deficit of the United States. As the devaluation of the dollar would make US goods cheaper in international markets and the revaluation of other countries' currencies would make goods of those countries more expensive, the shift in competitiveness was intended eventually to balance out existing deficits and surpluses. Of course, the US deficit on official settlements account had reached the astronomical figure of $30 milliard in 1971. But the bulk of this was accounted for by the flight from the dollar which was in turn set off by the deterioration in the US trade account over the previous three years. If the realignment were to correct the adverse trade position, which was actually in deficit in 1971 for the first time in decades, it was reasonable to expect that the imbalances due to short-term money flows would take care of themselves. However, the adjustment process was acknowledged to require time, and no improvement — in fact some further worsening — of the trading imbalance was anticipated for 1972 as a whole. Nevertheless, definite signs of an incipient turn-round in trade were expected to show by the end of the year.

What happened in the months following the Smithsonian agreement, however, did nothing to encourage the view that the necessary adjustment would eventually materialise. True enough, the US deficit dropped to $10 milliard in 1972 — still quite a formidable deficit — as the exchange market did not again come to the stage of panic selling of dollars. The critical factor, however, was that the imbalance in trade, which it was the prime purpose of the Smithsonian agreement to eliminate, increased considerably more than the most pessimistic forecasts had predicted. Meanwhile the substantial reflux of funds to the United States that had been hoped for never developed.

Group of Ten countries: Foreign trade balances.

	1971			1972		
	1st half	2nd half	year	1st half	2nd half	year
	in milliards of US dollars, seasonally adjusted					
Group of Ten, excluding USA						
Exports	85.1	92.1	177.2	102.0	108.4	210.4
Imports	81.6	86.8	168.4	96.6	103.4	200.0
Balance	3.5	5.3	8.8	5.4	5.0	10.4
United States						
Exports	22.2	21.4	43.6	23.5	25.8	49.3
Imports	22.5	23.0	45.5	26.8	28.7	55.5
Balance	— 0.3	— 1.6	— 1.9	— 3.3	— 2.9	— 6.2

The above table illustrates how the trade imbalance deteriorated further in 1972, particularly in respect of the United States. The US trade deficit on a customs basis rose between 1971 and 1972 from $1.9 to 6.2 milliard, while the combined trade surplus of the rest of the Group of Ten increased less markedly from $8.8 to 10.4 milliard. Even allowing for the unfavourable factors peculiar to the year 1972, this was a surprising outcome. Nor is the impression it leaves greatly modified by observing trends over the course of the year. The most they show is that in the latter part of 1972 there were signs that the commercial imbalance had passed its peak. Thus, the US trade deficit contracted from $3.3 to 2.9 milliard between the first and second halves of the year, and the combined trade surplus of the rest of the Group of Ten from $5.4 to 5.0 milliard.

United States. The decline in the US official settlements deficit from $30 to 10 milliard between 1971 and 1972 corresponded almost exactly to the drop in the net outflow of short-term funds — from $21 to under 2 milliard. Furthermore, the net long-term capital outflow also declined substantially, from $6.5 to only 1.3 milliard. 1972 was, however, the eighth successive year in which the current external account worsened — from a deficit (excluding government grants) of $0.8 milliard to one of $5.8 milliard.

Some 80 per cent. of this deterioration was on trade account, and it occurred despite a 14 per cent. increase in total exports — the biggest in any recent year and seven times as large, in percentage terms, as the 1971 increase. Moreover, most of the faster growth of exports in 1972 was in volume — the 3.3 per cent. increase in export prices being the same as the year before. It is true that a not insignificant part of last year's export growth can be attributed to "special" factors, rather than to the influence of the exchange rate realignment. For one thing there was some rebound of exports after they had been adversely affected by dock strikes in the late months of 1971; in addition bad harvests in several parts of the world led to increased US exports of agricultural products; and also some foreign purchases of US goods had probably been postponed in 1971 awaiting more favourable exchange rate relationships. Whatever the precise importance of these factors, the point is that 1972 was a good year for US exports. That it was also a disastrous year for the trade balance must therefore be attributed to the rapid rise in the dollar value of US imports.

US imports went up by $10 milliard, or 22 per cent., in 1972. Obviously the initial price effects of devaluation, as well as the general rise in raw-material prices, were a major factor in this; price increases accounted for about one-third of the increase in imports. On top of that the rapid expansion of the domestic economy had a strong effect in attracting imports. Purchases of foreign industrial supplies and materials other than fuels rose by $2.2 milliard, twice as much as in 1971; and fuel imports, too, increased sharply, by just on 30 per cent.

The really striking feature of the import performance, however, was the 27 per cent. rise in purchases of manufactured goods — a gain of $5.4 milliard. This followed a 20 per cent. increase in 1971, which had certainly included some speeding-up of deliveries as the outlook for the dollar became uncertain. If automotive imports from Canada, which are something of a special case, are excluded, the acceleration in manufactured goods imports is even more striking, from an increase of 17½ per cent. in 1971 to one of over 30 per cent. last year, i.e. nearly half as fast again as total imports. It was, of course, precisely in these goods that a large part of the deterioration in the US trade balance had taken place from 1964 to 1971, during which period imports of manufactured goods had risen roughly twice as fast as total imports. It should be added that the experience of the second half of 1972 was rather different from that of the first half, with imports of manufactured goods rising at about the same rate as total imports. Another related feature of US imports in 1972 was that imports from countries against which the United States had secured the greater part of its exchange rate advantage in 1971 maintained approximately their same proportion of total imports in terms of dollar values: the share of imports from Japan actually increased slightly, while that from western Europe other than the United Kingdom showed no change until the last quarter of the year.

As mentioned above, it had not been expected that the benefits to the trade balance of the realignment would be seen in 1972 because it generally takes time for new patterns of trade to develop after a change in relative price levels, but the added complication in the US case was that no help was to come from contracting internal demand; rather, home demand was being encouraged throughout 1972 to reduce unemployment. All things considered, however, as the trade deficit ran month after month at an annual rate of around $6 milliard, it became evident by the autumn that whatever adjustment might yet come in the next year or two, it would fall far short of giving the United States an adequate trade surplus; in fact the devaluation of the dollar had been too small.

While the Smithsonian exchange rate changes were a negotiated package rather than the result of cold calculation, they were judged at the time to be not too far from what was needed. As they showed no sign of achieving the goal, however, it is evident that the real world did not behave as expected. In Chapter III the outturn of US trade for 1972 is compared in some detail with what was forecast at the time of the realignment.

One reason why it seemed unlikely that the expected adjustment would ever result was that neither the US prices of imports nor the prices abroad of US exports responded to the devaluation as much as might have been anticipated. Of course, it is well known that in almost every case of devaluation prices of goods traded will not fully reflect the percentage change between currencies; foreign suppliers will cut margins to some extent to maintain their market and domestic exporters will use the occasion to increase operating profit margins. Besides, such price effects will be strengthened by similar actions by wholesalers and retailers in the distributive process. Such reactions were indeed significant after the dollar's devaluation; the put-through to prices was probably less than two-thirds of the changes in exchange rates. Moreover, there was evidently a special effort by many exporters in the revaluing countries to reduce costs, as productivity gains for those countries were high. No doubt these reactions were due to the particular importance of the US market for industrial goods.

In addition, the usual effect of higher import prices for buyers of imports was partly nullified in two ways. Firstly, quite a few categories of US imports were subject to quantitative limitations and, hence, relatively impervious to the rather small price changes involved in the devaluation. Secondly, buyers generally seemed not to hesitate to pay the higher prices, as they expected still higher prices in the future. Indeed, as the realignment was not convincing to market opinion, it seemed to spur foreign exporters and domestic importers to expand their trade before matters got worse.

Most of all, however, the whole magnitude of the US trade problem was greater than could be corrected by the rather small devaluation. The unique international trading position of the United States had changed over the two preceding decades much more than was apparent: this had resulted from gradual industrial catching-up in lower-wage countries rather than from, say, chronic inflation at home. Hence, the problem was not to effect marginal changes in the various categories of exports and imports but to bring whole new industries to a position where they could again compete effectively at home and abroad. This was acknowledged by the 10 per cent. devaluation of the dollar in February 1973 — which greatly supplemented the effective change in the US exchange rate resulting from the Smithsonian agreement. In March the US trade deficit narrowed considerably, and in April a surplus was recorded. It is, however, too early to assess the longer-term significance of this development.

Japan. Among the surplus countries expected to make room for an improvement in the US balance of payments, Japan was first and foremost. Its current-account surplus was by far the largest of any country — amounting in 1971 to $5.8 milliard, or about 2½ per cent. of gross national product. Besides, $3 milliard of its $7.8 milliard trade surplus for that year had been vis-à-vis the United States. For those reasons, too, the effective overall appreciation of the yen in December 1971, estimated at about 11 per cent., had been the largest of any currency involved.

Japan's net reserve increase was indeed much lower last year than in 1971, $2.9 as against 10.3 milliard, but this resulted entirely from changes on capital account. In fact, it was to a large extent due to measures taken by the Japanese authorities to hold down the increase in their reserves so as to bridge the gap until the hoped-for changes on current account took place. To a considerable extent this holding operation took the form of official placement of dollars with the Japanese commercial banks, through either swaps or deposits; essentially as a result of such placements there was a $2 milliard outflow of funds last year through the banking system, compared with a $2.5 milliard inflow in 1971. In addition, the authorities took various steps to increase Japan's longer-term foreign investments; these investments, together with severe controls on foreign investment in Japan, produced an increase in the net long-term capital outflow from $1.1 to 4.5 milliard.

All this was in vain, however. If the magnitude of the rise in the US trade deficit was the most surprising post-Smithsonian development, the biggest non-event of 1972 was the failure of Japan's trade surplus to show any signs of contracting in the face of both the large effective revaluation and the strong pick-up of the domestic economy. In fact, the surplus increased to $9 milliard and did not even decline in the course of the year.

As the counterpart of US developments last year, Japan's trade surplus, measured in dollars, increased despite the fact that imports, which had virtually stagnated in 1971, expanded by 10 per cent. in volume and 19 per cent. in value.

However, exports also increased by 19 per cent. in dollar value, the major part of which was attributable to higher dollar prices resulting from the 1971 exchange rate realignment. Nevertheless, the fall in the growth of export volume from 17.5 to 5.5 per cent. doubtless owed something to the reaction of buyers to higher prices, although the recovery of domestic demand in Japan and the fact that the 1971 volume was swollen by substantial "leads" must also have accounted for some of the deceleration in 1972. One more definite sign that the currency realignment was having some effect was the substitution of western Europe for the United States as the main growth area for Japanese exports; sales to that area went up by 40 per cent.

The reasons for the further increase in Japan's trade surplus include factors already mentioned in discussion of the US case. In particular the fact that the exchange rate realignment was not reflected as fully as had been expected in prices, and that the price elasticities turned out to be rather low, suggested that any adjustment that would finally work through would be inadequate. Of course, Japanese industry made strenuous efforts to adapt to the new situation, both by increasing productivity to limit price increases and by seeking new markets. It should be noted, however, that export sales were probably boosted later in the year by growing expectations of a further change in exchange rates. The trade surplus was significantly smaller during the early months of 1973 but this owed much to specific measures and the acceleration of domestic activity. Any element of delayed response to the Smithsonian realignment was certainly still small.

Germany. After the yen the Deutsche Mark was, together with the Swiss franc, the currency revalued the most in 1971. Next to Japan, Germany was expected to make the biggest contribution to the post-Smithsonian adjustment process, despite the fact that its current-account surplus in 1971 had been negligible — the $4.6 milliard trade surplus having been almost offset by the deficit on the rest of the current account. When the German authorities decided to revalue in 1971, however, they took the view that in the circumstances — that is, after the 1969 revaluation and the domestic overheating of 1969–70 — the existence of even a small current external surplus was a sign of the continued strength of the Deutsche Mark.

Germany's overall payments surplus in fact went up considerably between 1971 and 1972, from $3.8 to just over 5 milliard. Most of this came from capital inflows of $4.5 milliard which, in contrast to the Japanese experience, were even larger than in 1971. The Bardepot scheme brought about a sizable reversal on short-term capital account; but this was more than offset by a larger rise in the long-term capital surplus, itself associated with various substitutes — chiefly the sale of German securities to non-residents — for the short-term borrowing which the Bardepot had blocked.

Over and above this, however, there was an increase in the current external surplus from $0.2 to 0.5 milliard. Indeed, the trade surplus increased much more, to $6.3 milliard, gathering strength as the year progressed. Imports, it is true, rose by 9½ per cent. in volume and by 17½ per cent. in dollar value; but exports went up by 8½ per cent. in volume and by just on 20 per cent. in dollar value. That German exports could rise so much in volume in the face of the increase in dollar export prices indicates that Germany's competitive position was still strong. Thus the confidence of the German authorities in 1971 in revaluing for the second time within two years was amply justified by events. And the decision to revalue the Mark a further 3 per cent. in March 1973, within less than a month of the dollar's second devaluation, showed that they were no less confident then than they had been before.

* * *

What seem to be the prospects now? The view most generally held is that the new exchange rate structure which came about in the early months of 1973 is correct from an economic standpoint. Of course, initial perverse effects from the new devaluation of the dollar may keep US trade in deficit during a transitional period. But it is expected that the trade account will show improvement after a reasonable interval and that, when the adjustment process has been allowed time to work itself out, the US external account will come into approximate balance. Corresponding adjustments are expected for the surplus countries. The main condition still required, according to this view, is that the net outflow of capital funds from the United States be kept under control.

Other observers are less optimistic, however. They give weight to the fact that wage rates in the United States are still higher than in other industrial countries and they doubt whether the US advantage in productivity is large enough to make up for the difference. Besides, they see US import requirements as likely to increase steadily, particularly for raw commodities such as petroleum. In addition, they consider that there are several countries with surpluses too large to be cured by the relative revaluations that have taken place.

Estimates of effective exchange rate changes.

Currencies	5th May 1971 to 20th December 1971	20th December 1971 to end-May 1973	5th May 1971 to end-May 1973
	effective percentage changes		
Japanese yen	+ 11	+ 12	+ 24½
Swiss franc	+ 5	+ 14½	+ 20
Deutsche Mark	+ 5	+ 9	+ 14½
Belgian franc	+ 2	+ 4	+ 6
French franc	− 1	+ 6½	+ 5½
Dutch guilder	+ 1½	+ 3	+ 4½
Swedish krona	− 1½	+ 3	+ 1½
Canadian dollar	− 3	− 2½	− 5½
Sterling	+ ½	− 11	− 10½
Italian lira	− 1½	− 10½	− 12
US dollar	− 9	− 9½	− 17½

Notes: 1. The effective change in the exchange rate of the currency of an individual country is defined as equivalent to that unilateral change which it is estimated would affect the country's trade balance to the same extent as the actual multilateral changes in exchange rates that have taken place.
2. Rates used — 5th May 1971: parities for all except Canadian dollar, for which market rate;
— 20th December 1971: Smithsonian central and middle rates for all except Canadian dollar, for which Can. $1 = US $1;
— end-May 1973: market rates for all.
3. Where two-tier markets operate the commercial rate has been used.

It is hardly possible to be certain of one's ground in this matter. The above table indicates that the effective movements in exchange rates — that is, changes weighted to take account of trade patterns — over the last two years or so have been quite substantial for several currencies. Moreover, the cumulative effective devaluation of the dollar now ruling will, per cent. for per cent., produce a much more positive correction than the Smithsonian realignment could have done alone. But just how much improvement it brings will only be known precisely in the event. Experience has shown that the dynamics of the world economy are apt to change the underlying situation in which the adjustment process takes place and that the outcome three or four years ahead cannot be predicted. The only thing certain is that developments cannot just be left to chance and that both deficit and surplus countries must have an active balance-of-payments policy.

International monetary reform.

Well before the final breakdown of the fixed exchange rate system, steps had been taken to initiate discussions on the future of the monetary system. At the annual meeting of the International Monetary Fund in 1971, the Board of Governors had requested the Fund's Executive Directors to prepare a report on "measures that are necessary or desirable for the improvement or reform of the international monetary system". This report was presented in August 1972 and it brought out clearly the different points of view in the Fund's membership on these matters, putting some of the issues more frankly than had been done in earlier official documents. It did not, however, attempt to make agreed recommendations for action on any aspect of reform.

For the formulation and negotiation of such recommendations, the Board of Governors established an ad hoc Committee of Twenty with the official title of the Committee on Reform of the International Monetary System and Related Issues. The twenty members correspond to the twenty country groupings of the Fund's Executive Directors and the Committee was set up at the level of both Ministers and Deputies. Both groups have been holding meetings with the aim of presenting a report at the 1973 meeting of the Fund in Nairobi.

The Report by the Executive Directors points to five aspects of the system about which changes are to be considered. The first is the exchange rate mechanism, which includes both the indications of when changes in par values are necessary and the respective responsibilities of the deficit and surplus countries for making par value changes. The second is the re-establishment of convertibility and the arrangements for the settlement of imbalances among countries. Thirdly, there is the position in the system of the various reserve assets and in particular the status and function to be given to foreign exchange reserves, gold and special drawing rights. The fourth is the problem of disequilibrating capital movements and what might be done to lessen the intense market pressures which accompany them. And finally there is the possibility of new provisions in the IMF arrangements for the special needs of developing countries.

Assuming that the object of the exercise is to re-establish a par value system with more effective adjustment incentives, it might be said that the second topic, the convertibility of currencies and the methods of settling imbalances, was the primary task before the Committee. It was indeed the suspension of convertibility by the United States on 15th August 1971, without provision for its restoration in the Smithsonian agreement, which really spelt the end of the Bretton Woods conception and rules. But with the huge amassing of dollar reserves that has taken place in the last four years, it is generally accepted that re-establishment of dollar convertibility will be complicated and will at least require a considerable transitional period. Hence the discussions so far have centred around the prospective exchange rate system, including the function of exchange rate changes in the adjustment process, and the future status of the various kinds of reserves.

On the former of these problems there was from the outset general agreement on the desirability of retaining a fixed exchange rate system, but with some greater flexibility of rates than in the past. As a matter of fact, by the time the Committee of Twenty first met, exchange rates had already shown much more flexibility. From November 1967 until the time when the Committee began its work, there had been eleven adjustments of fixed parities by Group of Ten countries. There had been major devaluations of sterling, the French franc and the dollar, as well as minor ones of the lira and the Swedish krona; and all the other Group of Ten currencies, except the Canadian dollar, had been revalued, the Deutsche Mark twice. In addition, the Canadian dollar had been floating since June 1970, the Deutsche Mark and the guilder between May and December 1971, all the Group of Ten currencies between August and December 1971, and sterling from June 1972 onwards. This increased flexibility was not due to any improvement in the rules, however, nor did it bring about a nicely managed implementation of the adjustments. On the contrary, the changes in exchange rates had been unduly delayed and the adjustment processes were set in motion by the force majeure of market crisis.

Against this background, recent discussions have been concerned less with the principle of greater flexibility than with its application — that is, with improving and speeding up adjustment decisions and, more specifically, with identifying cases in which changes in exchange rates are called for. The main proposal has been put forward by the United States; it is that "disproportionate" changes over a given time in a country's official monetary reserves should be taken as an "objective indicator" of the existence of a payments disequilibrium requiring corrective action. Such action need not involve a change in the exchange rate if a correction can be secured by other means.

The proposal accepts certain objectives for the reformed monetary system that had received rather general support in recent years. One is that the system should make it feasible for all currencies, including the dollar, to maintain convertibility into the basic reserve assets of gold and SDRs by assuring that losses of reserves could be subsequently recouped. The second is to prevent exaggerated increases in foreign exchange reserves. And the third is that the future growth of official reserves should be largely through new allocations of SDRs, which likewise should be kept under international control and be limited to the global needs of the system. It is a system which requires that both deficit and surplus countries maintain discipline to keep their changes of reserves in line with the set limits or to adjust quickly to reverse excessive movements.

It was evident in the Bretton Woods system that persistent reserve losses which could not be corrected by domestic policy measures inevitably lead sooner or later to devaluation of the currency; undue delays in devaluing arose through excessive granting of official credit and through excessive accumulation of dollars by surplus countries (in a sense also granting of credit). To make the system more symmetrical, the proposal contemplates a comparable obligation on surplus countries to control their surpluses by either internal adjustment or revaluation of the currency — it being clear that one country's surplus is another country's deficit.

While the US proposal has been taken seriously and seen to be a logical scheme, it has met with rather strong objections on the grounds that a reserve loss or gain is not necessarily a sign of fundamental disequilibrium; it may originate from cyclical developments, from excess or deficiency of demand, from interest rate differentials or from speculative flows of money. Besides, a country's reserves can be affected by another country's misdeeds. It was therefore suggested that a better objective indicator would be the deficit or surplus of the basic balance of payments adjusted for the relative position of the country in the business cycle. Further objections, voiced by various countries, to the use of reserves as the key indicator were that this would put the onus of taking action on the surplus countries, that it would hurry countries into using the exchange rate as the main adjustment instrument and that it would frustrate countries' objectives with regard to the structure of their balance of payments.

It is apparent from past experience that a satisfactory working of a fixed exchange rate system requires that the concept of fundamental disequilibrium be made as concrete as possible. It is not likely, however, that really objective criteria can enable such situations to be identified simply by rule of thumb. There seems generally to be a need for a judgement case by case, based on a careful analysis of all the relevant factors, which will of course differ from one case to another. And as in some such cases, particularly those involving the dollar, both gains and losses of reserves will have occurred, there is also no avoiding a judgement on which countries should have responsibility for taking corrective action.

The recent breakdown of the fixed rate system has inevitably placed the whole discussion of the exchange rate régime in a rather different context. After this traumatic experience the opinion has been expressed that it might be better not to return to fixed rates at all. The Committee of Twenty, meeting at Ministerial level shortly after the exchange markets reopened on 19th March, stated the following views on the matter: "Members of the Committee recognised that exchange rates must be a matter for international concern and consultation and that in the reformed system the exchange rate régime should remain based on stable but adjustable par values. It was also recognised that floating rates could provide a useful technique in particular situations. There was also general agreement on the need for exchange market stability and on the importance of Fund surveillance of exchange rate policies." Taken as a whole, these words are hardly a clear-cut advocacy of a system of fixed exchange rates, to be changed only in cases of fundamental disequilibrium.

However, official opinion by and large remains favourable to the ideal of a fixed rate system, for the same reasons as in the past. On the one hand, it is considered useful in the management of economic affairs that governments be subject to the discipline of the balance of payments so that it acts as a brake on domestic inflationary forces. In addition, it is thought that fixed rates make it politically easier to limit direct controls on trade and payments, such as might be imposed under a régime of floating in order to avoid shocks to the structure of the external sector. None the less, the idea of floating for some years has many adherents. The main reason for this is the reluctance of the authorities within a system of fixed rates to have their external reserves and their domestic monetary policies affected against their will by any substantial external imbalance that may continue even after a realignment. This could happen, given the huge potential size of leads and lags and of other private liquid capital flows, if at a time when confidence was still at a low ebb new fixed rates were simply to afford a target for speculation. It could also happen as a result of the sluggishness of the response of the current account to changes in exchange rates, although the existence of such lags is also a forceful argument against completely free floating because the necessary conditions for stability may not be fulfilled. Finally, there are some who believe that a new fixed rate system cannot be built on the basis of an inconvertible dollar.

As to the second problem mentioned above, namely the future of the various reserve assets, there are many who start from the idea that the future growth of reserves should be controlled, so that the increase may be in accordance with global needs. This of course assumes a fixed rate system, as otherwise there would be little need for reserves at all. The idea of control stems from the belief that excessive reserve growth contributes to inflation and at the same time is a clear sign of inadequate adjustment policies.

In recent discussions also it has been fairly generally accepted that SDRs should in future be the principal means of reserve growth, partly — though not entirely — as an aid to global reserve management. There is more to this idea, however, than just accepting it and proceeding to allocate SDRs, as became clear during the first three years of SDR allocation. It has in fact important implications for the nature of the SDR, for the future of other reserve assets, for the adjustment process and indeed for the feasibility of maintaining fixed exchange rates as the normal relationship among currencies.

With regard to the nature of the SDR, it means first of all that SDRs must carry a rate of interest which makes them attractive to hold. This is of particular concern to countries which now hold their reserves mainly in foreign exchange because of the importance they attach to the income earned on them. Secondly, it means making SDRs a more independent reserve asset, which implies substituting some other guarantee for the link with gold as well as changing the rules at present governing their use, such as the holding limits and the reconstitution provisions.

As for other types of reserves, attention has naturally been focused on controlling the growth of foreign exchange reserves, with the idea that any further increases should be strictly limited. Even on the assumption that the adjustment process will work better and more promptly in the future, this proposal appears premature. To adopt it could require an over-adjustment process, in which exchange rate changes would be destabilising from the standpoint of trade and of the domestic economy — a cure which would be worse than the disease. Any management of global reserves will have to allow for some play in the system — in fact for some unmanaged growth of reserves; otherwise the adjustment of parities may need to be so frequent that confidence in a fixed rate could not be maintained. It would in any case not be easy to secure agreement on limiting exchange holdings, nor would it be difficult to get round such limits in one way or another if they existed.

The question of the place of gold in the reformed monetary system is of course quite different from that of exchange reserves. Gold does not involve the risk of an excessive increase in reserves. However, gold reserves are virtually frozen because no central bank will give up gold at the present official value with the market price soaring above it. There is also the probability that so long as that situation persists, countries will be cautious about using their gold-guaranteed claims on the IMF, which at the present include their SDRs. In addition, the glaring discrepancy between over $100 for gold in the market and its nominal legal value of $42 is an obstacle to the restoration of confidence in, and the convertibility of, the dollar.

As to what to do about gold in the new monetary system, the only point of agreement seems to be that the share of gold in global reserves will tend to decline as that of SDRs increases. For the rest there is a whole gamut of opinion. Some believe that gold should be "phased out" of the system, though without having yet indicated how this should be done; on the other hand, many countries believe that gold should be retained in the system, and even that the SDR link with gold should be kept. Likewise, opinions are divided between maintaining the present official value of gold and raising it to a realistic relationship with the market price. A view heard recently is that the fixed official value should be abolished or ignored, leaving countries free, if they wished, to use gold in official settlements at or about the market price. It is also held that the understanding reached in Washington in March 1968 should be lifted in order that monetary authorities may be free to sell gold to the market, as allowed under the Fund's Articles, or even free to buy and sell. However, whatever the effect of these proposals might be, the intention behind them is simply that gold be unfrozen, not that it should again become a positive component in the growth of reserves.

It is in this respect that the system has already undergone a profound change. Formerly the inflow of new gold into the system served not only to increase global reserves but to finance net payments surpluses for the system as a whole, because new gold was a current-account export of gold-producing countries whereas its receipt was a means of balance-of-payments settlement. Gold thereby contributed to exchange rate stability by allowing some play in the adjustment process. Allocations of SDRs, on the other hand, do not finance payments surpluses in this way. Rather, they simply create surpluses — and that only if one ignores the implicit liabilities — still leaving true payments surpluses to be financed in one way or another. Hence an SDR system demands more rapid and effective adjustments of payments deficits and surpluses, unless both persistent transfers of SDRs are permitted and allocations are on a sufficient scale.

On the subject of the large movements of funds that have agitated the exchange markets, not much in the way of positive ideas has emerged as yet — except to call them destabilising. In fact, however, the destabilisation has mostly come from resistance to changing parities that were clearly unrealistic or from the extreme pursuit of domestic monetary policy on closed economy assumptions. It seems to be expected that the adjustment process will work better in the future, though many milliards of dollars were bought over the past year before the authorities abandoned the Smithsonian exchange rates. As to limitations on the operation of monetary policy, there are no signs that it figures very much in official thinking. Hence emphasis is likely to be on controls, though they have not been conspicuously effective, not even the extreme measures used by the Japanese authorities.

The idea that the reformed system should have special provisions for the benefit of developing countries has meant so far that they should be allocated, by one technique or another, more SDRs than would result from allocations proportionate to their quotas in the IMF. This idea has come to be called the "link" between SDRs and development aid. It is not yet clear what could be done on these lines, but there is strong political pressure behind it. On strictly monetary grounds the link raises some difficult questions. SDRs were not intended to finance persistent deficits but to finance swings in payments, as is clear from the provisions for reconstitution of SDR debtor positions. Hence there remains in the SDR idea some sense of a credit facility. And should the developing countries tend to become the main debtors to the SDR system, it is not apparent that confidence in the SDRs could be maintained, particularly if their share in the total allocations was large. Just how the link may affect other channels of aid is another aspect of the problem that needs to be considered.

Thus it can be seen that there are very difficult issues to be resolved, which moreover, have to be resolved in such a way that the pieces fit together to make a workable system. Hence the negotiation is likely to be a time-consuming process.

II. ECONOMIC AND MONETARY DEVELOPMENTS AND POLICIES IN INDIVIDUAL COUNTRIES.

The policy-induced economic slow-down of 1970–71 gave way over the past year to a vigorous policy-induced expansion. Having met with scant success in their efforts to damp down wage/price inflation by demand restraint, national authorities soon felt impelled to turn again to objectives of growth and full employment. North America led the way and Japan was not far behind. In western Europe, where the pause in activity came later and was generally rather moderate, a sharp acceleration from late 1972 onwards quickly made up for lost ground. Thus, viewed in terms of post-war economic history, the spring of 1973 saw a fairly unusual convergence of cyclical trends internationally. The world economy seemed to be heading for a phase of generalised demand pressure not experienced since the mid-fifties.

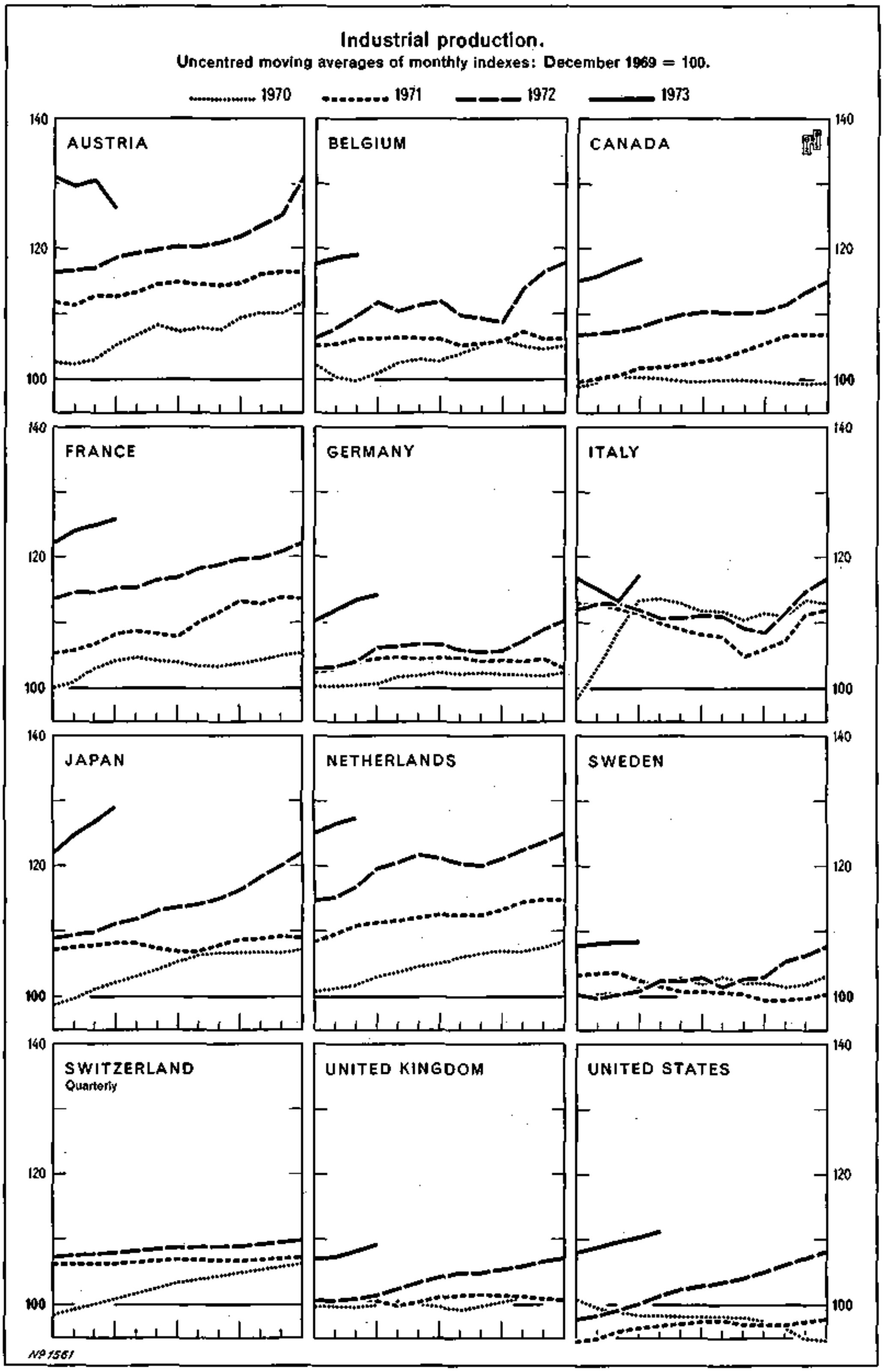
In recent months the upswing has shown strong self-reinforcing tendencies. Initiated largely by rising personal consumption, public-sector outlays and residential construction, demand expansion last year was increasingly stimulated by the mutual interaction of growing world trade. More recently, industrial investment has displayed signs of strength, particularly in the larger industrial countries.

In each successive upswing since the war wages and prices have recorded faster rates of increase than in the previous one. The present upswing is no exception — though in the United States a bold experiment in incomes and prices policy has up to now yielded good results. In most western European countries increases in wage rates or earnings last year were within a range of about 10–15 per cent., while consumer price increases generally bunched within a range of 6–8 per cent. As described in Chapter I, a new feature of the inflation has been soaring world-market commodity prices. Inflationary expectations have become deeply ingrained.

The expansion of the money supply over the past two years has been very large indeed. In most industrial countries the ratio of the average increase to the growth in the nominal gross national product has been 1.2–1.9. In terms of the increase in real gross national product the ratios were generally about 2.5–3.5 but even reached 8. Thus, national authorities have found themselves being pushed away from their accustomed norms of monetary growth.

There are several principal reasons why the expansion of bank credit and liquid assets was so strong. One is that the usual need to rebuild liquidity following a credit squeeze began rather quickly to merge with the desire to cushion against an impending new squeeze. A related reason was that real interest rates remained very low or negative almost everywhere and that long-term yields could be expected to move higher. Finally, the potential for monetary expansion had been substantially increased in many countries by the huge international flows of funds arising from exchange-market disturbances.

In view of these general developments the monetary authorities in the United States, Japan and a number of western European countries have since last autumn progressively tightened their policies with the aim of tempering the pace of activity.


Industrial production.
Uncentred moving averages of monthly indexes: December 1969 = 100.
1970
1971
1972
1973
140
120
100
AUSTRIA
BELGIUM
CANADA
FRANCE
GERMANY
ITALY
JAPAN
NETHERLANDS
SWEDEN
SWITZERLAND
Quarterly
UNITED KINGDOM
UNITED STATES
Nº 1561

In eastern Europe overall growth in 1972 again amounted to about 7 per cent., but in the Soviet Union the effect of adverse weather conditions on agriculture brought growth down to about 4 per cent. from 6 per cent. in 1971. Among the other eastern European countries the increase in national income produced ranged from 5–6 per cent. in the more industrialised countries up to as much as 10 per cent. in those now undergoing rapid industrialisation. In a number of countries, however, industrial production increased somewhat more slowly last year owing to labour shortages or smaller productivity gains.

The sections below describe the details of this changing pattern of problems and policies in individual countries.

* * *

United States. By the spring of 1973 a vigorous cyclical upswing had been in progress in the United States for more than eighteen months, with industrial production increasing at an annual rate of about 10 per cent. and real gross national product at nearly 8 per cent. The dynamic elements of demand were consumer spending, particularly on cars and household durables, business outlays on plant and equipment and, to an increasing extent, exports. Residential construction activity continued to rise, though not as rapidly as before; housing starts totalled 2.4 million in 1972, compared with 1.3–1.6 million per annum during the sixties. Inventory accumulation picked up sharply after mid-1972, but inventory/sales ratios continued to decline and in the early months of 1973 were at a comparatively low level.

The Federal Government's budgetary policy played a stimulative rôle. On a national accounts basis, the deficit narrowed only slightly from $21.7 milliard in 1971 to $18.1 milliard. Expenditure on goods and services turned up moderately as the decline in military spending associated with disengagement from Vietnam came to an end, and there was a sharp rise in transfer payments to persons and grants-in-aid to State and local governments. In addition, legislation had provided a number of new fiscal stimuli: personal tax cuts from the beginning of 1972, the repeal of the excise tax on motor-cars, a retroactive 7 per cent. tax credit on business investment and liberalised tax depreciation allowances.

For the public sector as a whole, however, the deficit on a national accounts basis fell from $16.9 milliard in 1971 to $5.9 milliard. This reflects a sharply improved position of State and local governments; although their expenditure continued to rise as before, an increase in tax revenue and Federal grants-in-aid raised their overall budget surplus from $4.8 milliard in 1971 to $12.6 milliard.

In view of the vigour and breadth of the upswing it is not surprising that imports rose sharply. In 1972 as a whole the volume of imported goods and services was nearly 12 per cent. higher than in 1971. After tapering off in mid-year it accelerated again during the autumn and into the early months of 1973.

On the labour market the unemployment ratio remained close to 6 per cent. until the late spring of 1972, partly because of sizable productivity gains characteristic of the early stages of an upswing and partly because of increases in available manpower. From June onwards, however, unemployment declined, to stand at 5 per cent. in April 1973. For men aged 20 and over the rate was only 3.4 per cent. Other indicators, such as lengthening delivery periods, also pointed to a diminishing margin of unused resources.

Mandatory wage and price controls remained in force throughout 1972 under Phase II of the Administration's incomes policy. The influence of the Pay Board, together with the lack of strain on the labour market and the relatively small number of wage contracts falling due for renewal, helped to limit pay increases. Once a number of post-freeze adjustments had been made in the early part of 1972, hourly earnings rose at an annual rate of less than 6 per cent. despite the vigour of the upswing, compared with over 7 per cent. in the year ending August 1971 before the introduction of the freeze. Moreover, disregarding the effects of increasing overtime work and the growth in the proportion of labour employed in higher-paid industries, the straight increase in contractual wage rates was quite moderate. A significant slow-down was also apparent in industrial wholesale prices and in consumer prices.

Towards the end of 1972, however, inflation began to accelerate once more, coming this time from an unaccustomed quarter. Largely because of an explosive increase in the prices for primary products and especially for agricultural commodities, wholesale prices had risen by December to 6½ per cent. above their level a year earlier. Then in the first four months of 1973 alone wholesale prices leapt ahead by 6.3 per cent. and consumer prices by 2.7 per cent. To some extent this was attributable to the transitional, partly psychological, impact of the switch from a mandatory prices and incomes policy to a voluntary one in January (Phase III), price controls being retained only for construction, health care and food processing and distribution. The Pay Board and Price Commission were abolished and the supervision of guide-lines and the remaining controls over wages and prices were entrusted to the Cost-of-Living Council, assisted by a new Labour-Management Advisory Committee on wages and by quarterly reports from the 800 largest firms on their costs and prices. The Council subsequently declared that the guide-line for wage awards would be kept at the existing figure of 5½ per cent. plus 1 per cent. for fringe benefits. The Administration affirmed its aim of reducing the rate of inflation to 2½ per cent. or less by the end of 1973. The Committee on Interest and Dividends had earlier extended the 4 per cent. limit on dividend increases for the duration of 1973. The President also obtained an extension of the Economic Stabilisation Act until April 1974, empowering him to reimpose mandatory controls over prices and incomes.

A number of measures were taken in the first quarter of 1973 to limit the upsurge of food prices. The suspension of quota restrictions on meat imports, first introduced in June 1972, was prolonged to the end of 1973. In addition, agricultural support payments were modified in order to boost the production of grain and livestock, while remaining export subsidies and support for the financing of grain stocks were withdrawn. At the end of March a ceiling was imposed on the price of beef, pork and lamb.

Credit grew rapidly throughout the upswing and showed some tendency to accelerate. Total funds raised in the credit markets by non-financial sectors, including equity issues, came to \$171 milliard in 1972, \$14 milliard more than the already large total in 1971, which had been swollen in connection with the run on the dollar. In the second half of 1972 financial flows reached an annual rate of \$189 milliard, increasing rapidly to \$215 milliard in the final quarter. As the table shows, the rise in 1972 was due to increased credit-granting by commercial banks and other financial institutions, chiefly savings and loan associations, in the form of business loans, consumer credit and mortgages. Security issues, in contrast, were lower than in 1971, reflecting a tapering-off in long-term borrowing by corporations and smaller cash requirements of the public sector. Equity issues declined only slightly from \$13.5 milliard in 1971 to \$12.4 milliard in 1972, but corporate and foreign bond flotations fell from \$20.3 to 13.6 milliard. State and local governments, in a position of exceptional surplus on their budgets, raised \$14.5 milliard compared with \$20.2 milliard, largely to consolidate their financial position and build up liquidity. Net issues of Federal Government securities (including those of government-sponsored credit agencies) declined from \$29.4 milliard in 1971 to \$23.6 milliard last year. But, whereas in 1971 the foreign sector (mainly official institutions) took up government securities equivalent to 90 per

United States: Uses and sources of credit-market funds.[1]

Items	1970	1971 1st half	1971 2nd half	1972 1st half	1972 2nd half	1973 1st quarter
	adjusted annual rates, in milliards of dollars					
Demand for funds						
US Government securities[2]	12.8	22.3	28.7	11.5	23.2	21.9
Corporate and foreign bonds	21.1	23.2	17.4	13.8	13.4	8.9
State and local-government securities	13.8	22.1	18.5	14.0	15.0	3.4
Mortgages	25.8	39.3	54.6	59.4	71.4	64.8
Consumer credit	4.3	6.5	13.6	15.6	22.4	25.3
Bank loans	5.0	7.9	18.0	15.9	25.8	71.8
Other	11.9	8.9	3.9	7.8	7.0	− 2.0
Total[2]	94.7	130.2	154.7	138.0	178.2	194.1
Met directly by						
Federal Government	2.8	4.4	2.0	1.6	3.1	0.2
Federal Reserve	5.0	8.4	9.3	4.8	− 3.9	22.2
Commercial banks	31.6	49.4	50.0	54.8	79.1	92.6
Other financial institutions	38.7	56.5	55.3	70.7	78.2	77.6
Private non-financial sector	6.3	−15.2	11.9	0.7	10.2	−33.3
Foreign sector	10.3	26.7	26.2	5.4	11.5	34.8
Total	94.7	130.2	154.7	138.0	178.2	194.1
Corresponding changes in financial assets						
Money (M_1)	7.7	17.9	10.7	13.2	18.4	12.7
Time and savings deposits	56.2	92.4	70.2	92.3	84.9	120.8
Credit-market claims	30.8	19.9	73.8	32.5	74.9	60.6
Total	94.7	130.2	154.7	138.0	178.2	194.1
[1] Does not include equity issues by non-financial business, which amounted to	6.8	12.7	14.2	13.1	11.8	9.8
Total net flows, including equities	101.5	142.9	168.9	151.1	190.0	203.9
Total, as percentage of GNP	*10.4*	*13.8*	*15.8*	*13.4*	*16.1*	*16.5*

[2] Excludes funds raised by US Government-sponsored credit agencies for re-lending purposes.

cent. of these net issues, this proportion dropped in 1972 to about 36 per cent., only to leap to 100 per cent. in the first quarter of 1973. From December 1969 to February 1973 foreign holdings of US Government securities rose from $11.4 to 61.1 milliard, while the holdings of private domestic investors declined from $210.6 to 204.0 milliard.

In the early months of 1972, before the strength of the recovery had become apparent, open-market policy was highly expansionary. Thereafter a less active posture was adopted, and member-bank borrowings from the Federal Reserve gradually increased. Although the discount rate was not raised, monetary policy took a definite turn towards restraint in the final quarter of 1972. The money supply according to the broad definition, which, however, excludes large-denomination certificates of deposit, rose by 10.8 per cent. in 1972, fractionally less than in 1971; narrowly defined, it went up by 8.3 per cent., compared with 6.6 per cent. in 1971. The increase in total bank loans and investments came to 14.1 per cent., compared with 11.4 per cent. in 1971.

The movement of interest rates reflected the pattern of credit demand, as well as the concentration of official open-market purchases on longer-term paper. Bond rates remained stable throughout the year, with medium-term government notes yielding about 6 per cent. and first-grade corporate bonds a little over 7 per cent.; short-term rates, however, began to rise after the first quarter. The Federal funds rate jumped from a low of just over 3 per cent. in early March to 4 per cent. later that month and then moved up more gradually to almost 5½ per cent. by the end of the year. The banks' prime lending rates were raised progressively from 4½ to 6 per cent. during the autumn months, but the increases drew admonitions from the Committee on Interest and Dividends, which also persuaded major banks using a floating prime rate linked automatically to market rates to modify and eventually suspend this practice. With no signs of financial disintermediation yet appearing, the large flow of funds to thrift institutions continued throughout the year and helped to meet the strong demand for mortgage credit.

The expansion of bank lending to commercial and industrial borrowers speeded up sharply during the winter, increasing during the first quarter of 1973 at an annual adjusted rate of about 30 per cent. With market interest rates continuing to rise, the Federal Reserve discount rate was put up in four steps from 4½ to 6 per cent. between January and mid-May. The banks' reserve position became tight, with borrowing from the Federal Reserve going up to reach $2.4 milliard at the end of May. The Federal funds rate averaged about 7¾ per cent. in May and the prime rate was raised in early June to 7½ per cent. for large firms, with a lower rate for small firms, personal loans and mortgages; the introduction of this differential was the result of continuing pressure from the Committee on Interest and Dividends to slow down the increase in credit costs. Longer-term rates began to move up for the first time since the start of the expansion, but they levelled off again in the spring.

Fiscal policy also took on a more restrictive appearance. Revised budget estimates for 1972–73 put expenditure at $249.8 milliard, only $3.5 milliard higher than originally estimated despite the rejection by Congress of the Administration's request for a statutory ceiling of $250 milliard. With tax revenues rising sharply owing to increased economic activity, the Federal deficit on a national accounts basis was now expected to fall to the neighbourhood of \$12 milliard for the calendar year 1973. The estimates for 1973–74, based on a projected growth in the gross national product during 1973 of nearly 10 per cent. in nominal terms and 6¾ per cent. in real terms, bring the budget to near-balance on a full-employment basis. The smallness of the projected rise in outlays reflected a curtailment of spending on several social programmes and on farm support.

While the Administration attached importance to containing the growth of public expenditure as an alternative to increasing taxation, the overall degree of restraint implied by these policies was moderate. The aim was not to bring about a sharp deceleration of the upswing, but to steer the economy on to its long-run potential growth path. The impetus of demand, however, is such that a situation of excessive pressure on resources may be rapidly approaching. Business fixed investment is expected to increase by 15 per cent. or more in 1973, and consumer spending, bolstered by rising personal incomes and by large tax refunds in the early spring, has been very strong up to now. In this atmosphere public discussion has turned increasingly to the possibility of tighter wage and price controls as well as new tax measures.

Recent weeks have seen significant new policy developments in both the price and the monetary spheres. In a tightening of Phase III controls at the beginning of May it was laid down that large companies must give advance notification if they intend to raise average prices by more than 1½ per cent. over early January levels. In the monetary field the twelve-month rates of increase in the money stock narrowly defined and broadly defined had dropped by April to 6.3 and 9.0 per cent. respectively. On the other hand, the adjusted bank credit proxy, a more comprehensive measure of the banks' loanable resources, was up by 12.8 per cent. In mid-May the Federal Reserve Board suspended altogether the Regulation Q ceilings on interest rates payable on large certificates of deposit and raised from 5 to 8 per cent. the reserve requirements against any increase in banks' resources resulting from issues of such certificates and of bank-related commercial paper. At the same time the reserve requirement against banks' foreign borrowings was lowered from 20 to 8 per cent. In addition to bringing immediate upward pressure to bear on domestic short-term interest rates and removing a possible constraint on their future rise, the measures help to make the incentives for banks to raise funds at home or abroad more equal.

Canada. Although monetary and fiscal policies were kept on a stimulatory tack, the expansion of overall demand lost some of its momentum for a time last year. Up until the autumn exports showed a tendency to decline and the recovery of business investment proceeded slowly. Personal consumption and government spending went on rising and housing activity provided a strong stimulus before tapering off late in the year. To an unusually large extent, however, the growth in overall demand was met from imports. Agricultural production fell as a result of adverse weather conditions, and industrial and construction activity was also retarded by major strikes, particularly in the third quarter. In contrast with developments elsewhere last year, the growth of labour productivity was only at about its long-term average. But the pace of output expansion was insufficient to absorb Canada's fast-growing labour force, so that the adjusted unemployment rate went up to 6.9 per cent. in September. Against this background the speeding-up of consumer-price increases was disappointing.

Though the main new factor was the rising cost of foodstuffs, wage earnings in industry continued to increase at an annual rate approaching 9 per cent.

The government's budget for 1972–73, though slightly less stimulatory than in the previous year, contained proposals designed to re-activate investment, including faster write-offs for industrial investment and a reduction in corporate taxes. However, parliamentary approval for these proposals was not forthcoming.

Monetary policy, for its part, was aimed at accommodating a high rate of credit expansion to help the economy to reach higher operating levels. At the same time this policy helped to moderate upward pressures on the exchange rate due to inflows of funds, particularly in the spring, deriving mostly from sales abroad of newly-issued bonds. But, in order to take account of the lagged effects of monetary expansion, the authorities sought to keep the growth of bank reserves within bounds. Following the development in the spring of aggressive competition among the banks for deposits, there was a marked acceleration in the growth of quasi-money and an intensification of the upward movement in short-term interest rates. In this situation the authorities, while temporarily easing bank liquidity, supported the conclusion among the banks of an agreement which placed a ceiling on the rate of interest paid on large time deposits with maturities of up to one year.

As a result of these policies deposits with chartered banks showed a rise of 15 per cent. last year, compared with 18 per cent. in 1971. As there was virtually no net increase over the year in the banks' holdings of liquid assets and government securities, their total loans plus other security investments went up by 23 per cent., with term loans to business and mortgage lending rising fastest.

Canada: Total funds raised on financial markets.

Items	1969	1970	1971	1972
	in milliards of Canadian dollars			
Non-financial business	4.2	3.2	5.3	4.5
Consumers	1.3	0.7	1.4	2.1
Mortgage borrowers	1.7	1.5	2.5	3.8
Provinces and municipalities	2.2	2.3	2.9	3.3
Total	9.4	7.7	12.1	13.7
Government of Canada	0.3	2.0	3.0	1.6
Grand total	9.7	9.7	15.1	15.3

Total funds raised by domestic borrowers slightly exceeded the high level already recorded in 1971; further large rises in consumer loans and mortgage borrowings more than offset a slight easing-off in borrowing by non-financial business. At Can. $1.6 milliard, the government's borrowing requirement was about the same as a year earlier, if financing of the growth in the foreign exchange reserves — substantial in 1971 but negligible last year — is excluded. On the capital market, sales of securities were somewhat smaller than in 1971, partly owing to a decline in government issues.

These substantial credit demands were accommodated without a sustained upward movement in interest rates. Both long and short-term rates rose early in the year to stand at levels above those of comparable US rates throughout the summer, but then turned down. By the end of the year differentials between bond yields in Canada and the United States had narrowed considerably and Canadian short-term interest rates stood well below the higher levels which US short money-market rates had reached.

Led by rising exports in the final quarter of 1972, a more broadly-based expansion seemed to be getting under way in early 1973. In the first quarter, when US short-term interest rates had risen further above those in Canada, bank loans went up at an adjusted annual rate of over 25 per cent. In these circumstances Bank rate was raised from the 4¾ per cent. level at which it had stood since October 1971 to 5¾ per cent. in two stages in April and May, and the chartered banks increased their prime lending rates from 6 to 7 per cent. In addition, the chartered banks were asked not to meet unusual requests for credit from foreign or foreign-owned corporations but to give priority to domestic small business and developing regions. The authorities' primary objective, however, was still to encourage a fuller utilisation of productive resources. The government has again presented to Parliament its proposals for corporate tax cuts and higher amortisation allowances. Moreover, its budget proposals for the fiscal year ending March 1974 provide for reductions in personal income tax, increases in pensions and a selective lowering of sales tax and customs duties. The budget would thus shift from an estimated outcome of approximate balance in 1972–73 to a deficit of nearly Can. $1 milliard.

Japan. At the beginning of 1972 the economic slow-down in Japan was almost a year and a half old — the longest cyclical slump in the post-war period. Expansionary policies had been pursued throughout 1971, but recovery had been delayed by uncertainties about the future exchange rate of the yen. A real upturn took hold only around the turn of 1971–72 and gradually gathered momentum to produce a year-on-year growth in real gross national product of 9.2 per cent. — some 3 percentage points more than in 1971.

The upswing was led not by exports and manufacturing investment, as in past cycles, but by government expenditure, house-building and personal consumption. To be sure, the 7½ per cent. expansion in exports of goods and services was a factor, but by past standards it was quite modest, while manufacturing investment actually fell. In contrast, the government increased its real spending by some 17 per cent., laying particular emphasis on public works: not only was the budget for 1972–73 very stimulatory from the outset, but steps were also taken to implement certain expenditures as early as possible. The Treasury loan and investment programme was revised upwards three times and a supplementary budget on ordinary account was passed in November.

As to other demand components, private house-building was also very buoyant, assisted by easy financial conditions, and fixed investment by non-manufacturing industry advanced strongly. Stock-building was lower than in 1971 but accelerated considerably during the year. Personal consumption, benefiting from rising incomes and increased transfer payments, went up by 9.3 per cent., compared with 7.1 per cent. in the preceding year.

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 (—)	1970	— 4,510	5,750	1,050	—1,580			— 710
	1971	— 4,130	7,530	830	—2,230			—2,000
	1972	— 6,170	10,580	720	—3,080			—2,050
Corresponding changes in financial assets and liabilities[2]								
Money and time deposits .	1970	3,670	6,715	—1,400	210	— 5,685	—3,510	
	1971	8,220	8,185	—1,820	255	— 10,755	—4,085	
	1972	7,440	13,905	—2,630	275	— 12,830	—6,160	
Insurance and trust claims	1970	185	2,175	— 360	10	25	—2,035	
	1971	375	2,590	— 475	10	5	—2,505	
	1972	665	3,160	— 610	5	10	—3,230	
Securities (net)	1970	— 655	1,405	175	— 810	110	— 65	275
	1971	— 635	1,705	385	—1,370	— 840	815	380
	1972	— 625	1,240	—1,040	—1,525	330	2,210	210
Loans	1970	— 9,420	—3,240	2,115	— 965	5,700	5,810	
	1971	— 13,620	—3,825	2,490	—1,130	9,530	6,555	
	1972	— 16,180	—5,375	3,010	—1,745	11,035	9,255	
Official reserves	1970							— 280
	1971							—3,775
	1972							— 915
Other foreign claims (net) .	1970	15	—	165	5	235	10	— 705
	1971	— 740	20	175	5	— 760	25	1,395
	1972	20	50	190	5	800	85	—1,345
Miscellaneous transactions[2]	1970	1,895	—1,305	355	— 30	— 385	— 210	
	1971	2,270	—1,145	75	—	2,820	— 805	
	1972	2,510	—2,400	1,800	— 95	655	—2,160	

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

The economic upswing was reflected in a fall in unemployment during the year from a high of 1.8 per cent. of the labour force in March to 1.2 per cent. in December. The rise in wages accelerated somewhat, but the 15.6 per cent. increase in monthly earnings was about in line with comparable cyclical experience earlier. With productivity also rising cyclically, the average pace of price inflation for the year was about the same as in 1971, the GNP deflator showing an increase of 5 per cent. As to imports, the revaluation of the yen in 1971 did not exert the expected degree of downward pressure on prices, partly because of rapid inflation abroad and partly because foreign suppliers and domestic distributors between them absorbed a substantial proportion of the potential benefit.

Monetary policy continued to be easy throughout 1972. Bank rate was reduced in June by half a percentage point to 4¼ per cent., the lowest figure for many years, and from June to August the Bank of Japan bought substantial amounts of government securities from the banks and commercial bills from the market, as well as granting the banks supplementary rediscount and loan facilities. Money and quasi-money rose by nearly 25 per cent., or at about the same rate as over the previous twelve months, but in contrast to 1971 much less of this was attributable to an increase in foreign assets: domestic credit to the private sector accounted for almost 90 per cent. of the growth.

The increase in total credit, according to flow-of-funds data, amounted in 1972 to nearly Yen 30,000 milliard, or 33.1 per cent. of the nominal gross national product, against 29.7 and 23.8 per cent. in 1971 and 1970 respectively. The personal sector's financial surplus again increased substantially. While borrowing much more to finance new housing and spending on durable consumer goods, households also showed a strong increase in liquidity preference. Their holdings of liquid financial assets rose sharply, but they acquired fewer securities than in 1971. However, the larger public-sector deficit in 1972 required additional bond financing, and this was made possible by a further significant expansion of financial intermediation, with the banks and other financial institutions taking up public-sector debt and making advances to business firms. Although its saving rose relative to its investment in new assets, the business sector had a considerably larger financial deficit than in the previous year owing to substantial acquisitions of land from the personal sector.

Towards the close of 1972 it became evident that inflationary pressures were building up. However, fiscal policy was committed to promoting structural changes. Since a greater domestic absorption of available resources was still a major aim of policy, the budget for 1973–74 remained expansionary. In comparison with the initial budget estimates for 1972–73, ordinary expenditure was to increase by some 25 per cent. and Treasury investments and loans by 28 per cent. Monetary action, moreover, was inhibited by the external surplus. Banks were requested to limit lending to finance purchases of real estate and equities and the two-year downward trend in interest rates was brought to a halt, but it was felt that any marked tightening of monetary policy would be an incentive to further unwanted inflows of funds from abroad.

Previous measures to reduce the external surplus, in particular those taken in June 1971 and May 1972, had made little impact. Renewed hopes were pinned on a third set of measures announced in October, but external inflows persisted, and indeed increased. In January 1973 commercial banks' reserve requirements were raised in order to absorb excess liquidity and new reserve requirements were imposed on debentures and money in trust. In February banks were asked to limit the increase in credits to major Japanese companies in the first quarter of 1973 to half that in the previous quarter. The floating of the yen in February promised to help in bringing monetary expansion under better control. Reserve requirements were raised further and from the beginning of April the discount rate was increased to 5 per cent. This was followed by action to bring about a more general rise in interest rates and by the fixing of a ceiling on new bank lending in the second quarter.

This transition to a restrictive monetary policy did not prevent inflation from gaining momentum during the early months of 1973. A growing demand-pull element was supplementing existing cost-push pressures. By early spring both wholesale and consumer prices were running about 10 per cent. higher than their respective levels twelve months earlier. In April the government proposed a seven-point anti-inflationary programme, including more flexible use of monetary and fiscal policies as well as action to liberalise import quotas and to reduce or stabilise prices of imported products. Monetary policy was tightened further at the end of May, when the Bank of Japan increased the discount rate to 5½ per cent. and announced a further increase in the banks' reserve requirements.

United Kingdom. By the early months of 1972 reflationary policies had achieved little in the way of lifting economic activity from its low ebb. Output had gone up by less than 2 per cent. on average over the previous three years, creating considerable spare capacity and raising unemployment to nearly 4 per cent. of the working population. Despite this and a pledge by 200 large firms to limit price rises on an annual basis to 5 per cent., pay settlements in private industry continued to run well into double figures. Public-sector awards were generally at a lower level of 7–8 per cent. until the prolonged strike in the nationalised coal industry in January–February ended with an award of 16 per cent. on an annual basis. Once again the wage spiral was eroding the United Kingdom's international competitiveness. The first quarter of 1972 witnessed an abrupt deterioration of the trade balance, attributable only in part to strike dislocations.

In this situation, despite the risk of worsening inflation and the external balance, the government gave priority in its March budget to domestic demand and employment. Extensive cuts in direct and indirect taxation, together with higher public expenditure, were calculated to raise the public sector's borrowing requirement to £3,358 million in 1972–73 — an increase of £2,000 million over the outturn for the previous year. The real gross domestic product was projected to increase at an annual rate of 5 per cent. from the second half of 1971 to the first half of 1973.

During the spring months, with the economy again operating free of labour disturbances, the underlying deterioration in the balance of payments was confirmed as the current-account surplus recovered only moderately. By mid-June growing anxiety about prospects for the balance of payments was added to concern about the trend of costs and prices; and the possibility of a national dock strike also affected confidence. Sterling soon came under heavy pressure in the exchange market. While the suddenness of the movement clearly reflected fears about the exchange rate, it should also be said that UK monetary conditions had been relatively easy for the previous six months. Faced with a large drain on reserves, the authorities decided to let the exchange rate float.

Meanwhile consumer spending had begun to expand strongly, reflecting the large rise in disposable incomes brought about by the tax cuts and by the lag of price increases behind wage awards. Real private consumption in the second half of 1972 was 7.0 per cent. higher than in the corresponding period of 1971, with much of the increase falling on cars and household durables. Private house-building also continued the recovery begun earlier due to the availability of plentiful mortgage credit. Public authorities' current expenditure rose by very nearly the 4 per cent. projected in the 1972 budget. On the other hand, private non-residential investment was weak, with manufacturing industry substantially reducing both its fixed capital outlays and its inventories for the second year in succession. Altogether, total final expenditure less private consumption and exports fell by 0.6 per cent. from the second half of 1971 to the second half of 1972.

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 insti-tutions
		in millions of £ sterling					
Saving plus net capital transfers	1970	4,967		2,506	3,306	360	
	1971	4,171		3,063	3,962	393	
	1972	3,134		3,602	4,449	718	
Gross domestic capital formation (—)	1970	—4,173		—1,445	—4,436	— 564	
	1971	—4,661		—1,903	—3,930	— 533	
	1972	—4,802		—2,403	—3,931	— 564	
Financial surplus or deficit (—)	1970	794	— 688[2]	1,061	—1,130	— 204	
	1971	— 490	—1,051[2]	1,160	32	— 140	
	1972	—1,668	— 18[2]	1,199	518	154	
Corresponding changes in financial assets and liabilities[3]							
Bank lending	1970	— 402	—2,595	— 59	—1,125	4,262	— 81
	1971	442	—2,228	— 576	— 730	3,511	— 419
	1972	— 589	—7,489	—1,927	—2,988	14,025	—1,032
Notes and coin and bank deposits	1970	— 187	3,384	942	322	—4,739	278
	1971	— 204	3,359	1,118	1,028	—5,482	181
	1972	— 498	7,501	2,013	2,273	—12,222	933
Total currency flow	1970	1,287	—1,287				
	1971	3,228	—3,228				
	1972	—1,265	1,265				
Overseas loans and investments	1970	266	— 191		— 35		— 40
	1971	303	19		— 290		— 32
	1972	473	— 565		101		— 9
Marketable government debt	1970	— 280	44	— 227	9	140	314
	1971	—3,700	473	466	— 1	1,383	1,379
	1972	982	353	— 23	— 21	—1,713	422
Non-marketable government debt	1970	326	— 32	— 50	— 231	— 21	8
	1971	— 171	— 28	395	— 184	— 16	4
	1972	— 359	—	464	— 76	— 21	— 8
Local-authority debt	1970	— 538	— 38	— 75	— 119	483	287
	1971	— 654	83	— 235	25	772	9
	1972	— 423	149	— 82	126	31	199
Claims on other financial institutions[4]	1970		51	3,417	— 10		—3,458
	1971		54	4,174	47		—4,275
	1972		— 112	4,726	68		—4,682
Shares and securities[5] . . .	1970	6	— 76	— 780	116	67	667
	1971	79	97	—1,239	— 45	184	924
	1972	35	— 550	— 771	— 138	115	1,309
Other domestic loans[6] . . .	1970	201		—1,351	— 316	39	1,427
	1971	98		—2,007	— 53	89	1,873
	1972	124		—2,937	— 29	350	2,492
Unidentified	1970	115	52	— 756	259	163	
	1971	89	348	— 936	235	— 225	
	1972	— 148	— 570	— 264	1,202	— 35	

[1] A negative figure indicates an increase in UK claims (or a decrease in UK liabilities) vis-à-vis the overseas sector. [2] Balance of goods and services. [3] A minus sign represents a decrease in assets or an increase in liabilities. [4] 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 purchase.

Source: Bank of England.

At the same time, the depreciation of sterling had little immediate effect on the volume of external trade. Exports of goods and services showed hardly any increase in real terms, partly because of the slow growth of world imports during the year (particularly in some important overseas sterling countries), but also because of insufficient competitiveness (at least until the June depreciation), recurring industrial disputes and the rapid expansion of consumer demand, which attracted output to the home market. The last three factors also boosted imports, the volume of which rose more than three times as fast as total final expenditure.

In the credit markets interest rates hardened, long rates almost continuously throughout 1972 and short rates from June onwards, when there was a sharp jump in yields associated with the flight from sterling and Bank rate was put up from 5 to 6 per cent. The outflow of exchange caused exceptional stringency in the money market and the Bank of England gave special assistance to the banks in the form of sale and repurchase facilities in short-dated gilt-edged stocks at a rate of 6½ per cent. The volume of credit, freed from quantitative control since September 1971, continued its rapid expansion. The money stock in 1972 increased at annual rates of 25 per cent. on the broad definition and 14 per cent. on the narrow definition, while the gross domestic product at current prices rose by approximately 10 per cent. The counterpart increase in bank lending was not closely associated with the expansion of real economic activity. Most of it went to the personal sector and to financial and property companies, which were also the largest private borrowers on the capital market. With the banks on balance disposing of government debt, public-sector financing requirements (hitherto smaller than anticipated) were met up to the end of the year through sterling accruing from the external deficit and through sales of debt to non-bank holders.

United Kingdom: Domestic credit expansion.

Items	1968	1969	1970	1971	1972
	in millions of £ sterling				
Public-sector borrowing requirement[1]	1,315	− 475	−	1,375	2,065
Net sales of public-sector debt to non-bank private sector (−)	− 25	− 345	− 115	−2,100	− 995
Bank lending to private sector[2]	575	510	1,125	1,580	5,720
Bank lending in sterling overseas	140	150	25	295	135
Domestic credit expansion	2,005	− 160	1,035	1,150	6,925

[1] The difference between the public sector's financial deficit (see previous table) and its net borrowing requirement is accounted for by loans of various kinds, refinancing of export credits and until 1971 transactions in import deposits. [2] Excluding lending in foreign currencies for investment overseas.

Domestic demand for funds by the public sector and by manufacturing industry was, however, expected to strengthen and the authorities were anxious to accommodate this without excessive growth of total credit. In August the banks were requested to make funds less readily available for property and other transactions not associated with industrial expansion. With short-term interest rates moving steadily upwards, new arrangements were introduced in October for determining the Bank of England's minimum lending rate to the money market. From then on the rate was to be set each Friday at the average rate of discount for Treasury bills fixed at that day's tender plus ½ per cent., rounded up to the nearest ¼. Under this formula the previous Bank rate of 6 per cent. was replaced by a minimum lending rate of 7¼ per cent. More definite tightening of monetary policy followed in November and December with two calls by the Bank of England for special deposits from the banks, totalling 3 per cent. in all and absorbing some £700 million of liquidity. The Treasury bill rate rose to nearly 8½ per cent. in late December — virtually double what it had been in April — and other market rates moved similarly. Bank liquidity came under pressure again in the early months of 1973, and in February the banks raised their base lending rate to 9½ per cent. The yield on some long-term government bonds went up to close on 10 per cent. in March. Thereafter the movement levelled off. By May the banks were able to reduce their base rate to 8½ per cent. and the Treasury bill rate fell to below 7½ per cent. In the first four months of 1973 the growth of the narrowly-defined money stock slowed down to an adjusted annual rate of about 11½ per cent. The comparable rate of increase for the broadly-defined money supply was 24 per cent., but this reflected a particularly rapid expansion early in the year, largely because of attractive yields on sterling certificates of deposit and other term deposits. Later, however, there were heavy sales of CDs in anticipation of the closure of a tax loophole at the time of the budget; and a fall in short-term interest rates made other deposit accounts less attractive.

The other development on the policy front was the adoption of a statutory prices and incomes policy from November onwards, following further acceleration of wages and the breakdown of tripartite talks aimed at a voluntary system of restraint. Rates of pay were frozen until 1st April and prices (except those for food and imported goods) until about a month later, thus covering the introduction of the value added tax. Phase II of the policy then came into operation, comprising (i) a ceiling on pay awards equivalent to about 8 per cent., to include fringe benefits but not increases arising out of promotions or from progress towards equal pay, towards a 40-hour week or a three weeks' annual holiday; dividends are not to rise by more than 5 per cent.; and (ii) a ban on price rises except after increases in allowable costs — these include import prices, indirect taxes, bought-in services and a proportion of any increase in labour costs, generally 50 per cent. but with allowances for labour-intensive industry. Profits as a percentage of turnover may not exceed the average of those in the best two of the last five years; otherwise price reductions may be ordered. Exceptions may be made if further price increases are judged essential to produce a rate of return adequate to attract funds for new investment, and also if increased costs had been absorbed to an exceptional degree before the start of the freeze. A Pay Board and a Price Commission were set up to administer Phase II.

The ceiling on pay increases at once gave rise to industrial disputes, chiefly in the public sector; but most of these had been settled by mid-April without infringing the ceiling and prospects were improved for some reduction in the United Kingdom's rate of inflation relative to that of other industrial countries. The problem will be to prevent a re-acceleration of wage increases when Phase III succeeds Phase II later this year.

As to the demand picture, consumer spending remained buoyant in the first quarter of 1973, showing a rise of 2.3 per cent. on the previous quarter and of 8.5 per cent. over twelve months. The volume of retail sales in March was some 12 per cent. above its level in March 1972. On the same comparison, the volume of merchandise exports was 15 per cent. higher than in January–March 1972. Despite this the external balance on current account deteriorated further, partly because of the adverse movement in the terms of trade caused by soaring world commodity prices and the depreciation of sterling. The stimulus to future exports was reinforced by the currency changes in the first quarter, which left sterling with a small additional depreciation against the weighted average of other major currencies, and by the exemption of export earnings from the Phase II controls on profit margins. Output accelerated, industrial production rising at an annual rate of 6 per cent. during the winter months. On the labour market unemployment showed a much prompter decline than in previous upswings. By May 1973 it had fallen to below 625,000, or 2.7 per cent. of the labour force, from its high point of over 910,000 (about 3.9 per cent.) in March 1972.

The 1973 budget, presented in early March so as to give adequate notice of the rate (10 per cent.) at which value added tax would replace purchase tax and selective employment tax on 1st April, was designed to keep the economy on the expansion path of 5 per cent. per annum which it was reckoned to have then reached. The public-sector borrowing requirement for 1973–74 was estimated at £4,423 million, compared with an outturn of £2,855 million for 1972–73; £800 million of the increase reflects a one-year shortfall in tax receipts during the transition to VAT. Measures to assist the financing of the deficit from non-bank sources were announced, including better terms on national savings, incentives for advance tax payments by companies, the issue of two new gilt-edged stocks designed to appeal in the one case to institutional investors and in the other to individuals in high tax brackets, and the restoration of exchange-cover facilities (abolished in March 1972) for borrowing overseas by public-sector bodies. In April the British Electricity Council announced plans to raise US $1,000 million, in tranches, on the international capital market. The loan was to have a floating interest rate and an average maturity of just under eight years.

The budget deficit and the increase in interest rates contributed to the rather uneven character of the expansion, but some signs of a better balance have begun to appear. Though still the leading element in demand, private consumption eased somewhat after the introduction of value added tax. A revival in industrial investment, including stock-building, seems to be under way, though over the short run this could be a source of external strain. Exports and export orders have recently shown encouraging strength, following the sharp and widespread acceleration in economic activity abroad, but careful management of the external balance will be needed in the period ahead, particularly as a decline in the exchange rate would tend to aggravate the wage/price spiral. Moreover, with industrial production having risen sharply in the first quarter of 1973, it remains to be seen for how long the overall growth rate of 5 per cent. can be maintained without significant labour shortages arising. As a help in keeping to this growth objective, the government announced in late May reductions in public expenditure estimated at £100 million in the current fiscal year and £500 million in 1974–75.

Germany. After an incipient upswing in the early months of 1972, aggregate demand in the Federal Republic showed little sign of rapid expansion until late in the year. Although orders for export and home investment had begun to revive again, private consumption and construction activity increased more slowly than before. Industrial production, following the irregular movement of exports and domestic demand, had a brief expansionary burst in the first quarter and then weakened somewhat. On average up to the autumn it was only 2 per cent. above the level of the previous year. Labour-market conditions eased a little further, the seasonally adjusted unemployment rate rising from 1.0 per cent. at the start of the year (compared with 0.7 per cent. in spring 1971) to 1.3 per cent. in the third quarter. Wages and salaries were about 9 per cent. higher than in the previous year — a significant moderation from the rise of 13–14 per cent. recorded during the boom of 1970–71 — and the increase in wholesale prices, at an annual rate of 2.8 per cent. up to the autumn, was about half as fast as during the boom. Consumer prices, however, gradually accelerated to an annual rate of increase of over 6 per cent.

Already in the early spring, with the economic outlook improved and business pessimism receding, the authorities became concerned that the recovery might gain excessive momentum. A complicating factor was the boost given to monetary expansion by the inflow of capital induced mainly by doubts about the Smithsonian structure of exchange rates. Steps to curb these inflows and to absorb the bank liquidity stemming from them were taken by the Bundesbank in late February. At the same time that the discount rate was reduced from 4 to 3 per cent., the banks' rediscount quotas were cut by 10 per cent. and reserve requirements on the growth of their foreign liabilities raised from 30 to 40 per cent. In addition, the Bardepot (cash-deposit) requirement on foreign borrowing by German firms was activated from 1st March, with the ratio for non-interest-bearing deposits to be kept with the Bundesbank set at 40 per cent. of such borrowing in excess of DM 2 million. At the end of May a further 10 per cent. cut in rediscount quotas was announced, to take effect from 1st July, together with an 8 per cent. increase in reserve requirements on domestic liabilities. This was to offset gains in bank liquidity from another source — the scheduled repayment as from June of the Federal Government's anti-cyclical surcharge on income tax, totalling DM 5.9 milliard. It was because of this repayment that the cash deficit of the Federal and Länder Governments was considerably larger in 1972 (DM 17 milliard) than in the previous year (DM 11.8 milliard). Additional fiscal stimulus, in the shape of activation of the public authorities' contingency budgets, had been mooted at the beginning of 1972 but was removed from the agenda in early March, when economic activity was seen to have picked up.

Before the liquidity-absorbing measures had come into effect the authorities were confronted with a second wave of capital inflows associated with the flight from sterling and its aftermath. In late June, therefore, the scheduled 8 per cent. increase in reserve requirements was raised to 20 per cent. and a further 10 per cent. was added in July to take effect from 1st August; minimum reserve ratios in respect of foreign liabilities were put up to 40 per cent. on sight deposits, 35 per cent. on time deposits and 30 per cent. on savings deposits; the additional reserve requirement in respect of increases in foreign liabilities was raised to 60 per cent.; and rediscount quotas were cut by a further 10 per cent. from 1st August. Also, the Bardepot scheme was tightened by reducing from DM 2 million to DM 0.5 million the amount of firms' foreign borrowing exempted from the Bardepot requirement, and by raising the deposit

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

Items	Years	Private households	Housing	Enterprises	Public sector	Foreign countries[1]	Credit institutions[2]	Other financial institutions[3]
		In milliards of Deutsche Mark						
Net saving plus capital transfers	1970	50.85	6.40	30.60	29.45	.	5.15	0.40
	1971	56.35	8.40	21.65	28.25	.	6.30	0.65
	1972	65.70	5.30	25.50	22.65	.	6.70	0.65
Net investment (−)	1970	.	−26.20	−67.30	−25.85	.	− 1.55	− 0.75
	1971	.	−32.10	−61.75	−27.00	.	− 1.65	− 0.90
	1972	.	−39.80	−58.35	−25.60	.	− 1.75	− 0.95
Financial surplus or deficit	1970	50.85	−19.80	−36.70	3.60	− 1.20[4]	3.60	− 0.35
	1971	56.35	−23.70	−40.10	1.25	1.75[4]	4.65[5]	− 0.25
	1972	65.70	−34.50	−32.85	− 2.95	− 0.05[4]	4.95	− 0.30
Corresponding changes in financial assets or liabilities[6]								
Money, time and savings deposits	1970	30.05	0.25	13.90	7.45	11.05	−64.55	1.85
	1971	38.25	0.25	18.65	8.95	3.55	−73.75	4.15
	1972	44.60	0.30	28.25	6.00	1.80	−84.75	3.80
Claims on non-bank financial institutions	1970	12.85	—	1.15	0.15	0.05	0.15	−14.30
	1971	15.20	—	2.05	0.15	0.05	0.10	−17.60
	1972	18.40	—	2.70	0.20	0.10	0.10	−21.50
Money-market paper	1970	—	—	0.30	1.85	1.40	− 3.50	—
	1971	—	—	0.55	− 0.55	− 0.50	0.50	—
	1972	—	—	− 0.55	− 0.20	0.15	0.60	—
Bonds and shares: Purchases	1970	11.20	—	3.55	0.70	1.00	3.40	2.20
	1971	8.70	—	2.80	2.65	3.00	6.80	3.40
	1972	10.85	—	1.65	2.05	9.00	8.15	4.35
Sales	1970	—	− 0.05	− 4.70	− 0.75	− 3.55	−12.80	− 0.20
	1971	—	− 0.05	− 8.45	− 1.95	− 0.60	−16.15	− 0.10
	1972	—	− 0.05	− 6.30	− 4.60	2.80	−27.65	− 0.20
Bank credit	1970	− 3.00	−11.05	−30.85	− 8.15	− 4.10	57.60	− 0.45
	1971	− 5.25	−16.15	−38.60	−10.60	− 0.30	71.30	− 0.45
	1972	− 7.40	−24.40	−48.80	−10.35	− 1.10	92.60	− 0.55
Other loans	1970	− 0.35	− 8.15	− 1.55	− 0.55	—	—	10.60
	1971	− 0.45	− 6.75	− 2.65	− 0.55	—	—	10.35
	1972	− 0.60	− 9.05	− 3.30	− 0.80	—	—	13.75
Other claims and liabilities	1970	0.05	− 0.75	−18.45	2.95	16.25	—	—
	1971	− 0.10	− 1.00	−14.50	3.20	12.40	—	—
	1972	− 0.20	− 1.25	− 6.50	4.80	3.10	—	—
Gold and foreign exchange	1970	—	—	—	—	−23.30	23.30	—
	1971	—	—	—	—	−15.80	15.80	—
	1972	—	—	—	—	−15.80	15.80	—

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

ratio from 40 to 50 per cent. Though these measures were sufficient to offset the impact of inflows of funds on bank liquidity, they did not counteract their primary effect on the money supply. In addition, new measures were taken relating to the sale of claims on residents to non-residents and the purchase of domestic fixed-interest securities by non-residents. With the help of all these measures, and with interest rates in other countries moving upwards, inflows of capital gave way to net outflows during the autumn.

This was doubly welcome to the authorities because of the abrupt change which was occurring simultaneously in the business situation. Export orders leapt ahead during the summer and autumn. By late 1972 they were nearly 40 per cent. higher than a year earlier. Domestic orders for plant and equipment followed the same course, though less buoyantly, after a short time-lag; and with other components of demand, notably house-building, also expanding strongly, activity forged ahead. Industrial output advanced between the fourth quarter of 1972 and the first quarter of 1973 at an adjusted annual rate of about 16 per cent. Wages and prices began to speed up again. Wage settlements in the early months of 1973 averaged 8½ per cent., but actual earnings showed a rise of more than 10 per cent. over a year earlier. Industrial wholesale prices were up by 5½ per cent. and consumer prices by 6.8 per cent.

In this situation and with insulating devices in operation against capital inflows the authorities saw scope for moving towards active monetary restraint. Between October and January the Bundesbank's discount rate was raised in four steps to 5 per cent. and the rate for secured advances to 7 per cent., while in early 1973 rediscount quotas were reduced twice, each time by 10 per cent. In addition, regulations were tightened in respect of the Bardepot requirement and foreign purchases of German domestic bonds. With the private sector's demand for bank credit continuing to climb steeply, the banks allowed their liquidity ratio to fall to an unusually low level; it stood at 4½ per cent. at the beginning of 1973. The volume of money and quasi-money showed an increase of almost 17 per cent. over the year as a whole, compared with rises of 14½ and 10½ per cent. in 1971 and 1970 respectively. Short-term interest rates, stable at a low level until the late summer, shot up abruptly in the fourth quarter. The yield on public-sector bond issues rose more gradually from a low of 7¼ per cent. in February 1972 to over 8½ per cent. at the turn of the year.

Total funds raised by domestic non-financial borrowers amounted to DM 126.7 milliard, equivalent to 15.3 per cent. of the gross national product, against 14.2 per cent. in 1971 and 13.1 per cent. in 1970. With net investment lower and profits higher than in 1971, the business sector's financial deficit declined last year. However, induced by the Bardepot scheme to repay direct short-term credits from abroad, enterprises increased their recourse to domestic bank credit while continuing to benefit from leads and lags in foreign trade; concurrently, they sharply accelerated their build-up of liquid assets. The private sector's high rate of deposit formation helped to sustain bank credit expansion and to facilitate a sharp increase in the flow of funds to housing. On the other hand, the public sector as a whole, swinging moderately into deficit, financed its additional needs mainly by recourse to bond issues.

On the fiscal side, the 1973 budget presented in February provided for expenditure of DM 120.4 milliard — an increase of 9.7 per cent. over the 1972 outturn. Tax increases were introduced, to take effect from mid-year, consisting of a one-year surcharge of 10 per cent. on corporation tax and on income tax in the top income brackets and an increase in the mineral-oil tax. The system of accelerated depreciation on buildings was abolished and special investment grants were lowered from 10 to 7½ per cent. In addition, the government decided to issue, in tranches, a stabilisation loan of

DM 4 milliard, the proceeds to be sterilised at the Bundesbank. The first tranche of DM 1.5 milliard was offered in March. Also, from 1974 interest payments will no longer be deductible in calculating personal income-tax liability.

In February and the beginning of March bank liquidity was again inflated by a huge inflow of funds — some DM 24 milliard in all — and a further series of measures was introduced. Firstly, controls were tightened on non-residents' direct and portfolio investment in Germany and on residents' borrowing abroad. Secondly, on 7th February the Bundesbank announced that banks would not be permitted to use more than 60 per cent. of existing rediscount quotas. At this time the banks took action to pass on the high administrative cost of reserve requirements on non-resident deposits by imposing in effect a negative interest burden on foreign accounts. Thirdly, on 1st March minimum reserves on domestic liabilities were raised by 15 per cent. for sight and time deposits and 7.5 per cent. for savings deposits. These measures, together with reserve requirements on new non-resident deposits at close on 100 per cent., were sufficient to offset the effect on bank reserves — though not the primary effect on the money supply — of the Bundesbank's purchases of foreign exchange. At the end of March the banks' liquidity ratio declined to a record low of 2.4 per cent.

The decision to revalue the Deutsche Mark by another 3 per cent. and then allow it to float in company with other European currencies further facilitated the enforcement of monetary restraint. In fact, the money market did become very tight in April and for a short time the Bundesbank eased tension by taking bills from the banks for ten-day periods at an annual interest rate of 12 per cent. However, with exports and industrial investment forging ahead and enterprise liquidity high, demand was pressing hard on productive resources and consumer prices reached a level 7½ per cent. higher than a year earlier. Monetary policy was kept as tight as was considered feasible and in early May the Bundesbank increased its discount rate to 6 per cent. Shortly afterwards the government announced a counter-inflationary programme which markedly strengthened that proposed in the budget. Key measures were the extension of the 10 per cent. tax surcharge into the medium-income brackets; a tax of basically 11 per cent. on enterprises' capital outlays, the proceeds of which are to be sterilised; and the temporary withdrawal of accelerated depreciation allowances in respect of plant and equipment investment and a cut in tax advantages on new owner-occupied houses. In the public sector there is to be a postponement until 1974 of DM 1 milliard of public works outlays and a 5 per cent. cut in all expenditure not fixed by law. Additional revenue, including unexpected receipts, will be used to the extent of DM 5.5 milliard to reduce the authorised borrowing of the public sector, and any remainder is to be sterilised. As revised, the programme's estimated overall effect in reducing aggregate demand, both directly and indirectly, has been put as high as DM 15 milliard. On 1st June the Bundesbank increased its discount rate to 7 per cent. and laid down that in principle no new lombard credits would for the time being be granted to the banks. Government bond yields rose to 10 per cent.

France. In the spring of 1972, following a brief decline in the growth rate, expansion regained its earlier momentum in response to a recovery in both external and domestic demand. During the summer, however, the acceleration in prices caused growing concern. Monetary policy, at first fairly easy, was tightened rather severely and the government, giving high priority to holding down inflation, acted to curb its own spending and also took direct action in the field of prices.

In early 1972 the government began to speed up the public investment programme while still planning to balance the budget for the year as a whole. For a time a continuation of the easier monetary policy adopted in 1971 seemed appropriate to both domestic and external requirements. The interest rates applied by the Bank of France in accommodating the banks via the money market were gradually lowered, broadly in line with tendencies in the Euro-dollar market, and in March banks' compulsory reserve requirements were reduced in respect of residents' deposits. Following the sterling crisis in June the money-market intervention rates were lowered further, quite sharply, and were kept generally below Euro-dollar rates until September. However, as the banks' domestic lending had accelerated, the reserve requirement applying to the increase in credits granted was raised from 2 to 4 per cent. in June. Moreover, in July reserve requirements against banks' liabilities vis-à-vis both residents and non-residents were increased by a uniform 2 percentage points in order to offset the effect of the recent inflows of funds on bank liquidity.

During the year private productive investment grew more slowly than it had done on average in recent years, but public investment and housing activity quickened. A sustained advance in consumer spending on durable goods, stimulated by the rapid rise in wages, helped to underpin the expansion. In addition, exports rose quite strongly, benefiting from the upswing in activity abroad and from improved price competitiveness resulting from the 1971 currency realignments.

The upswing was accompanied by a faster growth of imports and increasing shortages of skilled labour, though for structural reasons the overall level of unemployment remained fairly high. Increases in prices for manufactured goods were subject to constraint under contracts between the government and the various sectors of industry. In April these had been extended for a further year with only minor relaxations. In August the government announced that the arrangements would be enforced more rigorously and imposed a freeze on public-sector prices to last until the end of March 1973. These efforts were hampered, however, by rising wages and raw-material costs. Consumer prices of manufactured goods continued to go up about as fast as in 1971, while prices of food and services rose much more quickly.

Monetary restraint was a mainstay of the counter-inflationary policy adopted from the autumn onwards. In September, taking advantage of higher interest rates abroad and a temporary strengthening of the dollar in the exchange markets, the Bank of France began to raise the interest rates on its money-market lending. After a steep rise the average day-to-day rate reached 6.73 per cent. in December, compared with only 3.52 per cent. in August and 5.17 per cent. in January. The official discount rate was reduced from 6 to 5¾ per cent. in April and maintained at that level, well above the rates charged during the summer on official money-market assistance, until it was put up to 7½ per cent. in two stages in November. Moreover, reserve requirements against the growth in credit were raised steeply: in respect of the rise since April 1972 the coefficient was set at 15 per cent. in September and increased to 33 per cent. in November. This ensured that even if the growth in total credit — then running at 23 per cent. over the year — slowed down substantially, the banks' blocked reserve assets, and hence their borrowings from the Bank of France, would increase rapidly. In addition, the banks were urged to exercise restraint in granting personal loans and mortgage credits, both of which had gone up sharply.

In 1972 money and quasi-money expanded by 18.5 per cent., after having risen by 17.7 per cent. during 1971. Partly because the interest rates on certain savings and time deposits had been lowered early in the year in line with money-market rates, quasi-money grew more slowly than in 1971, while the increase in the narrowly-defined money supply accelerated. The expansion of credit to the economy formed the counterpart of practically the whole of the growth in liquidity. Last year the net increase in the banking system's foreign assets was substantially less than in 1971 and Treasury operations exerted a net contractive influence. With the rise in its ordinary expenditure, at only about 8 per cent., outpaced by the growth of revenue, the government had an overall budget surplus of Fr.fr. 4.4 milliard, compared with a deficit of Fr.fr. 3.5 milliard in 1971. In these circumstances the Treasury had less recourse to funds from the savings-bank system, repaid short-term borrowing from the commercial banks and built up its cash position at the Bank of France at the end of the year.

Moving in the same direction as money-market rates but within a much smaller range, the banks' short-term lending rates were reduced by half a percentage point in March, then raised by 1.3 percentage points in four stages between September and April 1973. Interest rates on mobilisable mortgage credits were freed from controls in November and thereafter rose sharply. On the bond market yields edged downwards early in the year and then remained fairly stable until November. With the market highly receptive, new capital issues in 1972 exceeded even the high level of the previous year, the largest increase being that in security issues of the nationalised industries.

In December the authorities introduced a new package of counter-inflationary measures. One element was that credit institutions which increased their lending beyond certain limits — 19 per cent. in the twelve months ending April 1973 and 17 per cent. in the twelve months ending July 1973 — would be made subject to supplementary reserve requirements. The authorities' aim is to reduce the growth of the money supply to 15–16 per cent. in 1973.

Other key measures were a reduction in the general rate of value added tax from 23 to 20 per cent. from January 1973 and the suspension for the first six months of 1973 of the value added tax on beef (previously 7½ per cent.). Enterprises were asked to pass on the tax cuts to consumers and to avoid any price increases during the following three months. The government also established norms for wage increases: if the rise in prices came to less than 4 per cent., increases in nominal wages should not exceed 6 per cent. except in the case of the lowest-paid. The underlying consideration seems to have been that it would be difficult to achieve a slow-down in wages unless the rise in prices were checked first. The authorities also increased the interest rates on savings deposits and the premiums paid to savers who maintained their balances during the year.

The government's 1973 budget proposals provided for overall balance and were to allow expenditure to increase by no more than the expected rise in the nominal

Changes in official discount rates since 1971.

Country and date of change	Official discount rate in %
Austria	
22nd January 1970	5
28th November 1972	5½
Belgium	
10th December 1970	6½
25th March 1971	6
23rd September 1971	5½
6th January 1972	5
3rd February 1972	4½
2nd March 1972	4
23rd November 1972	4½
21st December 1972	5
10th May 1973	5½
Canada	
12th November 1970	6
15th February 1971	5¾
24th February 1971	5¼
25th October 1971	4¾
9th April 1973	5¼
14th May 1973	5¾
Denmark	
12th May 1969	9
20th January 1971	8
15th April 1971	7½
10th January 1972	7
28th June 1972	8
3rd October 1972	7
Finland	
28th April 1962	7
1st June 1971	8½
1st January 1972	7¾
France	
20th October 1970	7
8th January 1971	6½
13th May 1971	6¾
28th October 1971	6½
13th January 1972	6
6th April 1972	5¾
2nd November 1972	6½
30th November 1972	7½
Greece	
15th September 1969	6½
10th May 1973	7

Country and date of change	Official discount rate in %
Germany	
3rd December 1970	6
1st April 1971	5
14th October 1971	4½
23rd December 1971	4
25th February 1972	3
9th October 1972	3½
3rd November 1972	4
1st December 1972	4½
12th January 1973	5
4th May 1973	6
1st June 1973	7
Italy	
9th March 1970	5½
5th April 1971	5
14th October 1971	4½
7th April 1972	4
Japan	
28th October 1970	6
20th January 1971	5¾
8th May 1971	5½
28th July 1971	5¼
29th December 1971	4¾
24th June 1972	4¼
2nd April 1973	5
30th May 1973	5½
Netherlands	
4th August 1969	6
5th April 1971	5½
15th September 1971	5
6th January 1972	4½
2nd March 1972	4
8th September 1972	3
6th November 1972	4
4th June 1973	4½
Portugal	
25th April 1970	3½
6th February 1971	3¾
18th December 1972	4
South Africa	
27th August 1968	5½
31st March 1971	6½
10th August 1972	6
28th March 1973	5½

Country and date of change	Official discount rate in %
Spain	
23rd March 1970	6½
22nd January 1971	6¼
5th April 1971	6
22nd October 1971	5
Sweden	
11th July 1969	7
19th March 1971	6½
23rd April 1971	6
10th September 1971	5½
12th November 1971	5
Switzerland	
15th September 1969	3¾
22nd January 1973	4½
United Kingdom*	
15th April 1970	7
1st April 1971	6
2nd September 1971	5
22nd June 1972	6
16th October 1972	7¼
30th October 1972	7½
4th December 1972	7¾
11th December 1972	8
27th December 1972	9
22nd January 1973	8¾
26th March 1973	8½
16th April 1973	8
24th April 1973	8¼
14th May 1973	8
21st May 1973	7¾
United States	
4th December 1970	5½
8th January 1971	5¼
22nd January 1971	5
19th February 1971	4¾
16th July 1971	5
19th November 1971	4¾
17th December 1971	4½
15th January 1973	5
26th February 1973	5½
4th May 1973	5¾
11th May 1973	6

* As from 13th October 1972 the Bank of England's minimum lending rate is fixed, as a rule, at ½ per cent. above the average rate at each Friday's Treasury bill tender, rounded up to the nearest ¼ per cent.

gross national product. To offset the loss in tax revenue expected to result from the reduction in the value added tax, the government issued a Fr.fr. 6½ milliard long-term loan in January 1973. The loan bore interest at 7 per cent. but both interest and capital were indexed to the European unit of account. Since the issue was also designed to absorb liquidity, the proceeds have been frozen until required.

The cuts in value added tax had an immediate impact on consumer prices, which remained almost stable during the early months of 1973. For further help in dampening inflationary expectations the authorities counted principally on monetary restraint supported by a strengthening of the defences against inflows of funds. Economic activity continued to expand buoyantly, but there was a pause in the growth of money and credit, partly associated with the large issue of government securities, and interest rates continued to rise. At the end of March the controls on service prices and limits on trade margins were prolonged and new twelve-month price contracts with industry were concluded. Under these the general norm for increases in prices of manufactured products was raised slightly, to 3.6 per cent., but with an optional alternative of 3.0 per cent. plus allowance for rises in raw-material costs. Charges in the public sector were made subject to the same rules. Monetary restraint was continued, the limit for the authorised increase in bank credit being lowered to 15 per cent. for the twelve months ending October.

Italy. Economic activity picked up somewhat last year after the near-stagnation of 1971, but the extent of the recovery was disappointing. Industrial production rose by only 2.5 per cent. during the year, and the growth of the real gross national product still fell short of that of productive potential. Rising by 11.2 per cent., exports remained the most dynamic component of demand. Personal consumption quickened but gross investment rose by merely 2 per cent., and that only because of a clear acceleration in stock-building after a sharp fall in 1971 ascribable partly to fiscal factors. Construction and equipment investment both declined, with expenditure on public works, on which recovery hopes had largely been pinned, falling by over 9 per cent. In view of the long-standing under-utilisation of resources together with the substantial external current-account surplus, it is paradoxical that the plans for increases in structural investment in the public sector have encountered so many difficulties and that, despite growing capital outflows, efforts to stimulate the economy have had to rely so much on monetary policy.

Last year the public administration showed a current-account deficit (excluding capital transfers) of Lit. 1,885 milliard, compared with one of Lit. 820 milliard in 1971 and a surplus of Lit. 750 milliard in 1970. This movement was largely caused by the appearance of a sizable deficit in social insurance funds, as the combined deficit of the central and local administrations, which amounted to Lit. 1,100 milliard, was much the same as in 1971. Big increases in public capital expenditure had been envisaged, but a considerable part of the funds voted remained unutilised; however, public authorities' current spending went up substantially. Direct tax revenues increased sharply as a result of the previous rise in nominal disposable income and in the share of wages and salaries in the national income. Indirect tax revenues, on the other hand, rose very slowly, reflecting not only the slackness of the economy but also the fiscal exemptions introduced at mid-year with the aim of discouraging deferment of private investment pending the changeover to the value added tax. Another factor was the earlier reduction in the petrol tax.

The overall financial deficit of the public sector came to Lit. 6,005 milliard, compared with Lit. 4,550 milliard in 1971 and Lit. 2,275 milliard in 1970. With no change in this sector's net long-term bond issues placed in the market, the increase in the deficit was met mainly from funds collected through the postal system and by increasing direct borrowing from the credit institutions. In particular, direct

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

Items	Years	Public sector	Public and semi-public enterprises[1]	Other enterprises and housing	Household sector	Banks and financial institutions	Rest of the world[2]
		in milliards of lire					
Gross saving (including capital transfers)	1971	— 2,535	675	5,870	9,300	600	— 975
	1972	— 3,685	690	5,780	11,315	630	— 830
Gross domestic capital formation (—)	1971	— 2,015	— 2,680	— 7,960	—	— 280	
	1972	— 2,320	— 3,100	— 8,185	—	— 300	
Financial surplus or deficit (—)	1971	— 4,550	— 2,005	— 2,090	9,300	320	— 975
	1972	— 6,005	— 2,410	— 2,405	11,315	330	— 830
Corresponding changes in:							
Financial assets							
Liquid assets	1971	755	30	2,415	6,335	1,795	40
	1972	— 250	390	3,205	8,195	665	— 5
Bonds, shares and participations	1971	820	120	520	1,840	2,570	395
	1972	755	140	560	2,350	3,045	395
Other net lending	1971	215	20	220	1,265	8,205	2,045
	1972	660	— 55	1,235	1,270	12,960	4,700
Financial liabilities (—)[3]							
Short-term liabilities[4] . .	1971	— 3,690	— 830	— 1,040	— 140	— 9,785	— 2,325
	1972	— 4,945	— 735	— 2,555	— 500	—14,220	— 4,380
Long-term liabilities							
Domestic	1971	— 1,085	— 320	— 3,355	—	— 540	— 740
	1972	— 1,040	— 720	— 2,775	—	— 420	— 975
Foreign	1971	— 75	145	— 365	—	— 255	—
	1972	— 70	30	— 145	—	— 425	—
Bonds, shares and participations	1971	— 1,530	— 1,165	— 790	—	— 1,655	— 390
	1972	— 1,495	— 1,455	— 1,060	—	— 1,445	— 580
Statistical discrepancy . .	1971	40	— 5	305	—	— 15	—
	1972	380	— 5	— 870	—	— 170	15

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

borrowing from the Bank of Italy alone amounted to Lit. 1,550 milliard, compared with Lit. 1,040 milliard in 1971.

As a proportion of gross national product, gross saving of private enterprises (including housing) declined over the two years 1970–72 from 10.3 to 8.4 per cent., while the sector's gross investment fell from 15.5 to 11.9 per cent. On the same comparison, gross investment by the public sector and enterprises with government participation rose slightly from 6.8 to 7.9 per cent.

Treasury deficit financing was the principal means the authorities used to bring about a further large increase in the monetary base last year. In addition, in view of the liquidity losses resulting from capital outflows following the sterling crisis, the banks were permitted to incur net liabilities in their foreign positions. In April, when the official discount rate was lowered from 4½ to 4 per cent., steps were also taken to discourage the banks from holding idle deposits at the Bank of Italy.

Under these policies the money supply continued on the upward course evident since late 1970. For money broadly defined the increase (adjusted for distortions due to bank strikes in December) came to 18.6 per cent., compared with 17.6 per cent. in 1971. Banks' domestic loans accelerated in the second half of the year to go up by Lit. 5,250 milliard in the twelve months to November, compared with Lit. 2,995 milliard in the previous twelve months. Although the banks also substantially increased their acquisitions of bonds, their liquidity remained fairly comfortable. At 4.0 per cent. of their deposits, their liquid-asset ratio in November was only slightly lower than a year earlier.

On the capital market net issues came to Lit.7,225 milliard, or Lit. 1,215 milliard more than in 1971, when there had been an increase of Lit. 2,405 milliard. Issues by the public sector and by public enterprises, mostly taken up by the banks, again accounted for the major share of the market. As issues by the mortgage credit institutions declined, the special credit institutions borrowed Lit. 2,445 milliard, only Lit.220 milliard more than in 1971. Share issues came to Lit. 1,240 milliard, compared with Lit. 975 milliard in 1971. With the monetary authorities aiming at maintaining easy market conditions, yields declined somewhat in the first part of the year but edged up again in the final quarter despite support purchases by the authorities. As expectations of an early recovery in enterprises' profits became more widespread, share prices recovered somewhat in the last quarter of 1972 after many years of continuous decline.

During the year a limited number of stimulatory budget measures were approved, but more substantial proposals to stimulate private investment were shelved. The reform of the system of direct taxation was postponed until 1974 but the value added tax system was finally introduced in January 1973, the basic rate being set at 12 per cent. In conjunction with these changes various tax concessions were granted, mainly with a view to moderating the increase in consumer prices. Direct action was also taken in order to limit rises in the prices of certain foods, electricity and pharmaceutical products.

Despite rapidly increasing capital outflows late in the year and in early 1973, monetary policy was kept expansionary. In December the authorities encouraged the banks to borrow abroad and to cede the foreign exchange on a swap basis. Principally for external reasons, the Bank of Italy also raised its basic rate on fixed-maturity advances to the banks against security from 3½ to 5½ per cent. However, monetary conditions eased again after the adoption of the two-tier exchange market system in January 1973 and the floating of the exchange rates in both markets in February.

In the latter part of 1972 and beginning of 1973 agreements were reached on the renewal of labour contracts covering half of all wage and salary-earners. These provided for very large increases in actual wages and for further cost-increasing concessions relating to working conditions. By February 1973 wage rates stood about 17 per cent. higher than a year earlier. The changeover to the value added tax, the sharp rise in primary product prices and the depreciation of the lira in the exchange markets also contributed to increasing inflationary pressures in early 1973. By April consumer prices were showing a rise of 10.5 per cent. over twelve months. Early in May wages were boosted further by an unprecedentedly large quarterly cost-of-living adjustment through the operation of the sliding scale.

Belgium. In early 1972 the government had reacted to the slow-down in economic activity by introducing a vigorous programme of public expenditure and by increasing housing grants and fiscal incentives to private productive investment and exports. In addition the National Bank lowered its discount rate from 5½ to 4 per cent. in three stages during the first quarter, and in May hire-purchase terms were relaxed.

The recovery of economic activity, which began in the first quarter of 1972, remained hesitant until the fourth quarter, when it quickened as exports increased sharply. Government expenditure and personal consumption rose strongly, but industrial investment fell and residential construction recovered only gradually. With labour productivity rising rapidly, unemployment edged upwards until November and then declined, although as yet there were no signs of emerging labour-market strains. Wages went up faster as recovery progressed, but the productivity advance helped to hold down unit labour costs. Largely reflecting the rising costs of imports, wholesale prices increased during the year by 8.3 per cent. Consumer prices, advancing more rapidly after mid-year, went up by 6.4 per cent., compared with 5.6 per cent. in 1971.

From July onwards new monetary measures were brought into force in order to offset most of the impact on bank liquidity of inflows of funds during the sterling crisis. The authorities negotiated an agreement providing for the freezing of about B.fr. 10 milliard of the banks' funds in non-interest-bearing accounts at the National Bank. The arrangements for constituting the deposit included a 100 per cent. reserve requirement against the growth of banks' commercial Belgian franc liabilities to non-residents. The deposit agreement was supplemented by a cut of one-ninth in banks' rediscount quotas and underpinned by arrangements to ensure that the banks would continue to increase their portfolio of public-sector securities.

In November the blocked deposit agreement was replaced by a system of reserve requirements which applied to commercial banks, savings banks and public credit institutions and which was designed to restrain liquidity creation from domestic as well as from external sources. Under this scheme the financial institutions had to deposit with the National Bank an amount equivalent to 70 per cent. of the sum of (i) 25 per cent. of the base period level of net commercial Belgian franc liabilities to non-residents and 100 per cent. of the net growth of such liabilities, and (ii) 4 per cent. of other domestic currency sight deposits and 1½ or ½ per cent. of other Belgian franc time and savings deposits, depending on maturity.

Early in the year the authorities had encouraged a decline in interest rates on the money market, but after a period of relative stability market rates moved upwards again from October onwards. As external constraints on monetary policy became less severe and a tightening was regarded as appropriate on domestic grounds, the

National Bank raised its discount rate in two stages, in November and December, from 4 to 5 per cent.

The central government's expenditures (including advances to the Road Fund) rose by nearly 18 per cent. last year, against under 13 per cent. in 1971; hence the Treasury's financing requirement increased to nearly B.fr.64 milliard from B.fr.34 milliard the year before. As in 1971, the deficit was more than covered by issues of long-term securities, though most of these were taken up by the banks. The balance was used to make net repayments of short-term indebtedness to the central bank and also of foreign indebtedness.

Private-sector borrowing from financial institutions rose strongly, a large part of the increase going to finance consumption and housing. At the same time, however, non-banks reduced their net foreign indebtedness, and recourse to security issues was virtually the same as in 1971. In conjunction with a good rise in savings, growing liquidity preference and inflows of funds, currency and demand deposits went up by 14 per cent. during 1972, against 10 per cent. in the preceding year. With interest rates on ordinary time deposits and security yields falling early in the year and then remaining virtually unchanged till November, the growth in private-sector holdings of such longer-term placements slowed down.

In early 1973, with economic activity at more satisfactory levels, the authorities increased their efforts to curb inflation. In February the banks' rediscount quotas were cut further and the reserve-requirement arrangements were prolonged and tightened. Moreover, banks' own net foreign exchange liabilities in relation to the regulated market were made subject to a 100 per cent. reserve requirement.

Efforts to tighten budgetary policy were hampered by previous commitments, but the original budget aim for 1973 was to restrict the rise in government spending to 12.7 per cent. In apparent conflict with this aim, additional expenditure was approved early in the year. However, in February the government decided to space out budgetary expenditures during the first four months of the year and introduced more selective criteria for the start of public works programmes and for granting assistance to private investment projects. At the same time, restrictions on hire-purchase and on personal loans were tightened considerably and steps were taken to spread out housing starts. In addition, a freeze of at least two months on public-sector prices was announced, and the length of the delay imposed for price rises in the private sector pending their approval by the Price Commission was temporarily increased. In early May the government announced various expenditure economies, and about the same time the official discount rate was raised from 5 to 5½ per cent.

Netherlands. The weakening of domestic demand that had begun in the spring of 1971 continued throughout most of 1972. Thanks to restraint measures, public expenditure declined in real terms. In addition, after levelling off in 1971, industrial investment fell substantially, partly because of a previous narrowing of profit margins associated with rising wage costs. On the other hand, the growth rate of private consumption picked up and residential construction accelerated. With domestic demand relatively weak, imports expanded only slowly and exports showed strong gains, particularly in the first half and again towards the turn of 1972–73.

Despite the easier demand situation, wage earnings in industry rose in 1972 — as in the preceding year — by 12½ per cent., although the rate of increase tended to slacken somewhat during the year. Labour productivity in manufacturing industry went up by 8½ per cent., or appreciably faster than in 1971, to some extent because investment continued to be directed towards labour-saving rather than to increasing capacity. The unemployment rate, which had been as low as 1.5 per cent. of the labour force in spring 1971, climbed to 3.2 per cent. in mid-1972, thereafter dropping only to 2.7 per cent. at the end of the year. In contrast, vacancies fell during 1972 to their lowest level for a long time. Unit labour costs in industry increased less fast than in 1971, while profit margins recovered somewhat. Over the year consumer prices went up by 7.9 per cent., against 8.4 per cent. in 1971.

As a result of overall budget restraint the central government shifted from a financial deficit of Fl. 1,660 million in 1971 to a surplus of Fl. 225 million in 1972. At the same time, in order to deal selectively with the problem of rising unemployment, it introduced in stages a work-creating programme involving expenditure over two years of Fl. 860 million. Moreover, the counter-cyclical tax surcharge (the so-called "regulator") was reduced from mid-year from 5 to 3 per cent.

In the face of large official acquisitions of foreign exchange the public authorities pursued active debt-management policies with a view to limiting liquidity creation. Despite its financial surplus, the central government borrowed as much on the capital market as in the previous year, using the proceeds mostly to improve its position vis-à-vis the central bank. The local authorities, notwithstanding a slightly lower financial deficit than in 1971, substantially increased their borrowings at long term and used the excess largely to repay short-term indebtedness to the banks, the government and the money market.

As a result of these developments the Nederlandsche Bank was able to adapt its policy along lines by and large consistent with both domestic and external considerations. In March 1972, with the demand for bank credit expected to remain moderate, guide-line limitations on short and long-term bank credit were lifted. Exchange restrictions were tightened in March and July, but such inflows of funds as occurred were largely permitted to exert downward pressure on short-term market interest rates. Primarily to deter inflows of funds, but increasingly also to stimulate investment, the official discount rate was lowered in three steps, between January and September, from 5 to 3 per cent. After falling to very low levels in the late summer, short-term market rates began to rise again as a result of policy interventions. In early November, when interest rates were rising abroad and aggregate demand was picking up, the discount rate was put up to 4 per cent. again.

At Fl. 9.0 milliard the private sector's financial deficit (which is measured net of private-sector savings channelled to institutional investors) was about the same in 1972 as in the previous year. On the one hand industrial fixed investment was at a low ebb, and on the other a marked increase in private-sector savings was channelled via the institutional investors. At the same time recourse by resident borrowers to the Dutch capital market increased to Fl. 19.9 milliard from Fl. 14.4 milliard in 1971, reflecting mainly mortgage financing and business borrowing to rebuild liquidity. Another factor was that exchange measures had contributed to a changeover from

Netherlands: Changes in financial assets and liabilities.

Items		Govern-ment	Local authorities	Banking	Institu-tional investors[1]	Personal and business sector	Rest of the world[2]
		in millions of guilders					
Financial surplus or deficit (—) (cash basis)	1970	— 1,230	— 2,720	3,240	7,530	— 7,385	565
	1971	— 1,660	— 2,860	4,920	8,955	— 8,930	— 425
	1972	225	— 2,605	4,435	11,190	— 9,000	— 4,245
Corresponding changes in financial assets and liabilities[3]							
Primary liquidity	1970	—	20	—	125	2,590	
	1971	—	30	—	220	3,660	
	1972	—	190	—	40	5,025	
Secondary liquidity	1970	—	120	—	670	300	—1,690
	1971	—	— 190	—	325	— 590	—2,680
	1972	—	180	—	— 545	105	—3,225
Bank credit	1970	560	— 1,200	— 130	25	— 1,390	
	1971	540	— 140	755	— 215	— 1,710	
	1972	2,110	1,280	— 2,785	— 340	— 2,040	
Net recourse to capital market.	1970	— 1,895	— 1,660	3,370	6,710	— 7,260	735
	1971	— 2,215	— 2,510	4,165	8,630	— 8,250	180
	1972	— 2,220	— 4,270	7,220	12,030	—11,380	— 1,380
Direct external capital transactions. . . .	1970	100	5	—	—	— 1,620	1,515
	1971	15	— 55	—	—	— 2,040	2,080
	1972	330	15	—	—	— 710	365

[1] Includes life assurance companies, pension funds, social insurance funds and savings banks. [2] A negative figure indicates an increase in the Netherlands' claims (or a decrease in its liabilities) vis-à-vis the rest of the world. [3] A minus sign represents a decrease in assets or an increase in liabilities.

net inflows to outflows on long-term capital account, so that residents had become more dependent on domestic sources of funds.

Total credit flows are estimated to have risen as a proportion of the nominal gross national product from about 14 per cent. in 1971 to close on 17 per cent. in 1972. However, with an increased proportion of funds flowing to the capital market, the growth of liquid assets was restrained, rising year-on-year about in line with the nominal net national product and on a December–December basis by some 12 per cent. Though it fluctuated considerably during the year, the yield on long-term government securities stood in December at about 7.3 per cent., or at roughly the same level as a year earlier. Short-term market interest rates, which varied widely in response to external flows of funds, on average remained low.

Massive inflows of funds in February and March 1973 called for new measures to reduce bank liquidity. Cash-reserve requirements on domestic liabilities, which had been reintroduced on a limited basis in September, were raised progressively to reach 7 per cent. by April but were cut back to 4 per cent. in May. In March reserve requirements (80 per cent. from mid-April) were introduced with respect to the increase in a bank's foreign guilder liabilities. In addition, non-resident guilder accounts were subjected to negative interest rates (subsequently abolished in early May) and bank liquidity was absorbed through special sales of securities.

With the economy beginning to show signs of recovery the budget for 1973 again aims at holding down overall expenditure, but it provides for specific measures to relieve unemployment. The counter-cyclical tax surcharge was lifted altogether at the beginning of 1973, but the effects of this change were more than offset by increases in other taxes. A tripartite "social contract" for 1973, which was concluded last November, provides for moderate wage rises and, linked to this, price surveillance. In April 1973 the cost of living was up 8 per cent. on a year earlier, and it was expected that there would be further substantial increases in both wages and prices during the year. Forecasts point to a recovery in private investment, particularly in stocks, and a slight drop in unemployment. Mainly in view of rising interest rates in neighbouring countries, the Nederlandsche Bank raised its discount rate on 4th June to 4½ per cent.

Switzerland. After having eased slightly in the latter half of 1971, the expansion of aggregate demand in Switzerland regained momentum from the spring of 1972 onwards. Public expenditure and residential building were initially the fastest growing elements but soon private consumption, stimulated by wage increases, and subsequently investment and foreign demand also speeded up. The impact of excess demand made itself felt not so much on the balance of payments but rather in a faster rise in costs and prices. Consumer prices increased by nearly 7 per cent. during the year and the GNP price deflator was as much as 9.3 per cent.

A policy difficulty from the outset was the economy's high degree of liquidity stemming from the huge money inflows of the previous year. In April the National Bank imposed a minimum reserve requirement on the increase in banks' domestic liabilities for the first time, and in May the reserve requirements on the growth of foreign liabilities, though reduced from 100 to 50 per cent., were applied on a more stringent basis. In addition, foreign borrowing in Switzerland continued to be encouraged, and ancillary exchange measures were introduced with a view to increasing the resultant net outflow of funds.

These measures somewhat tightened money and capital-market conditions in the second quarter. This trend was interrupted, however, by huge inflows from abroad during the sterling crisis. Extensive new exchange barriers were erected, including a ban on foreign investment in domestic securities and real estate, a commission levy on increases in non-resident franc deposits, and restrictions on borrowing abroad and on the foreign exchange position of banks. But still funds from abroad moved into Swiss francs, particularly by repatriation of resident-owned funds. In July part of the liquidity increase was absorbed by raising minimum reserve requirements on the growth of both resident and non-resident deposits; in the case of foreign deposits the provisions of the 1971 agreement were replaced by legal ordinances. In September the programme for non-resident security issues was enlarged and the requirements for conversion of the proceeds into foreign currencies were applied more widely.

By the autumn financial markets had become somewhat tighter but bank credit continued to expand strongly. With the agreed limitation on the growth of credit due to expire at the end of July, new domestic bank lending had accelerated from May onwards and by the end of the year the twelve-month rate of increase was about 11 per cent., compared with around 7 per cent. in 1971. The increase in credit commitments for building purposes in the first nine months of 1972 was 76 per cent. higher than in January–September 1971, which in turn was already 47 per cent. higher than in the corresponding period a year earlier. Additional measures to absorb liquidity would have run the risk of inducing a further repatriation of funds, particularly as the banks' net foreign assets at end-November totalled Sw.fr. 19.1 milliard. To discourage such repatriation the National Bank even gave assistance at times to alleviate strains.

The expansion of the money stock slowed down remarkably. Including time deposits, it increased by only 0.7 per cent., following a rise of 26.6 per cent. in 1971. Including savings deposits as well, however, the rise came to 6.0 per cent., against 24.2 per cent. the previous year. Publicly-offered net placements on the security market increased to Sw.fr.7.4 milliard from Sw.fr.6.5 milliard in 1971 but the rise was almost all in non-resident flotations, which reached Sw.fr.2.5 milliard. In addition, medium-term foreign notes were issued in Switzerland to the amount of Sw.fr.3.3 milliard, against Sw.fr.4.8 milliard in 1971, when these notes could still be sold to non-residents without quota limits.

At about the turn of the year the unabated increase in demand and prices called for new anti-inflationary measures: restrictions on building were tightened, depreciation allowances for tax purposes were limited and price, wage and profit surveillance was introduced. In addition, a "Federal Decree on measures in the credit sector" gave authority to impose several other restrictions. The increase in domestic lending by banks and similar institutions in the year ending 31st July 1973 was limited to 6 per cent. of the level permitted for end-July 1972 under the previous gentleman's agreement. Since most banks had already used up or even exceeded this allowance, it effectively meant a stop to new credits. Moreover, controls on issues of domestic securities were introduced and steps taken to discourage consumer credit by raising down-payments and shortening redemption periods. The decree also authorised the imposition of minimum reserve requirements on both the amount and the increase of domestic and foreign liabilities, but this broadened authority was not used until March, when requirements were tightened by a call for both types of reserves in respect of non-resident deposits. In the meantime, to forestall large selling of dollars against Swiss francs, the central bank withdrew from the market late in January and allowed the currency to float.

In the spring of 1973 economic conditions remained buoyant, but restrictions on the growth of bank credit were beginning to make themselves felt, particularly in the building sector. Moreover, the appreciation of the franc had dampened prospects in the exporting industries, in some cases quite markedly. While prices have continued to rise at a very exceptional rate for Switzerland, there is the possibility now that excess demand for output and labour may recede somewhat. Restraint on rapidly growing public-sector outlays would still be a desirable policy, but up to now it has remained beyond the Confederation's reach.

Austria. Contrary to expectations, the overall rate of growth increased last year. After expanding strongly up to the spring, domestic demand decelerated during the summer but strengthened again in the autumn. Throughout the year building activity was high and fixed industrial investment continued to rise because of good profit results and favourable tax arrangements. In the autumn consumption accelerated, influenced by price uncertainties associated with the introduction of value added tax scheduled for the beginning of 1973. Finally, exports slowed down in the first half of 1972 but picked up again after mid-year.

Budget policy, which had originally been based on an expected economic slowdown, was not reorientated towards stabilisation objectives until the latter part of the year. For 1972 as a whole, however, the budget appears to have had a slightly restrictive effect on the domestic economy.

Since the money stock had already swollen excessively as a result of inflows of funds, monetary restraint measures were necessary from the beginning of the year. In January the authorities acted to reduce bank liquidity by means of open-market operations, by increasing minimum reserve requirements and by prolonging the agreement with the credit institutions on the partial sterilisation of inflows and abstinence from taking in funds from abroad. At the same time credit ceilings under the standing credit-control agreement were lowered. In June, after further large inflows from abroad, additional measures were called for: the government undertook not to raise funds abroad — in fact it repaid external debts in advance — and issued a loan, the proceeds of which were sterilised. The credit institutions, for their part, agreed to place further funds abroad. In the late summer, to absorb a seasonal increase in liquidity due to tourist receipts, short-term open-market operations were extended. And in the autumn, to offset the effects on liquidity of the maturing of sterilisation paper issued earlier, minimum reserve requirements were raised again. With a view to preventing further capital imports, it was agreed that banks should, in principle, stop selling schilling bonds to non-residents and that building societies should no longer finance house-building by foreigners. Since the banks' credit-granting was regarded as excessive, the credit ceiling was lowered again and banks agreed to charge a commission on unused credit facilities and not to advertise consumer credits.

As a result of these measures bank liquidity was brought down in relation to domestic liabilities. The banks' total new credit-granting to the economy went up from Sch. 38 milliard in 1971 to about Sch. 48 milliard in 1972. Excluding security purchases, lending increased by 21 per cent., compared with 19.9 per cent. the year before. The money supply, defined to include time but not savings deposits, expanded by 24.4 per cent., against 16.0 per cent. in 1971 and only 8.3 per cent. in 1970.

By the final quarter of 1972 strains on the economy were evident on both product and labour markets. Consumer prices, which had been expected to rise by less than 5 per cent. over the year, reached an annual rate of 7.6 per cent. in December, while wage rates went up over the year by 16.1 per cent., against 9.8 per cent. in 1971.

Against this background, and in view of the impending introduction of value added tax, further stabilisation measures were introduced late in the year. On the government's initiative, the unions and employers agreed to exercise wage and price restraint for six months. The government's direct contribution to greater stability was to block 15–20 per cent. of certain expenditure appropriations and to postpone other outlays. In the monetary field the discount rate was raised from

5 to 5½ per cent. and the reserve requirement tightened in several respects. The credit-control agreement was extended to cover special institutions and the credit ceilings provided for under the agreement were lowered. The authorities announced the intention to restrict bank credit expansion to about 12 per cent. in the year ending November 1973. In addition, arrangements were made to limit credit-granting by insurance companies and building societies. To insulate monetary policy from external disturbances a six-month ban was imposed on the acquisition of domestic securities and real estate by non-residents, on certain types of borrowing abroad by residents and on lending to foreigners for use in Austria.

In the spring of 1973 aggregate demand remained strong but real growth was expected to slow down somewhat because of supply limitations. The stabilisation programme received further reinforcement in March, when the schilling was revalued slightly. Around this time bank liquidity became fairly tight and the National Bank eased matters somewhat through open-market operations and by lowering minimum reserves. The crucial difficulty continues to be the development of prices, which are forecast to rise by as much as 7.5 per cent. in 1973. There being some possibility also that wage negotiations will take place earlier than scheduled, the authorities are seeking on a broad front to bring expansionary forces under control. Recently the government announced that the stabilisation programme scheduled to expire at end-May would be prolonged and intensified.

Denmark. The deceleration of growth that had occurred over the two previous years continued into the early part of 1972, but from the spring onwards economic expansion picked up. The pause in housing gave way to an upturn, private consumption strengthened and public expenditures continued to rise rapidly. Industrial investment remained weak, though towards the end of the year there were signs of a recovery. As the year progressed unemployment declined, while imports turned up sharply after a slack period lasting until the summer. The rise in consumer prices quickened, amounting to 7.1 per cent. over the year.

In view of the need to improve the foreign trade balance — a task complicated by the commitment to eliminate the 10 per cent. import surcharge in stages between July 1972 and March 1973 — the economic policies pursued last year were intended to be restrictive. The government's budget for the year ending March 1973 provided for a surplus of D.kr. 2.6 milliard, following a small deficit the year before, and the banks' lending commitments for purposes other than social housing remained subject to a ceiling.

In the event, however, it soon became clear that restraint on government spending was failing to materialise. In July the government asked the local authorities to curb investment outlays and announced certain economies in its own spending. Most of these, however, were of a longer-term nature. In the autumn a 2½ per cent. tax was imposed on the sale of houses and certain purchase taxes were increased, but this was designed only to offset the budgetary costs of changes in personal income tax due to take effect in January 1973. With strains emerging in the building sector, non-priority construction was made subject to quantitative restrictions in October.

In the field of monetary policy, the ceilings on bank lending commitments were repeatedly renewed but were raised by 8 per cent. in stages during the year to help foster a recovery of industrial investment. The official discount rate, which had been reduced to 7 per cent. in January, was raised to 8 per cent. in June. At the same time, credit facilities available to the banks at the Nationalbank were curtailed by lowering the limit for advances against bonds from 90 to 60 per cent. of their value. The discount rate was brought down to 7 per cent. again once the uncertainties as to whether Denmark would become a member of the European Communities had been dispelled.

Taking advantage of an unutilised margin under the earlier ceiling, the banks expanded loans to the private sector over the year by 12½ per cent., compared with 4½ per cent. in 1971. In addition, they increased their security holdings substantially. The money supply, broadly defined, went up by just over 15 per cent., compared with 9½ per cent. in 1971. On the capital market total net issues rose to D.kr.12.9 milliard, compared with D.kr. 9.3 milliard in 1971 and only D.kr. 6.5 milliard in 1970; a large part of the increase was due to more mortgage bond issues. After falling steadily for most of the year, bond yields turned up in the final months of 1972. And in February 1973, the banks' agreement on maximum deposit rates, in force for nearly forty years, was terminated; a number of banks soon raised interest rates on time deposits.

With the build-up of demand pressure continuing, the ceiling on bank lending was extended to cover the first half of 1973 and raised by 4 per cent. In addition, the interest rate charged on central-bank accommodation against bond collateral was raised to a level slightly above the average yield obtained through bond purchases. The budget for 1973–74 at first envisaged a surplus of D.kr. 1.2 milliard, but in order to increase this the government introduced a number of stabilisation measures in March. These included the abolition of the exemption of new housing from value added tax, increases in company taxation and a reduction in income and company-tax allowances. Also, children's allowances and old-age pensions were to be graduated according to income and certain public investment projects were to be postponed.

The renewal of the national wage agreements in March occasioned weeks of industrial strikes and lock-outs, the first for many years. The settlement finally reached provided for a substantial increase in basic hourly rates spread over two years, equal pay for women and a shortening of the working week. In view of indexation arrangements and expected further wage drift, the overall effect of the settlement will be an acceleration in the growth of wages compared with their increase over the past two years.

Norway. After a protracted period of strength which had necessitated policies of moderate restraint, domestic demand weakened considerably last year. The sharp increase in fixed capital formation in 1971 was followed in 1972 by a marked decline in investment in ships and a much slower growth in other investment categories, though investment in the public sector and residential construction remained fairly strong. Since higher consumer prices and the increases in taxation and social insurance contributions made inroads into disposable real income, the increase in personal consumption was only small. Exports, on the other hand, which rose sharply after a year of weakness, helped to bring the overall real growth rate to a satisfactory 4.2 per cent. and to reduce the current-account deficit in accordance with the government's longer-term aims.

Public-sector budget policy was designed to reduce demand pressures in 1972. In accordance with structural objectives central expenditure rose by 13 per cent., whereas the nominal gross national product increased by less than 9 per cent. However, as a result of higher taxation and social security contributions, the surplus before loan transactions for the public sector as a whole worked out at 2.2 per cent. of the gross domestic product, compared with 1.9 per cent. in the previous year. Despite overall restraint the government provided for regional work-creating programmes. Moreover, the authorities speeded up the release of blocked investment funds held with Norges Bank and reduced the incentives for new inpayments of such funds.

To promote investment the monetary authorities fixed a higher quota for bond issues than in 1971 and revised upwards the target for domestic credit expansion, which in the previous autumn had been set at 7 per cent. In addition, as the savings banks' lending slackened in the early months of 1972, their obligations to hold primary liquidity reserves were first reduced and then lifted altogether.

From the early summer onwards industrial production began to recover under the influence of external demand. With a view to keeping credit expansion within bounds, primary reserve requirements were reimposed in August on the larger savings banks in the south, and later in the year those applying to the commercial banks were raised in two steps by 2 percentage points. For the year as a whole the banking system's net foreign assets increased somewhat more than in 1971, while domestic credit expansion was also slightly faster. Money and quasi-money advanced during the year by 12.8 per cent., compared with 12.6 per cent. in 1971.

Following the abolition in mid-November 1971 of a temporary price freeze the rate of increase in consumer prices accelerated and by September 1972 they stood over 8 per cent. higher than a year earlier. The government thereupon reintroduced a general price freeze, which from the beginning of 1973 was replaced by a system of price surveillance. Shortly afterwards the twelve-month increase in prices dropped to about 6.8 per cent. but before long accelerated again. As the two-year wage settlements concluded in 1972 provided for substantial increases as well as automatic cost-of-living adjustment arrangements, upward pressures on prices are expected to remain strong.

The government's 1973 budget again leans towards demand restraint. The relative expansion of public-sector activities is to be continued but expenditure growth is to be moderated and revenues are to be strengthened by higher excise taxation. The public sector as a whole, including social security funds, is expected to achieve a surplus, before loan transactions, equivalent to 2.4 per cent. of the gross domestic product, or somewhat higher than in 1972. In view of anticipated large-scale investments by the shipping sector net borrowing abroad will be allowed to expand, but domestic credit growth is to be kept within target limits designed to avoid excess demand pressure. However, lending by the state banks, mainly to finance housing construction and road-building, will continue to grow vigorously.

Sweden. The economy recovered only slowly from the recession that began in 1971. The downturn then recorded in personal consumption, housing construction and local authorities' investment gave way to a slight expansion last year. The incentives given to private fixed investment were effective, but stock accumulation again decelerated. Hence, notwithstanding a stepping-up of government investment and stronger growth of exports — reflecting partly the improved conditions in the pulp and paper industry — the growth of real gross national product came to only 2 per cent., not enough to reduce unemployment.

The stimulatory policy measures introduced during 1971 were maintained last year with fresh impetus but little alteration in the general pattern. Besides providing for relief work these measures were directed primarily towards investment, concentrating on the release of investment funds, increased tax allowances for investment in machinery and equipment (in November extended to construction) and further government support for local authorities' environmental investment. As for housing, demand had become so well satisfied that the scope for further stimulus was very limited. As the need for counter-cyclical action has continued longer than was first expected, the budget deficit in the fiscal year 1972–73 (July–June) may rise to S.kr. 7.2 milliard, against the originally estimated S.kr. 3.3 milliard.

Following a progressive relaxation during 1971, monetary policy maintained an easy stance in 1972, without significant changes in the application of policy instruments. A substantial rise in liquidity was brought about by the rapidly growing budget deficit, only part of which was financed by increased sales of securities outside the banking system, and by an accelerated rise in external reserves. During the year the broadly-defined money supply increased by 12½ per cent., following a rise of 10½ per cent. in 1971.

The increase in total net credit, at S.kr. 27 milliard, was equivalent to 14 per cent. of the gross national product. In 1971 the figure had been 12 per cent., while in 1970, when restraint policies were still in force, it was only 9 per cent. But, as a very large amount last year went to finance the government budget deficit, the increase in credit to all other borrowers was about the same proportion of the gross national product as in 1971. Much the same can be said of new credit to the business sector alone. In 1971 it had risen strongly as enterprises reconstituted their liquidity but last year credit to industry slowed down and consumer credit, which is included in this sector, was the dynamic component. The net financing requirement of the local authorities decreased in absolute terms last year but housing credit continued to increase owing to the rise in land prices and construction costs.

A major part of the total credit expansion last year was accounted for by the banks, which benefited from an increased flow of deposits. With business credit demand easing, the commercial banks stepped up their loans for consumption and housing. But they were able to acquire large amounts of short-term government bonds, to comply with their cash and liquidity reserve requirements without difficulty and also to maintain a positive net position with the Riksbank throughout the year. From the beginning of 1972 the savings banks, rural credit associations and the post-office bank were required to meet higher liquidity ratios, in consequence of which they substantially

Sweden: Net credit flows.

Lenders	Years	Borrowers: Government	Local authorities	Housing sector	Business sector	Total
		in millions of Swedish kronor				
Riksbank	1970	1,600	—	30	—	1,630
	1971	1,520	—	— 30	30	1,520
	1972	— 180	10	—	—	— 170
Commercial banks	1970	— 840	300	1,990	— 140	1,310
	1971	1,220	200	600	3,190	5,210
	1972	1,950	120	1,950	4,050	8,070
Other banks	1970	1,080	220	1,640	1,010	3,950
	1971	— 700	670	1,590	950	2,510
	1972	1,830	450	2,770	1,470	6,520
Public insurance institutions	1970	760	690	3,270	2,040	6,760
	1971	950	920	4,140	3,270	9,180
	1972	1,930	770	2,720	2,760	8,180
Private insurance institutions	1970	370	60	750	710	1,890
	1971	— 90	140	1,740	910	2,700
	1972	460	290	1,420	1,070	3,240
Others	1970	240	10	10	230	490
	1971	— 270	10	40	370	150
	1972	350	40	20	740	1,150
Total	1970	3,210	1,280	7,690	3,850	16,030
	1971	2,630	1,840	8,080	8,720	21,270
	1972	6,340	1,680	8,880	10,090	26,990

increased their net bond purchases. The bond market was weakened, however, by a cut-back in the purchases of the National Pension Fund. This was a result not of a slow-down in the growth of the Fund's resources but of the repayment by it of previously incurred short-term indebtedness to other financial institutions. Total net new bond issues were only slightly larger last year than in 1971. Government issues were much higher but there was a sharp decline in flotations by each of the other main borrowing sectors. Most affected by the reduced access to long-term funds was housing and the needs of this sector were met to an unusual extent by short-term bank loans.

Wages rose sharply up to the spring of 1972 as the effects of the two-year contracts negotiated in 1971 worked through. Thereafter, with the labour market under no strain, they flattened out for a time, but in December hourly earnings still stood about 11 per cent. higher than a year earlier. The rise in consumer prices gradually slowed down until nearly the end of the year, when the effects of rising food prices were felt more strongly. The government imposed a freeze on prices of most food products as from January 1973, cancelling already-agreed increases and raising farm subsidies. Measures designed to redistribute tax burdens took effect early in 1973. Personal income-tax rates were reduced somewhat while to help offset the revenue loss the payroll tax was increased from 2 to 4 per cent. and certain other indirect taxes were raised.

With exports accelerating strongly in early 1973, recovery at last gathered strength. The weakness of housing demand and local-authority investment, however, continued to moderate the overall pace of advance.

Finland. After a brief but pronounced slowing-down of growth in 1971, economic activity regained considerable momentum from about mid-1972 onwards. The main impetus came from a strong revival of external demand, but consumption expenditure also recovered well and residential construction rallied. Public expenditure advanced much faster, with particular emphasis being placed on investment. On the other hand, for the second successive year since the investment boom in 1969–70, plant and equipment outlays showed little change, partly owing to uncertainty surrounding future trade relations with the European Community.

Consumer prices rose by 7.3 per cent. during 1972 following some relaxation in the late spring in controls over prices and rents. Wages continued to advance rapidly, but unit labour costs increased less fast than before owing to improved productivity. Import prices climbed sharply and wholesale prices went up by 11½ per cent.

The government's budgetary policy was expansionary in 1972, especially towards the end of the year. A speeding-up of public expenditure was aimed partly at reducing unemployment, and the granting of government loans to finance public housing increased sharply. Moreover, the government raised more funds abroad so as to reduce its domestic indebtedness, thereby helping to ease monetary conditions for other borrowers.

Monetary policy adopted a stance of cautious ease. Interest rates were lowered by ¾ of a percentage point at the beginning of 1972 and the banks' borrowing quotas at the central bank were kept relatively high during the year. In accordance with a government decision of August 1971, counter-cyclical funds deposited earlier with the Bank of Finland were repaid to the extent of nearly F.mk.590 million over the year, the liquidity effects of which were largely offset by the sale of deposit certificates to the banks. In addition, private borrowers were encouraged to take up credits abroad and the requirement for advance payment in respect of certain imports was terminated in June 1972. At the same time the global ceiling on consumer credit was lifted, and this was followed in July by a substantial easing of hire-purchase terms. Subsequently, at the turn of 1972–73, the Bank of Finland asked the banks to shift the emphasis of their lending towards investment. On the other hand, it curtailed its own participation in lending to the private sector.

In anticipation of a further advance in activity the 1973 budget provides for a slightly expansive policy in the early part of the year, with a gradual swing to restraint if required by actual developments. Emphasis continues to be placed on restoring a high level of employment, and the timing of budget appropriations, investment subsidies and loans will be adapted towards this end. In March, with continuing strong upward pressures on consumer prices, price and rent controls were extended for another year.

Spain. Under the stimulus of monetary and fiscal policies, the economic upswing that had begun in late 1971 speeded up in the course of the past year. Industrial investment, which had fallen in 1971, rebounded sharply, helped by a 7 per cent. tax credit for new equipment ordered during the first half of 1972. Private consumption quickened and exports continued to rise well.

Faster growth of output was accompanied by rising imports, a steady fall in non-farm unemployment and larger wage rises, with hourly earnings in 1972 averaging 16.5 per cent. more than in 1971. Consumer prices rose more rapidly in the summer, to reach an annual rate of increase of about 9 per cent. In these circumstances monetary and fiscal policies were gradually tightened. However, in view of the labour reserves available in agriculture and the strength of the balance of payments, the authorities felt able to continue to encourage a high rate of economic growth while using selective measures to counter inflation. A set of such measures introduced in October included the weekly fixing of prices of essential foodstuffs by provincial governors, reductions in customs tariffs on a range of products, an easing of quantitative import restrictions and reforms in the system of food imports under state trading, with most of these imports to be turned over to private enterprises. These measures helped to slow down the rise in consumer prices, which in December stood 7.3 per cent. higher than a year earlier.

Higher tax revenues helped restore the *government's budget to balance* last year, after a deficit in 1971, and the authorities issued substantial amounts of government securities to offset part of the liquidity effects of the continuing external surplus. Moreover, early in the year compulsory cash reserve requirements for savings banks were introduced. Even so, the broadly-defined money supply increased by 23 per cent., about the same as in 1971, and bank credit to the private sector went up by 22 per cent., compared with 18 per cent. in 1971. Though these were again high rates of increase, the authorities were able to get a much better grip on bank liquidity. The growth of the monetary base was brought down to 14.6 per cent., compared with 22.4 per cent. in 1971, and the banks' free liquidity as a percentage of their deposits, which had remained almost constant in 1971, fell from 5.5 at the beginning of last year to 1.6 in December.

In addition to increasing its borrowing from banks, the private sector floated more security issues and took more credit from abroad. In line with the authorities' objectives, there seems to have been a decline in financing via privileged circuits.

In early 1973 demand and output were expanding rapidly. The government's 1973 budget was designed to avoid giving an inflationary stimulus to the economy and monetary policy still sought to limit the expansion in liquidity. At the same time, however, the authorities continued to aim at ensuring a good rate of economic growth. In the early months of the year the banks' free reserves began to rise again under the influence of large official purchases of foreign exchange. Since increases in the banks' net foreign liabilities had become an important source of domestic liquidity creation, the authorities extended to the entire stock of the banks' convertible peseta deposit liabilities to non-residents the 100 per cent. reserve requirement which had previously applied only to the increase in these deposits. The compulsory ratios for banks' investments in government bonds were reduced from 15 to 14 per cent. in January; for the first time, three-month Treasury bills, ineligible for meeting this requirement, were issued on a large scale in March. Moreover, the computation of banks' cash reserve requirements was put on a daily basis. On balance, these steps were designed to bring about a significant absorption of bank liquidity. In addition, they constituted an important refinement of the instruments of monetary policy.

Portugal. Following a mild slowing-down in 1971 output growth regained momentum last year. Exports went up faster and fixed investment activity increased while private and public consumption continued to advance strongly. After accelerating sharply in 1971, consumer prices again rose at an annual rate of about 9 per cent.

The authorities' net purchases of foreign exchange brought about a further large increase in bank liquidity, considerably outweighing the effects of an across-the-board increase of 1 percentage point in banks' reserve requirements in May. During the year bank credit to the private sector accelerated further, and the private sector's money and quasi-money holdings went up by 24 per cent., compared with 21 per cent. in 1971 and 13 per cent. in 1970. There was also a marked increase last year in bond and share issues, as well as in long-term financing through special credit institutions, including the National Development Bank.

In June, with price inflation becoming a cause for concern, the government introduced price ceilings for certain goods and services and for others made price increases subject to review. At the same time tax surcharges were imposed on high incomes of individuals and companies, while sales of certain goods were made subject to a luxury tax. As tax revenues rose faster and the government's investment spending slowed down after growing very rapidly in 1971, the Treasury accounts showed an increased overall surplus last year.

In December 1972 the authorities announced new counter-inflationary measures, including certain changes in direct taxes, a tax on motor vehicles and steps to tighten monetary policy. The Bank of Portugal's discount rate was raised from 3¾ to 4 per cent. and most of the credit institutions' borrowing and lending rates were also increased. In addition, bank reserve requirements were raised by 1 percentage point from January 1973. Concurrently the banks' credit-granting for consumption, their financing of imports and their short-term lending to other credit institutions were made subject to limits fixed in relation to their domestic currency deposit liabilities. Earlier, to encourage thrift, special high-interest-bearing deposit facilities were introduced for contractual savings destined for housing purposes or for the purchase of domestic shares and bonds.

Yugoslavia. As a result of numerous restrictive measures taken in 1971, the rapid expansion of demand moderated in 1972. Total domestic expenditure went up by 5 per cent. at constant prices, with fixed investment rising by only 3 per cent. On the other hand, thanks to devaluations of the dinar in January and December 1971, together with selective measures to restrict imports and encourage exports, the current account changed from a substantial deficit in 1971 to a sizable surplus in 1972. The overall outcome was that the real social product rose by 6 per cent., compared with 8.5 per cent. in 1971.

The rise in prices, however, was again substantial. Over the twelve months to December 1972 the cost of living went up by 17 per cent., after increasing by 18 per cent. in the previous year. Food prices alone advanced by 20 per cent. Although prices remained blocked in principle, they had to be adjusted in the light of cost developments.

The money supply increased over the twelve months to November 1972 by 36 per cent., against 15 per cent. in the previous year. This acceleration was primarily associated with large net purchases of foreign exchange following sizable net sales in 1971. Bank credit, on the other hand, expanded by only 15 per cent., or somewhat less than the year before. This was to a certain extent the result of various restrictive measures which were taken from the spring onwards, when it was seen that liquidity creation through the balance of payments was assuming large proportions. Thus, compulsory reserve requirements were increased, supervision of banks was tightened and in September the growth of bank credit was limited until the end of the year. In addition, most types of borrowing abroad were made subject to a compulsory interest-free deposit at the National Bank with rates ranging up to 40 per cent.; in December these rates were raised to a general maximum of 75 per cent.

Since inflation showed little sign of abating, further measures were taken in late 1972 and early 1973. Most effective were probably those in the field of wages. The pay of employees in the services sector was frozen until the end of June: wage payments in illiquid enterprises unable to settle liabilities falling due were cut by up to 10 per cent. and the salaries of federal civil servants by the same amount. In addition, a temporary 4 per cent. tax on certain imports was introduced and steps were taken to curb non-productive investment and consumer credit. Moreover, some republics imposed "stabilisation taxes" on certain types of consumer expenditure and on higher incomes. Finally, in mid-February, when there was a further 10 per cent. devaluation of the dinar in line with that of the dollar, a new effort was made to freeze prices for most goods and services, this time at their end-December 1972 level. In May this freeze was replaced by an agreement between the central government and the individual republics to limit the rise in the cost of living in 1973 to 15 per cent.

Inflation remained an acute problem in the spring of 1973. The wage measures described, however, suggest that the slow-down in the growth of personal income during 1972 from a twelve-month rate of 30 per cent. in the first quarter to 18 per cent. in the last may continue. As regards the long-standing problem of enterprise "illiquidity", a stringent system of compulsory collection of inter-company claims is now being applied with a view to achieving a more efficient utilisation of resources.

A limited foreign exchange market was opened in May 1973 as a step towards dinar convertibility. Banks which comply with certain standards may trade among themselves the more important convertible currencies; they are no longer required to deal only with the National Bank.

Australia. Although monetary and fiscal policies were eased from late 1971 onwards the gross national product grew very slowly during most of 1972 and unemployment rose steeply. Personal consumption remained hesitant and productive investment fell off after a boom in construction and mining. Exports and housing continued to advance, however, and late in the year, with policy becoming more stimulatory, consumption began to recover.

The external current account recorded a surplus of A$350 million last year, against a deficit of A$800 million in 1971. Moreover, despite the easing of monetary policy and the exchange control measures introduced in September 1972, net capital inflows continued at the same high rates as in 1971, reaching nearly A$2 milliard for the year as a whole. As a result, after doubling in 1971 to reach US$3.3 milliard, the official gold and foreign exchange reserves climbed further last year to US$6.1 milliard. The swing in the current account was attributable partly to the cyclical weakness of imports and rises in the prices of Australia's commodity exports. However, not only had the deficits recorded in 1970 and 1971 been small by past standards but, in addition, the Australian dollar had emerged from the December 1971 currency alignments with an effective overall devaluation. Against this background it was revalued in December 1972 by 7.05 per cent. against other currencies and it did not follow when the US dollar was devalued in February 1973. In this context, one must bear in mind the relative appreciation of the yen, since Japan's share in Australian overseas trade has increased very rapidly in recent years.

A series of expansionary budget measures introduced during the year included higher grants to State governments for public works programmes, a 20 per cent. tax allowance for investment in manufacturing industry and a 2½ per cent. cut in the personal income-tax surcharge together with increases in social security benefits. Largely as a result of these measures, the Federal Government's domestically effective surplus in the fiscal year ended June 1972, originally budgeted at A$630 million, or nearly 2 per cent. of the gross national product, came to only A$390 million. Moreover, the 1972–73 budget proposals, presented in August, provided for substantial increases in pensions, subsidies to industry and payments to State governments, together with a reduction in personal income tax averaging 10 per cent., and envisaged a small domestic deficit in 1972–73.

Official purchases of foreign exchange, together with the emerging deficit in the government's budget, contributed to a substantial increase in liquid assets of the economy and interest rates fell progressively. Reflecting a marked strengthening of liquidity preference, the money supply broadly defined went up by nearly 20 per cent., compared with only 9 per cent. in 1971. Accelerating after mid-year, bank lending to the private sector rose by 16 per cent., but the banks were also able to increase their holdings of liquid assets and government securities, which taken together as a percentage of deposits moved up from 34.4 to 38.

Early 1973 saw a quick spreading of domestic recovery and falling away of unemployment. Inflationary pressures had eased somewhat in 1972, with consumer prices going up by 4½ per cent. and average wage earnings by 9 per cent., but the rise has recently accelerated. In January–March the external current account was still in surplus. However, partly in consequence of tighter exchange controls — in particular the restraints on borrowing overseas, introduced in September and made progressively more restrictive in December and February — large net outflows developed in the weeks following the devaluation of the US dollar and the overall external balance moved into deficit. As demand pressures were beginning to emerge, the authorities permitted domestic monetary conditions to tighten and in April increased the commercial banks' cash reserve requirement from 6.6 to 7.6 per cent.

South Africa. Earlier restraint policies to check demand excesses, together with the devaluation of the rand in December 1971, helped achieve a marked improvement in the external position last year. The authorities also succeeded in slowing down the expansion of public spending and shifting its emphasis towards infrastructure investment. The growth of private consumption weakened further, while private fixed investment levelled out and stocks were run down after a three-year build-up. As a result the overall pace of growth was disappointing. Consumer prices rose by 7.4 per cent. in 1972, but this was largely ascribable to devaluation and the rise in food prices.

Benefiting from both higher market prices and the devaluation, merchandise exports went up by 36 per cent. in value terms last year, while a steep rise in import prices was more than offset by the fall in their volume. In addition, with the market value of gold output increasing by R. 240 million, the external current-account deficit fell from nearly R. 1,000 million in 1971 to only R. 100 million last year. Net capital inflows, though below the very high figure of 1971, accounted for R. 500 million of the year's rise in official external reserves from US $711 to 1,290 million. With reserves rising further in early 1973, virtually all the reserve losses recorded from early 1969 onwards had been recouped. Against this general background the import controls introduced in November 1971 were liberalised in July 1972.

The government's 1972–73 budget proposals had provided for moderately stimulatory measures, including tax incentives for exports and industrial investment together with a relaxation of building controls and consumer credit restrictions. Other steps were selective reductions in sales tax, personal income — tax adjustments and a cut in the reimbursable surcharge ("loan levy") on dividend payments received by business firms. However, as a safeguard against inflation, the proposals envisaged a slower growth of expenditure and a reduction in the overall borrowing requirement, supplemented by a government programme embracing more flexible labour and import control policies. Late in the year it was decided to ease hire-purchase restrictions further, to cut sales taxes and to repay in advance the blocked proceeds of the 1966 surcharge on incomes.

In the calendar year 1972 the government's overall budget deficit came to R. 750 million, compared with R. 845 million in 1971, and a larger proportion was financed from non-monetary sources. However, the liquidity of the economy was increased by the external surplus, and short-term interest rates fell progressively. Bank rate was cut from 6½ to 6 per cent. in August, and a general lowering of banks' deposit and lending rates followed. Moreover, the long-standing ceilings on bank credit — granting were raised in two stages in April and September and then abolished in November, when they were replaced by a system of cash and liquidity requirements. This change was primarily a structural reform but the new ratios were chosen so as to leave the banks with ample liquidity.

The broadly-defined money supply expanded by about 19 per cent., against only 7 per cent. in 1971, with long-term bank deposits rising by close on 50 per cent. Although bank lending to the private sector accelerated late in the year, it went up in 1972 as a whole by less than 12 per cent., so that the banks were able to build up their liquid assets.

In early 1973 there were signs of economic recovery but with a still considerable margin of unused capacity. The government's budget proposals for the year ending

March 1974 provide for an acceleration in government spending reflecting mainly increases in civil service wages and in pensions. Other slightly stimulatory measures include subsidies and tax concessions for exports and industrial investment, cuts in sales taxes, abolition of the levy on dividends received by firms and a cut in the surtax on high personal incomes. A lowering of Bank rate to 5½ per cent. in March was followed by a reduction in bank lending rates. Deposit rates were not lowered, however, and to encourage thrift a new higher rate for deposits at over two years was introduced.

Eastern Europe. In the *Soviet Union* the slow-down in economic growth from rates of 9 and 6 per cent. in the preceding two years to 4 per cent. in 1972 principally reflected a decline in agricultural output due to bad weather conditions. Although most crops were affected — and hence also meat production — it was the poor grain harvest that had the most adverse consequences, necessitating substantial imports to cover the shortage. The growth of industrial output slowed down for the second year in succession and was slightly below last year's target, mainly because of a shortfall in the production of consumer goods. Among the reasons for this deceleration were the unfavourable winter weather conditions, which hampered construction, and a comparatively low increase in industrial investment in 1971. Another factor was the slow-down in productivity growth from about 7 per cent. in 1970 to 5.2 per cent. in 1972, partly because capacity-enlarging investment took precedence over rationalisation or replacement measures and because there was little further progress towards a more economical use of raw materials. Total fixed capital investment increased by 6.6 per cent., compared with 7.3 per cent. in 1971 and 11.5 per cent. in 1970, even though industrial investment alone expanded by as much as 16 per cent. Wage incomes of households went up at the same rate as in 1971 (6.2 per cent.) but the growth of total money income slowed down from 7.2 to 6.8 per cent. Prices in general remained relatively stable and real consumption grew by about 4 per cent., compared with 5.2 per cent. in 1971. According to the plan for 1973 the overall rate of expansion should pick up as agricultural output recovers. In industry the growth target for the year is 5.8 per cent., compared with an actual outcome of 6.5 per cent. in 1972, and producer goods are being given relatively greater emphasis.

In the *German Democratic Republic* economic growth accelerated in 1972 after a year of slow-down. Incomplete data suggest that this change was due partly to a recovery of agricultural output after three years of bad crops. Despite a continuing shortage of manpower, industrial production also grew at a faster rate than in the preceding year, thanks largely to a more balanced supply of energy and materials and a 5.5 per cent. rise in labour productivity. The availability of additional productive capacity played a more limited rôle than usual because of the stagnation of investment in 1971. During 1972 investment began to expand again, but the 3 per cent. increase was still rather low by earlier standards. The growth of consumer goods output appears to have accelerated in response to official encouragement. Wage increases, improvements in social transfer payments and a larger volume of agricultural sales produced a rise of 5–6 per cent. in the money incomes of households; real incomes advanced at about the same rate since prices were held stable. Total retail sales likewise increased by 6 per cent., considerably more than in preceding years, while sales of goods other than food rose by nearly 9 per cent. Overall, therefore, actual developments

Eastern European economies: Sectoral output and national income produced.

Countries	Gross output						National income produced[1]	
	Industry		Agriculture		Construction			
	1971	1972	1971	1972	1971	1972	1971	1972
	real annual increases, in percentages							
Bulgaria	9.5	8.3	3.0	4.8	5.9	.	7.0	7.0[2]
Czechoslovakia	6.9	6.4	3.2	3.6	9.7	9.4	5.2	5.7
German Democratic Republic	5.6	6.3	— 0.9	.	5.3	4.3[2]	4.5	5.4
Hungary	7.0	5.6	9.2	4.0	7.0	1.0	6.5	5.0[2]
Poland	8.3	10.8	3.7	8.1	8.0	14.4[2]	8.2	9.0[2]
Rumania	11.7	11.7	18.4	9.0	9.3	7.5	12.8	10.0
USSR	7.7	6.5	1.1	— 5.0[2]	8.8	9.0	6.0[2]	4.0[2]

[1] Net material product. [2] Estimate.
Source: UN Economic Commission for Europe, *Economic Survey of Europe in 1972.*

fulfilled the authorities' objective in terms of higher living standards. The same emphasis emerges from the plan for 1973, which for the first time provides for a larger increase in the output of consumer goods (7.1 per cent.) than in that of producer goods (4.9 per cent.). The overall targets for 1973 are set slightly higher than the results achieved in 1972.

In *Poland* good harvests, ample productive capacity and buoyant final demand combined to produce substantial economic growth in 1972. Industrial production benefited from the recovery of investment in 1971, better utilisation of existing plant and an increase of about 4½ per cent. in the labour force resulting from more liberal employment regulations. Moreover, labour productivity in industry rose by 6 per cent., a further substantial increase. In accordance with policy aims, the production of consumer goods expanded faster than that of producer goods, rising by 11 per cent. in 1972, after growing by 8 per cent. in 1971 and by an average of 6.5 per cent. between 1965 and 1970. At the same time, fixed capital investment leapt up by 21.5 per cent. after a rise of 7.7 per cent. in 1971. Partly reflecting higher income from agricultural output, but also distributional policy generally, the money income of the population increased by 15 per cent. Retail sales rose by 12.6 per cent. Therefore, since under the existing freeze the price level remained stable, living standards appear to have improved considerably. On the other hand, the combined pressure of consumer and investment demand exceeded productive capacity and necessitated a sharp increase in imports, which were partly financed on the Euro-markets. This year pilot enterprises are being established on an experimental basis giving local managers more responsibility in matters of investment and labour affairs and allowing wages to be linked to the performance of the enterprise. The plan provides for overall growth targets in 1973 higher than those for 1972 but below last year's actual results, with stress again being laid on the output of consumer goods.

In *Czechoslovakia* agricultural output again improved last year and new measures were taken to extend collective farming and centralise management. In the industrial sector, on the other hand, growth rates declined further in 1972. The main problems continued to be shortages of energy resources, insufficient utilisation of capital equipment and a shortage of labour. The government's policy lays considerable stress on increasing industrial labour productivity, which once more rose considerably (by 5.8 per cent.). Efforts to rationalise the use of materials did not meet with great success. The growth of total investment, which had slowed down after reaching a peak in 1969, recovered last year to 8.3 per cent. The increase in wages (5 per cent.) was less than the increase in productivity, the difference being used to raise social transfer payments. The total money income of households expanded by 5.8 per cent. and the growth of private consumption was only slightly lower. Consumer prices, which have been frozen since 1970, fell slightly, but the supply of consumer goods, though greater than before, was somewhat inconsistent with demand patterns. Since available resources are fully employed, the plan for 1973 aims at maintaining much the same growth rates as in 1972 and at giving more emphasis to the output of producer goods.

In *Hungary* the authorities tightened credit restrictions and import controls around the turn of 1971–72 after investment and the volume of imports had increased steeply. The objective was to stabilise investment at a high level and, more generally, to give priority to structural improvements rather than to expansion. As a result, fixed capital investment dropped by 2 per cent., with demand for both plant and equipment goods and construction easing during the year. Employment in industry declined somewhat but labour productivity improved by 6.5 per cent., or only slightly less than the year before. Both real income per head and retail sales increased by 3–3.5 per cent., or less than in previous years. There was cause for concern in the rise in retail prices — no more than 3 per cent. on average, but substantially higher for some essentials — and in the widening gaps between various types of income. In consequence, the prices of certain basic foodstuffs were frozen and selective increases in wages, social benefits and rates of taxation were introduced in 1973 to even out income disparities. In general, government control will be tightened and central planning will assume greater importance. To promote international co-operation new regulations were issued concerning the formation of joint companies with foreign firms. The plan for 1973 provides for slightly slower economic growth, but for a 3 per cent. recovery in investment.

In *Rumania* the growth of agricultural output slowed down in 1972, following outstanding crops in 1971. On the other hand, industrial production continued to grow as rapidly as in the preceding year. Outlays on fixed capital investment rose again by 10.5 per cent. despite a shortfall in the planned output of building materials. Production of consumer goods went up more slowly, with certain products, including foodstuffs, remaining in short supply. As some of these shortages were due to difficulties in distribution, a number of measures were taken to increase trading efficiency. Retail trade turnover increased in 1972 by 6.3 per cent., or somewhat less than the 7.5 per cent. rise in households' money incomes. In December 1972 Rumania became the first member of the Comecon to join the IMF and the IBRD. Its quota in the Fund was fixed at SDR 190 million. To promote international co-operation the programme for joint investment ventures by domestic and foreign corporations was taken a step further by the issue of appropriate regulations. The plan for 1973 calls for a continued growth in net material product of about 10 per cent., with the increase in industrial gross output accelerating to 14.7 per cent. from an actual outcome of 11.7 per cent. in 1972.

In *Bulgaria* the national income grew at a rate of 7 per cent. for the third year in succession. The 1972 outcome was due to better results in agriculture despite less favourable weather conditions. In the industrial sector growth slowed down slightly but generally maintained its comparatively high rate. An actual decline in investment in 1971 and imbalances resulting from rapid industrialisation go far towards explaining the deceleration last year. There was also a growing shortage of labour, together with a high turnover of workers. To overcome some of these difficulties control over enterprises was tightened and wages and special incentives were substantially improved. In addition, the output of consumer goods is being promoted under the 1973 plan. In industry productivity went up by 5.9 per cent. For the economy as a whole, with retail prices stable, real wages increased in 1972 by about 2.5 per cent. on average while total real income per head rose by 4 per cent., or less than in previous years. This left more room for investment, which increased by about 11 per cent. The plan for 1973 provides for growth of roughly 8 per cent. in the national income.

III. WORLD TRADE AND PAYMENTS.

In line with the renewed economic upswing the growth of world trade accelerated in 1972 after the slow-down in 1971, so that the yearly turnover in dollar terms reached $374 milliard. World trade is thus by now nearing a quarterly rate of $100 milliard — a figure indicative of the large swings in payments possible through shifts in leads and lags. At the beginning of the sixties the average turnover of world trade was about one-third as large.

The rise in value last year, at about 17 per cent., was some 5 percentage points more than in the previous year. The faster gain was ascribable mainly to trade volume, which went up by 10 per cent., compared with 5¾ per cent. the year before. Unit values of internationally traded goods rose by about 6½ per cent., or 1½ per cent. more than in 1971. The trend of prices, at first under the influence mainly of the dollar devaluation in 1971, increasingly reflected the sharp advance in basic commodity prices as the expansion in world economic activity, and hence in world trade, gathered momentum. At all events, given the repercussions on prices of the devaluation of

International trade.[1]

Areas	Exports (f.o.b.)		Imports (c.i.f.)		Rates of increase in exports		Rates of increase in imports	
	1971	1972	1971	1972	1971	1972	1971	1972
	in milliards of US dollars				in percentages			
Developed areas								
Europe[2]								
EEC	100.9	123.0	99.1	117.3	*14.0*	*22.0*	*12.0*	*18.5*
EFTA	47.9	55.2	55.2	64.1	*12.0*	*15.0*	*9.0*	*16.0*
Other countries[3]	6.7	8.5	12.2	14.6	*17.5*	*26.5*	*9.0*	*18.5*
Total	155.5	186.7	166.5	196.0	*13.5*	*20.0*	*11.0*	*17.5*
United States	43.5	49.0	48.3	58.9	*2.0*	*12.5*	*14.0*	*22.0*
Canada	17.6	20.1	16.8	20.5	*9.0*	*14.0*	*16.0*	*22.0*
Japan	24.0	28.7	19.7	23.5	*24.5*	*19.0*	*4.5*	*19.0*
Other countries[4]	9.4	11.6	12.2	12.0	*9.0*	*24.0*	*10.0*	*— 1.5*
Total[5]	250.4	296.5	263.5	310.4	*12.0*	*18.5*	*11.0*	*18.0*
(Volume index 1970 = 100)	*(106.3)*	*(115.9)*	*(105.8)*	*(115.7)*	*(6.5)*	*(9.0)*	*(6.0)*	*(9.5)*
Other areas	61.5	69.8	62.9	71.1	*12.0*	*13.5*	*12.0*	*13.0*
(Volume index 1970 = 100)	*(104.4)*	*(118.1)*	*(107.7)*	*(120.0)*	*(4.5)*	*(13.0)*	*(7.5)*	*(11.5)*
Grand total	311.9	366.3	326.4	381.5	*12.0*	*17.5*	*11.5*	*17.0*
(Volume index 1970 = 100)	*(105.5)*	*(115.8)*	*(106.0)*	*(116.4)*	*(5.5)*	*(10.0)*	*(6.0)*	*(10.0)*

[1] Represents roughly 90 per cent. of world trade, as the exports and imports of centrally-planned economies are included only to the extent that they are reflected in trade with the rest of the world. [2] Economic areas as at end of December 1972. [3] Greece, Ireland, Malta, Spain, Yugoslavia. [4] Australia, Israel, New Zealand, South Africa. [5] Total may not tally with individual items since only figures for regions, but not for countries, have been adjusted to a uniform basis.

the dollar — effectively 9 per cent. between mid-1970 and mid-1972 — the overall 12 per cent. rise in world prices of traded goods in dollar terms in the last two years is not altogether surprising. The second devaluation of the dollar in early 1973, together with the continuing inflationary climate, will give further impetus to the growth in dollar prices of internationally traded commodities.

In value terms the trade of developed countries expanded last year by 18 per cent., while that of the developing countries went up by 13 per cent. In terms of volume, however, the position is reversed, since the prices of the developing countries' exports and imports showed on average little change in dollar terms.

Imports of industrial countries accelerated, the principal exceptions being Australia and South Africa where imports actually fell owing to continued domestic slack. A particularly sharp pick-up was recorded by Japan — from a 4½ per cent. rise in 1971 to one of 19 per cent. last year. In Europe both the EFTA and the EEC areas recorded a pronounced increase in import growth over 1971: from 9 to 16 and from 12 to 18½ per cent. respectively. Among the EFTA countries the acceleration was especially marked in Austria, Switzerland and the United Kingdom, while in the EEC France and Italy showed unusually large rises. The acceleration in imports of European countries other than members of the EEC or EFTA was mainly accounted for by Spain. Under the influence of the domestic upswing, imports in both Canada and the United States recorded a 22 per cent. rise.

As for exports, the largest expansion — 22 per cent. — was recorded by the EEC, with all member countries showing a high rate of growth. Exports from the EFTA area also expanded at a faster pace, though they were held back somewhat by the weak performance of UK exports. The growth rate of Japanese exports slowed down from 24½ per cent. in 1971 to 19 per cent. in 1972; a deceleration in sales to North America was partly offset by an increase in those to Europe. Exports from North America gathered momentum — from an overall expansion of 4 per cent. in 1971 to one of 13 per cent. last year. US exports to Japan rose steeply, by 22 per cent., following a 13 per cent. fall in 1971.

Growth of exports from main industrial areas.[1]

Exports from	Years	Exports to						
		EEC	EFTA	North America[2]	Japan	Other developed countries[3]	Other areas	Total
		in percentages over previous year, based on dollar values						
EEC	1970	18.5	17.0	10.5	33.0	17.5	13.5	17.0
	1971	15.0	12.5	18.0	− 4.5	11.0	12.5	14.0
	1972	22.5	25.5	17.0	24.5	23.0	15.5	22.0
EFTA	1970	15.0	19.5	3.0	14.5	11.0	8.5	13.0
	1971	8.5	11.5	18.5	6.5	11.5	15.5	12.0
	1972	17.5	20.0	18.0	20.0	7.5	8.5	15.0
North America .	1970	23.5	18.5	3.5	33.0	22.0	16.5	14.5
	1971	− 1.0	− 5.0	14.5	−10.5	5.0	2.5	4.0
	1972	5.0	6.5	18.0	22.0	12.5	10.0	13.0
Japan	1970	34.5	46.5	19.5	—	33.0	13.5	21.0
	1971	25.5	21.5	29.0	—	10.0	25.5	24.5
	1972	34.5	42.5	19.0	—	18.0	13.5	19.0

[1] Economic areas as at end of December 1972. [2] Excluding Mexico. [3] Comprising the countries mentioned under footnotes 3 and 4 to the table on page 86 and centrally-planned economies.

Balances of payments.

As 1972 wore on there was little indication that the adjustment process on current, especially trade, transactions was beginning to take place. It was recognised after the Smithsonian agreement that in the short run adverse terms-of-trade effects would outweigh equilibrating volume effects in both devaluing and revaluing countries. Late in the year, however, the response of volumes to new relative prices was still painfully limited, or even non-existent. Thus the trade surplus increased in Japan and in Germany, while the deficit widened sharply in the United States. This sapped faith in the ultimate viability of the Smithsonian realignment of parities and rendered it increasingly vulnerable to a new crisis. By the autumn the question was "when" rather than "whether".

The balance-of-payments results recorded in 1972 by the main industrial areas revealed a highly disequilibrated state of affairs. On trade account, the biggest change last year was the increase of more than $4 milliard in the deficit registered by the United States. The United Kingdom also experienced a sharp deterioration, with a $2.5 milliard turn-round from surplus into deficit; this was the main reason for the $1.8 milliard rise in the deficit of the EFTA. Canada's surplus declined by nearly $0.9 milliard. On the other hand, the EEC surplus widened by $3 milliard, mainly because of developments in Germany and the Netherlands. Japan's surplus reached $9 milliard, $1.2 milliard more than in 1971. Overall, the trade surplus of the main industrial countries declined by $2.6 milliard to $8.3 milliard in 1972.

While movements in the trade balances of industrial countries to some extent compensated each other, balances on invisible transactions generally deteriorated. The US deficit increased by $1.1 milliard and the Canadian and Japanese deficits by $0.1 and 0.3 milliard respectively. The rise in German and French net outpayments resulted in a $1.7 milliard worsening of the position of the EEC. Only in the EFTA was there a $0.5 milliard improvement, mainly because of growing surpluses on tourism account in Austria, Switzerland and Portugal. The overall current-account surplus vis-à-vis the rest of the world thus fell sharply from $8 milliard to $2.7 milliard in 1972.

Capital transactions were dominated by the $13.2 milliard contraction in the US deficit, which still amounted to $6.7 milliard in 1972. The exceptionally large net outflow during the crisis year 1971 had led to some expectation that significant reflows might take place in 1972. But these did not occur, and last year's net outflow was higher than in 1969 and 1970. Canada's capital balance shifted from deficit into surplus, showing a $1.1 milliard swing. A counterpart to these changes in North America was to a large extent seen in movements in the other industrial areas. Japan's $1.9 milliard surplus in 1971 gave way to a $2 milliard deficit. A swing of almost the same size was recorded for the EEC, where the net surplus — $3.8 milliard in 1971 — practically vanished; Italy's net outpayments increased by $2 milliard, while France and the Netherlands moved into deficit, with turn-rounds of $1.2 and 0.9 milliard respectively. Germany's surplus, on the other hand, rose by $1.2 milliard. The EFTA also showed a sharp decline in net capital inflows, from $3.7 milliard in 1971 to $1.2 milliard last year, chiefly because of the $2.5 milliard drop in Switzerland's net receipts. Altogether there was thus still a sizable ($7 milliard) net capital outflow from the main industrial areas to the rest of the world in 1972.

Balances of payments of the main industrial areas.

Items	Years	United States	Canada	Japan	EEC	EFTA	Total
		in milliards of US dollars					
Trade balance	1970	+ 2.2	+ 3.0	+ 4.0	+ 5.7	− 5.0	+ 9.9
	1971	− 2.7	+ 2.6	+ 7.8	+ 7.9	− 4.7	+ 10.9
	1972	− 6.8	+ 1.7	+ 9.0	+ 10.9	− 6.5	+ 8.3
Services and transfers .	1970	− 1.8	− 2.0	− 2.0	− 4.0	+ 5.5	− 4.3
	1971	− 0.1	− 2.2	− 2.0	− 4.9	+ 6.3	− 2.9
	1972	− 1.2	− 2.3	− 2.3	− 6.6	+ 6.8	− 5.6
Current balance	1970	+ 0.4	+ 1.0	+ 2.0	+ 1.7	+ 0.5	+ 5.6
	1971	− 2.8	+ 0.4	+ 5.8	+ 3.0	+ 1.6	+ 8.0
	1972	− 8.0	− 0.6	+ 6.7	+ 4.3	+ 0.3	+ 2.7
Net capital movements .	1970	− 5.1	+ 0.7	− 0.6	+ 4.3	+ 2.6	+ 1.9
	1971	− 19.9	− 1.0	+ 1.9	+ 3.8	+ 3.7	− 11.5
	1972	− 6.7	+ 0.1	− 2.0	+ 0.4	+ 1.2	− 7.0
SDR allocations	1970	+ 0.8	+ 0.1	+ 0.1	+ 0.7	+ 0.5	+ 2.2
	1971	+ 0.7	+ 0.1	+ 0.1	+ 0.6	+ 0.4	+ 1.9
	1972	+ 0.7	+ 0.1	+ 0.1	+ 0.6	+ 0.5	+ 2.0
Overall balance*	1970	− 3.9	+ 1.8	+ 1.5	+ 6.7	+ 3.6	+ 9.7
	1971	− 22.0	− 0.5	+ 7.8	+ 7.4	+ 5.7	− 1.6
	1972	− 14.0	− 0.4	+ 4.8	+ 5.3	+ 2.0	− 2.3

* Equal to changes in net official assets and the net external position of commercial banks according to multilateral surveillance definitions (excluding revaluation gains on gold and gold-guaranteed net official assets and, where possible, on the overall net external position), except in the case of the United States, where it represents the net liquidity balance.

For the second consecutive year the overall balance of the main industrial areas as a whole, including SDR allocations of some $2 milliard, showed a deficit. The $8 milliard decline in the US deficit was more than offset by a reduction in the surpluses of Japan, the EEC and the EFTA, so that the overall deficit of $2.3 milliard was $0.7 milliard higher than in 1971.

In the discussion of country developments below, the data for the major western European countries are presented in terms of domestic currencies. Balances of payments of all other countries are analysed in terms of dollar figures, although references to merchandise trade are always based on customs data in domestic currency except in the case of Greece and Turkey. Overall balances refer to changes in net official assets (including SDR allocations) and in the net external position of commercial banks, except in the case of the United States, the United Kingdom, Turkey and Yugoslavia; they generally exclude changes in the valuation of holdings of gold and gold-based net official assets stemming from parity changes. So far as possible, other valuation changes affecting official positions and the banks' positions, and hence overall balances, have also been excluded (as is, in particular, the case for all countries whose balances of payments are given in domestic currency). This, together with differences in the statistical treatment of some items, accounts for discrepancies between overall balances given in this chapter and those in Chapter IV.

* * *

United States. A key factor leading to the second devaluation of the dollar on 13th February 1973 was the sharp worsening of the US merchandise trade balance in the course of 1972. Over the year as a whole exports rose by 14 per cent. in value and by 10½ per cent. in volume but the corresponding increases for imports were 22½ and 13½ per cent. As a result, the trade deficit (excluding military transactions) widened to $6.8 milliard from $2.7 milliard in 1971.

The main aspects of this deterioration have been reviewed in Chapter I. In this section an attempt will be made to assess in broad quantitative terms why the actual outcome last year was so different from the forecasts based on the Smithsonian realignment. Four major factors were involved. First, cyclical developments may have accounted for a deterioration of some $2 milliard. This was twice as much as expected, the difference being largely due to the strength of the upswing in economic activity in the United States. Secondly, there was the impact of exchange rate changes. Such changes have value and volume effects which tend in the short run to operate in opposite directions. In this instance, estimates suggest that the beneficial volume effects of the realignment were fairly limited — amounting to perhaps $1 milliard — and were concentrated on exports. The adverse terms-of-trade developments, on the other hand, may have accounted for a deterioration of $2.5 milliard. On balance, the negative impact was $1.5 milliard, or three times as much as had been expected, the reason being the low degree of responsiveness of the volume of imports in the short term to new relative prices. Thirdly, there were two special factors: the rebound from the effects of the 1971 strikes may have brought about a $0.7 milliard improvement, more or less as anticipated, while there was an unforeseen further small improvement due to especially high wheat exports. All this leaves, finally, a residual deterioration of about $1.5 milliard, which was much larger than forecast. Increased oil imports accounted for $1.1 milliard, a rise nearly twice as high as that in the previous year. Excluding this, there remains a trend deterioration of about $1 milliard, or slightly less than that recorded from 1965 onwards. To sum up, the actual overall deterioration worked out at nearly $4.2 milliard, whereas end-1971 forecasts had predicted a deterioration of about $1.75 milliard. The difference of some $2.5 milliard was principally caused by a higher-than-expected expansion of imports.

Also contrary to anticipations was the worsening of the balance on invisibles account by about $1 milliard last year, to give a deficit of $1.2 milliard. It was expected that the foreign currency earnings from US companies abroad would rise buoyantly with an upswing in activity — especially as expressed in depreciated dollars. In the event investment income rose by only $0.9 milliard, compared with $1.5 milliard in 1971. In addition, outpayments relating to foreign investment in the United States went up by $1 milliard as a result of rising US short-term interest rates and increasing liabilities vis-à-vis non-residents. Hence the balance on investment income, in previous years a source of growing receipts, worsened somewhat and, with a $0.8 milliard decline in sales of military equipment and a few other smaller changes, the current balance closed last year with an overall deficit of $8 milliard, or $5.2 milliard more than in 1971.

On the other hand, net capital outflows (including errors and omissions but excluding "liquid" flows) went down from $19.9 milliard to $6.7 milliard. The deficit on long-term capital account dropped to $1.3 milliard in 1972 from $6.5 milliard in the previous year. Nearly half the improvement was due to a sharp rise in foreign buying of US securities, which last year totalled $4.5 milliard. US direct investment abroad declined by $1.4 milliard to $3.3 milliard, while foreign direct investment

United States: Balance of payments.*

Items	1971	1972 Year	1972 1st quarter	1972 2nd quarter	1972 3rd quarter	1972 4th quarter	1973 1st quarter
	in millions of dollars						
Merchandise trade (f.o.b.)							
Exports	42,790	48,840	11,660	11,560	12,380	13,240	15,340
Imports	45,455	55,655	13,490	13,340	13,905	14,920	16,260
Trade balance	− 2,665	− 6,815	− 1,830	− 1,780	− 1,525	− 1,680	− 920
Other current items							
Military transactions	− 2,895	− 3,540	− 885	− 955	− 850	− 850	.
Travel and transportation	− 2,430	− 2,585	− 665	− 645	− 615	− 660	.
Investment income	+ 7,995	+ 7,900	+ 1,880	+ 1,785	+ 1,925	+ 2,310	.
Other services	+ 745	+ 820	+ 200	+ 190	+ 205	+ 225	.
Remittances	− 1,530	− 1,555	− 390	− 380	− 370	− 415	.
Government grants	− 2,045	− 2,210	− 600	− 535	− 540	− 535	.
Total	− 160	− 1,170	− 460	− 540	− 245	+ 75	.
Current balance	− 2,825	− 7,985	− 2,290	− 2,320	− 1,770	− 1,605	.
Long-term capital							
US Government	− 2,380	− 1,370	− 345	− 95	− 320	− 610	.
Direct investment	− 4,830	− 3,015	− 1,625	+ 250	− 880	− 760	.
Securities	+ 1,375	+ 3,885	+ 675	+ 605	+ 820	+ 1,785	.
Other	− 620	− 760	− 130	− 105	− 195	− 330	.
Total	− 6,455	− 1,260	− 1,425	+ 655	− 575	+ 85	.
Basic balance	− 9,280	− 9,245	− 3,715	− 1,665	− 2,345	− 1,520	.
Non-liquid short-term private capital	− 2,385	− 1,635	− 510	+ 590	− 505	− 1,210	.
Errors and omissions	−11,055	− 3,805	+ 940	− 1,310	− 1,825	− 1,610	.
SDR allocations	+ 720	+ 710	+ 180	+ 180	+ 175	+ 175	—
Net liquidity balance	−22,000	−13,975	− 3,105	− 2,205	− 4,500	− 4,165	− 6,800
Liquid private capital							
Claims	− 1,075	− 1,140	− 675	+ 195	− 615	− 45	− 1,555
Liabilities	− 6,690	+ 4,815	+ 555	+ 1,190	+ 440	+ 2,630	− 1,870
Total	− 7,765	+ 3,675	− 120	+ 1,385	− 175	+ 2,585	− 3,425
Official reserve transactions balance	−29,765	−10,300	− 3,225	− 820	− 4,675	− 1,580	−10,225

* On a transactions basis, seasonally adjusted.

in the United States increased by $0.4 milliard. US Government transactions were also equilibrating, the deficit falling to only $1.4 milliard from $2.4 milliard in 1971. With the improvement on long-term capital account offsetting the deterioration on current transactions, the $9.2 milliard deficit recorded last year in the basic balance was about the same as in the previous year.

The net outflow in the errors and omissions item shrank from $11.1 milliard to $3.8 milliard. Big as this change was, the continuing outflow was evidence of persisting uncertainties weighing on the dollar. After a $0.9 milliard reflux in the first quarter, net outpayments averaged $1.6 milliard in each of the following three quarters. Recorded non-liquid short-term capital outflows showed only a limited ($0.8 milliard) contraction over 1971, which was essentially due to a reduction in trade credit.

Taking into account the SDR allocation, the net liquidity balance closed with a deficit of $14 milliard. This compares with deficits of $22 milliard in 1971, $3.9 milliard in 1970 and $3.4 milliard on average over the period 1965–69.

The balance on liquid private flows shifted from a deficit of $7.8 milliard in 1971 to a surplus of $3.7 milliard last year, mainly as a result of movements of bank funds. The swing resulted largely from the changeover from net lending to net borrowing in the position of US banks vis-à-vis foreign branches and that of foreign banks located in the United States vis-à-vis head offices abroad. The bulk of the inflows took place in the fourth quarter and mostly involved transactions with Canada and Japan; short-term interest rates were rising in the United States while they remained stable in those two countries.

The official reserve transactions balance thus closed with a deficit of $10.3 milliard, more than three-quarters of it resulting from current transactions. In 1971 the deficit had reached $29.8 milliard, but only one-tenth of this was attributable to the current account.

The payments gap widened sharply in the first quarter of 1973. The deficit on official reserve transactions came to $10.2 milliard, or about the same as that recorded for the whole of 1972. Liquid private capital flows accounted for one-third of this, having suffered a $5.9 milliard turn-round from the preceding quarter. The deficit on other capital movements increased by about $3 milliard, to a total of $5.5 milliard. The bulk of the capital outflow occurred during two periods — in February, before the devaluation, and in early March, before the currency adjustment. The flight from the dollar took place despite a substantial improvement on current account. The trade deficit fell to $920 million from $1,680 million in the fourth quarter of 1972. Exports rose sharply by $2.1 milliard, or 16 per cent., over the quarter. More than half of the increase was accounted for by an upsurge in agricultural exports, prices of which were rising steeply. Imports increased by $1.3 milliard, or 9 per cent. The improvement in the US trade position arose principally from transactions with western Europe and Japan. In April, when there was a further sharp improvement, the trade balance moved into a surplus of $0.2 milliard. Exports rose by 2 per cent. on the March figure, while imports dropped by 2½ per cent.

Canada. After surpluses of $1,010 million in 1970 and $390 million in 1971 the current balance swung into a deficit of $585 million last year. Non-merchandise transactions showed little deterioration, the turn-round being mostly due to trade. It reflected not only Canada's position among the leaders in the upswing of the business cycle but also the repercussions of extensive strikes, which led to some permanent export loss, and the effects of the appreciation of the Canadian dollar between 1970 and end-1972. In the first quarter of 1973 the current account on a seasonally adjusted basis worsened further. The deficit rose to some $290 million from $45 million in the previous quarter, mainly owing to a deceleration of exports. On an unadjusted basis the current deficit came to $450 million, which was slightly less than that recorded in the first quarter of 1972.

Imports continued to accelerate last year, showing an increase over the year of 20 per cent. in value and 16 per cent. in volume; although the expansion was

Canada: Balance of payments.[1]

Items	1971	1972[2]					1973[2]
		Year	1st quarter	2nd quarter	3rd quarter	4th quarter	1st quarter
	in millions of US dollars[3]						
Merchandise trade (f.o.b.)							
Exports	18,480	21,040	4,790	5,290	5,130	5,830	6,080
Imports	15,890	19,300	4,520	4,740	4,830	5,210	5,670
Trade balance	+ 2,590	+ 1,740	+ 270	+ 550	+ 300	+ 620	+ 410
Services and transfers	− 2,200	− 2,325	− 585	− 565	− 510	− 665	− 700
Current balance	+ 390	− 585	− 315	− 15	− 210	− 45	− 290
Current balance unadjusted	+ 390	− 585	− 465	− 95	− 60	+ 35	− 450
Long-term capital	+ 390	+ 1,790	+ 335	+ 640	+ 270	+ 545	
Basic balance	+ 780	+ 1,205	− 130	+ 545	+ 210	+ 580	+ 20
Short-term capital[4]	− 1,380	− 1,755	− 350	− 795	− 390	− 220	
SDR allocations	+ 115	+ 115	+ 115	—	—	—	—
Overall balance	− 485	− 435	− 365	− 250[5]	− 180	+ 360	− 430

[1] On a transactions basis. [2] Quarterly data in respect of the current balance are seasonally adjusted. [3] Conversion at quarterly average spot rates. [4] Including errors and omissions. [5] Excluding gains of $135 million resulting from the revaluation of gold and gold-guaranteed net official assets which took place in May 1972.

broadly based the pace was set by finished products, both consumer and investment goods. Merchandise exports grew by 12½ per cent. in value and by 9½ per cent. in volume, almost twice the rates recorded in 1971. Exports to the United States went up by 16 per cent., while those to other countries advanced by 5½ per cent. The growth in exports was very uneven in 1972, as strikes in Canada and abroad distorted normal trade patterns throughout the year.

Long-term capital inflows had fallen substantially in 1970 and 1971 as the authorities had asked the provinces and big corporations to give priority to domestic sources of finance in view of the current-account surplus. Although policy remained unchanged last year, many provinces and municipalities turned again to foreign financing, both because of a widening of the long-term interest rate differential vis-à-vis the United States and because of substantially lower rates in international markets for Deutsche Mark and Swiss franc issues. Some Canadian borrowers also wished to maintain their presence in international capital markets. Thus, new provincial and municipal borrowing abroad came to $1,360 million in 1972, compared with $740 million in 1971. The other main change occurred in dealings in outstanding Canadian securities, which last year yielded a net inflow of $230 million after an outflow of about the same magnitude in 1971. Overall net long-term capital receipts came to $1,790 million, $1,400 million more than in 1971.

The net long-term inflow was almost entirely offset, however, by short-term outflows; these movements of funds, mostly unrecorded, were partly motivated by developments in exchange markets during the period. The overall balance closed with a deficit of $435 million, not dissimilar to that of 1971. In the first quarter of 1973 capital transactions again showed a very small surplus, so that the overall deficit came to $430 million; this was slightly higher than in the corresponding quarter of the preceding year, but in 1973 there was no SDR allocation.

Japan. An important factor sapping confidence in the Smithsonian realignment throughout last year was the maintenance of Japan's huge trade surplus. It rose to $9 milliard for 1972, $1.2 milliard more than the year before, despite a quicker-than-expected expansion of domestic demand in the second half of the year.

Currency revaluation often tends to improve the trade balance for a time because the favourable terms-of-trade effect is offset only gradually by an acceleration of imports and a slowing-down of exports. For Japan this explanation in fact largely accounts for the continuing strength of the trade balance. The terms-of-trade improvement in 1972 over the previous year came to 4½ per cent.; in dollar terms import prices increased by 8 per cent. while export prices rose by 13 per cent. since there was a decline in yen prices of perhaps 3 per cent. The fact that the volume growth of exports was much smaller than in 1971, declining from 17½ per cent. to 5½ per cent., may to some extent reflect a rather typical reaction of Japanese exports to a sharp recovery in domestic demand.

Japan: Balance of payments.[1]

Items	1971 Year	1972 Year	1971 1st half	1971 2nd half	1972 1st half	1972 2nd half	1973 1st quarter
	in millions of US dollars						
Merchandise trade (f.o.b.)							
Exports	23,565	28,080	10,655	12,910	12,490	15,590	7,410
Imports	15,780	19,080	7,855	7,925	8,805	10,275	6,335
Trade balance	+ 7,785	+ 9,000	+ 2,800	+ 4,985	+ 3,685	+ 5,315	+ 1,075
Services and transfers	− 1,990	− 2,345	− 1,105	− 885	− 1,505	− 840	− 540
Current balance	+ 5,795	+ 6,655	+ 1,695	+ 4,100	+ 2,180	+ 4,475	+ 535
Long-term capital	− 1,080	− 4,470	− 15	− 1,065	− 1,495	− 2,975	− 2,205
Basic balance	+ 4,715	+ 2,185	+ 1,680	+ 3,035	+ 685	+ 1,500	− 1,670
Short-term capital[2]	+ 2,960	+ 2,455	+ 1,215	+ 1,745	+ 605	+ 1,850	+ 705
SDR allocations	+ 130	+ 130	+ 130	—	+ 130	—	—
Overall balance	+ 7,805	+ 4,770	+ 3,025	+ 4,780	+ 1,420[3]	+ 3,350	− 965[3]

[1] On a transactions basis. [2] Including errors and omissions. [3] Excluding estimated gains of $135 and 205 million respectively resulting from the revaluation of gold and gold-guaranteed net official assets which took place at the end of January 1972 and in February and March 1973.

The impact of the realignment was clearly evident in the geographical distribution of trade. In value exports to the United States grew more slowly, while those to western Europe accelerated sharply, rising by 40 per cent. during 1972 to reach nearly $5 milliard. Obviously Japanese exporters were making a determined effort to find new sales outlets as a partial substitute for their receding prospects in the United States.

Imports increased at a considerably faster rate as the year progressed. In volume terms, seasonally adjusted, the annual rates of increase were 13½ and 21½ per cent. in the first and second halves of 1972 respectively as economic recovery and stock-building gathered momentum. For the year as a whole, however, the income elasticity of imports worked out at 1.4, compared with 1.6 in 1966, a roughly comparable year of recovery.

Notwithstanding a rise in tourism and government transfer payments, the deficit on invisibles was only slightly larger in 1972 than in 1971 because of growing receipts from investment income. On balance, therefore, the current account yielded a larger surplus than in the previous year: $6.7 milliard compared with $5.8 milliard.

The surplus on the basic balance, however, was less than half that for 1971. In fact the net long-term capital outflow amounted to $4.5 milliard in 1972, four times the figure for the previous year. In line with official policy intentions, Japanese participation in the financing of international loans was increased and residents stepped up their purchases of foreign securities. At the same time, tight exchange controls led to smaller inflows.

Short-term capital inflows (including errors and omissions) amounted to a considerable $2.5 milliard in spite of the fact that measures to restrict prepayments for Japanese exports — a principal source of such inflows — were reimposed at the end of February, after having been lifted at the beginning of the year.

A broadly-based programme designed to reduce the trade surplus was approved by Parliament in November 1972. Measures were taken both to promote imports (mainly tariff cuts, enlargement of quotas for restricted imports and easier payment facilities) and to restrain exports (inter alia, quantitative limitations on some key products and a tightening of export-credit conditions). These measures, the continuing rapid expansion of home demand and large-scale purchases of primary products help to explain the contraction in the trade surplus during the first quarter of 1973. It fell to $1.1 milliard from $1.7 milliard a year earlier. With a deficit of $0.5 milliard on invisibles, the current account showed net receipts of $0.6 milliard. The narrowing of the current-account surplus was accompanied by a sharp swing of the capital account into deficit as a result of tight exchange controls on inflows and the liberalisation of outflows: net outpayments on long-term transactions amounted to $2.2 milliard, while short-term receipts came to $0.7 milliard, leaving a deficit for the quarter of $1.5 milliard, compared with near balance a year earlier. The overall balance thus showed a deficit of nearly $1 milliard, against a surplus of roughly the same amount in the first quarter of 1972. In April there was a further overall deficit amounting to nearly $1.2 milliard, which was mainly attributable to the unwinding of previous leads and lags and substantial long-term capital outpayments.

United Kingdom. The overall balance last year recorded a deficit of £720 million, a swing of £2,465 million over the year. The deterioration concerned both the current and the capital accounts; the £1,045 million current surplus recorded in 1971 faded away, while the net inflows of £575 million on capital account in 1971 gave way to a net outflow of £880 million last year.

United Kingdom: Balance of payments.[1]

Items	1971	1972	1971[2] 1st half	1971[2] 2nd half	1972[2] 1st half	1972[2] 2nd half	1973[2] 1st quarter
	in millions of pounds sterling						
Merchandise trade (f.o.b.)							
Exports	8,795	9,135	4,255	4,540	4,490	4,645	2,630
Imports[3]	8,480	9,830	4,200	4,280	4,665	5,165	2,995
Trade balance	+ 315	— 695	+ 55	+ 260	— 175	— 520	— 365
Services and transfers	+ 730	+ 730	+ 370	+ 360	+ 350	+ 380	+ 175
Current balance	+ 1,045	+ 35	+ 425	+ 620	+ 175	— 140	— 190
Current balance unadjusted	+ 1,045	+ 35	+ 415	+ 630	+ 135	— 100	— 345
Capital movements							
Official long-term capital	— 270	— 250	— 90	— 180	— 80	— 170	— 55
Foreign investment in the United Kingdom	+ 1,180	+ 755	+ 740	+ 440	+ 345	+ 410	+ 355
UK private investment abroad	— 855	— 1,350	— 450	— 405	— 645	— 705	— 365
Net foreign currency borrowing by UK banks to finance UK investment abroad	+ 275	+ 715	+ 165	+ 110	+ 350	+ 365	+ 145
Trade credit	— 260	— 80	— 175	— 85	— 40	— 40	— 65
Other non-bank short-term capital	+ 110	— 60	+ 110	—	+ 10	— 70	— 20
Total	+ 180	— 270	+ 300	— 120	— 60	— 210	— 5
Balancing item	+ 395	— 610	+ 265	+ 130	— 370	— 240	+ 265[4]
SDR allocations	+ 125	+ 125	+ 125	—	+ 125	—	—
Overall balance	+ 1,745	— 720	+ 1,105	+ 640	— 170	— 550	— 85

[1] On a transactions basis. [2] Data in respect of the current balance are seasonally adjusted. [3] Including progress payments for US military aircraft and missiles. [4] Includes debit item of £38 million representing payment of guarantees on sterling balances.

It was to be expected that after the exceptionally good results of 1971, which had been due to both domestic economic slack and better terms of trade, there would be a reversal in the current balance. In the event, the balance worsened quite sharply, although the economy was still operating below capacity. The deterioration, which affected visible trade most, began early in the year. Despite a further small gain in the terms of trade, after a 9 per cent. improvement since 1969, the visible balance in the first half of 1972 showed a deficit of £175 million, compared with a surplus of £260 million in the second half of 1971. The volume of exports fell at an annual rate of 4 per cent., while that of imports rose by 17 per cent. Although gross national product did not show a clearly upward trend until the second half of the year, consumer expenditure expanded sharply from the beginning of the year onwards. On the other hand, there was a rapid run-down in stocks, which have a high import content. Strikes at home and poor demand from primary producing countries — partly because of import restrictions — no doubt contributed to the deterioration in the visible balance. Most of the swing seems, however, to have been due to the delayed response of trade volumes to the worsening of the United Kingdom's competitive position.

Net receipts on invisibles were still more than sufficient to offset the trade deficit during the first six months of the year, so that the current account yielded a surplus of £175 million.

Confidence in the pound had been shaken, however, by the weaker trade returns and an intensification of wage and price pressures. It was also evident that the authorities intended to hold to an expansionary domestic policy. Hence, it is not surprising that the worsening of the current account was accompanied by substantial capital outflows. In the first quarter there was still a net capital inflow of £70 million (including the balancing item), though this was quite a change from the £495 million inflow recorded over the same period of the preceding year. The capital account passed into deficit in the second quarter, showing a shortfall of £495 million compared with a surplus of £70 million in the corresponding period of 1971.

These developments were essentially the result of two factors; on the one hand, foreign investment in the United Kingdom in both the public and private sectors fell from £740 million in the first half of 1971 to £345 million in the first half of 1972 and, on the other hand, the balancing item recorded a sharp reversal from a surplus of £265 million to a deficit of £370 million between the same periods. UK overseas investment rose steeply but the rise was almost matched by the growth in net foreign currency borrowing to finance this investment, so that the net deficit of £295 million resulting from these two items in the first half of 1972 was only £10 million higher than that recorded in the first half of 1971.

In the second half of 1972 the current-account balance showed a deficit of £140 million — a £315 million swing from the position in the first half of the year. Merchandise exports were stagnant in terms of volume so that the small overall gain stemmed only from a rise in unit values. This was an unfavourable result at a time when world trade was expanding very rapidly. The two-and-a-half week dock strike in July and August may have caused some loss in exports and the domestic recovery may also have absorbed some potential exports. Imports went on expanding strongly at an annual rate of about 20 per cent. in value terms, half of this being due to greater volume and the rest to the depreciation of sterling and to rising commodity prices.

For the first time since 1966 the surplus on invisible trade did not increase; for the year as a whole it amounted to £730 million, the same as in 1971. The deficit on government account widened, reflecting partly the higher sterling costs of military expenditure abroad. The net surplus on interest, profits and dividends fell from £465 to 435 million: the earnings of foreign companies in the United Kingdom rose, while UK oil companies operating abroad experienced a drop in earnings offset in part by a gain in the sterling earnings of other kinds of companies. There were also increases in net income on official reserves as a result of higher interest rates abroad, and in earnings from financial services and civil aviation. On the other hand, the deficit arising from tanker services grew larger and the surplus on travel account fell after several consecutive years of increase.

Following the floating of sterling the very high level of interest rates in the United Kingdom attracted a large volume of foreign funds in the form of both direct and portfolio investment. The capital account as a whole, however, continued to deteriorate in the second half of 1972 in relation to the corresponding period of 1971, so that a surplus of £10 million was replaced by a deficit of £450 million. The swing was mainly due to changes in the balancing item, which again showed a deficit, as in the first half of 1972, going over from receipts of £130 million in July–December 1971 to payments of £240 million in the same period of 1972. It recorded a temporary surplus in the third quarter, when leads and lags were favourably affected by the dock strike, and possibly also because of an unwinding of speculative positions. However, it reverted to a substantial deficit (£435 million) in the fourth quarter, by which time the dollar was showing relative strength. The deficit arising from the difference between outflows for purposes of UK private investment abroad and inflows resulting from net foreign currency borrowing increased by £45 million over the corresponding period of 1971 to reach £340 million. Total UK private investment abroad, swollen by the decision to join the EEC, came to £1,350 million for the year as a whole, nearly £500 million more than in 1971.

The deficit on visible trade grew further in the first quarter of 1973, but the increase was more than accounted for by a sharp adverse swing in the terms of trade. Import prices were some 10 per cent. higher than the average for the two preceding quarters, and import volume was up by 6 per cent. In contrast, export prices rose by only 3 per cent. and there was an encouraging increase of 11 per cent. in export volume. The seasonally adjusted current deficit, at £190 million, was some £120 million larger than the quarterly average recorded in July–December 1972. Identified capital movements were in approximate balance: one significant feature was an upsurge of foreign investment in the UK oil sector, associated with the exploitation of North Sea oil and gas resources. Finally there was a very large positive balancing item so that the overall deficit contracted to £85 million.

Germany. The development of Germany's trade balance last year was another factor tending to raise doubts about the viability of the Smithsonian realignment. For the year as a whole the trade surplus came to DM 26.4 milliard — DM 3.8 milliard higher than that recorded in 1971. Moreover, the improvement gained momentum in the course of the year: the surplus in the fourth quarter, in particular, reached a record DM 9 milliard. It was generally recognised, of course, that after revaluation the trade surplus might temporarily increase before volumes of exports and imports could adjust to the new relative prices. But it was precisely this adjustment that did not seem to materialise as the year progressed.

The year-on-year improvement in the terms of trade came to 3 per cent., or about half the effective revaluation of the Deutsche Mark during this period. Import prices fell by 2 per cent., while export prices rose by 1 per cent. Imports expanded in value by 7 per cent. and in volume by 9½ per cent. This was less than had been anticipated on the assumption that the German economy would undergo a strong domestic upturn. In the event, real domestic demand growth slowed down somewhat during most of 1972, so that the elasticity of imports remained the same as in 1971. The argument of a delayed adjustment of volumes is, however, confuted by the fact that the expansion of import volume dropped off between the first and second halves of the year — from 10½ per cent. to 8 per cent. With regard to exports, despite the revaluation Germany was able to maintain its market share in volume terms. Special factors had caused some exports to be shifted over from late 1971, but this does not go far towards explaining last year's strong performance. The year-on-year growth rate of exports was 9½ per cent. in value terms and 8½ per cent. in terms of volume, compared with 8½ and 6½ per cent. respectively in 1971. Moreover, contrary to the development of imports, export volume accelerated to record an expansion of 11 per cent. in the second half of the year, against a rise of only 6 per cent. in the first half. Furthermore, foreign orders placed with German firms were 35 per cent. higher in the fourth quarter of 1972 than in the corresponding period of the previous year.

While the growth in exports and imports was broadly based, the increase in the surplus was concentrated on trade with a small number of countries: the United States (+DM 1.9 milliard), the United Kingdom (+DM 1.5 milliard), Austria (+DM 0.9 milliard), Switzerland (+DM 0.6 milliard) and the socialist bloc (+DM 1.1 milliard). On the other hand, there was a larger deficit vis-à-vis EEC member countries (—DM 1.9 milliard).

The gains on trade account were again largely offset by an increased deficit on invisibles account. Service transactions resulted in net outpayments of DM 11.8 milliard, or DM 1.1 milliard more than in 1971. The change was due, for the most part, to the swelling deficit on foreign travel, which rose by DM 1.6 milliard to reach DM 8.6 milliard and was only partially compensated by (i) a changeover on investment income account from a small deficit to a small surplus owing to higher interest income on official reserves, and (ii) an increase of DM 0.3 milliard in revenues from foreign military agencies. The deficit on transfers account expanded sharply, by DM 2.4 milliard,

Germany: Balance of payments.[1]

Items	1971	1972					1973
		Year	1st quarter	2nd quarter	3rd quarter	4th quarter	1st quarter
	in millions of Deutsche Mark						
Merchandise trade (f.o.b.)							
Exports	136,680	149,490	35,255	36,440	35,460	42,335	41,690
Imports	114,020	123,075	29,195	31,325	29,210	33,345	34,405
Trade balance	+22,660	+26,415	+ 6,060	+ 5,115	+ 6,250	+ 8,990	+ 7,285
Services and transfers	−21,525	−25,090	− 6,210	− 5,500	− 7,820	− 5,560	− 6,570
Current balance	+ 1,135	+ 1,325	− 150	− 385	− 1,570	+ 3,430	+ 715
Long-term capital	+ 6,215	+12,835	+ 4,800	+ 5,950	+ 2,520	− 435	+ 385
Basic balance	+ 7,350	+14,160	+ 4,650	+ 5,565	+ 950	+ 2,995	+ 1,100
Short-term capital	− 345	− 5,430	− 400	− 1,565	+ 2,800	− 6,265	+ 405
Errors and omissions	+ 7,860	+ 7,205	+ 5,980	+ 3,695	− 480	− 1,990	+12,790
SDR allocations	+ 625	+ 620	+ 620	—	—	—	—
Overall balance	+15,490	+16,555	+10,850	+ 7,695	+ 3,270	− 5,260	+14,295

[1] On a transactions basis.

to reach DM 13.3 milliard. This was primarily due, on the one hand, to a DM 1 milliard increase in payments to the European Agricultural Guidance and Guarantee Fund, and, on the other, to a DM 0.9 milliard rise in remittances by foreign workers. The current-account surplus in 1972 therefore came to DM 1.3 milliard, or only DM 0.2 milliard more than in 1971.

At DM 14.5 milliard, the surplus on private long-term capital transactions was DM 5.6 milliard more than in 1971 and constituted the largest such inflow ever recorded in Germany. The bulk of the inflow took place in two phases during the first half of the year. The first of these was in March, when, in circumvention of the Bardepot (activated on 1st March) and minimum reserve requirements on foreign liabilities, specially-tailored paper was sold to foreigners. The second came in June when the pound sterling was floated. To counter new inflows at the end of June the authorities made the acquisition of domestic bonds by non-residents from residents subject to authorisation. This measure was highly effective: whereas non-residents purchased German bonds totalling DM 6.5 milliard in the first seven months of the year, in the remaining five months there were net sales amounting to DM 0.8 milliard. In the course of 1972 the increase in the margin between yields on domestic and international DM-denominated bonds was largely responsible for the reversal of the balance on net German investment abroad. Profit-taking on German-held foreign DM bonds accounted for DM 4.2 milliard of the total DM 5.3 milliard swing. The basic balance closed with a surplus of DM 14.2 milliard, or about double that recorded in 1971.

Domestic short-term interest rates were declining early in 1972, but so also were international rates. The effective differential in favour of domestic rates disappeared only with the introduction of the Bardepot, but re-emerged at the beginning of the third quarter, so that the cash-deposit requirements had to be tightened from 1st July onwards. In the fourth quarter the interest rate differential in fact became negative, and remained so until early February 1973. In all, recorded short-term capital movements in 1972 showed a net outflow of DM 5.4 milliard, or DM 5.1 milliard more than in 1971. The bulk of the outflow took place in the fourth quarter, when enterprises reacted to the higher cost of foreign borrowing by substantially increasing their repayments to foreigners. The balancing item continued to yield a substantial net surplus of DM 7.2 milliard, all the inflows being concentrated in the first half of the year.

The situation changed dramatically in February and early March 1973 when the flight from the dollar had a counterpart largely in a rush into the Deutsche Mark. Unidentified movements of funds swung over from a deficit of DM 2 milliard in the fourth quarter of 1972 to a surplus of DM 12.8 milliard in the first quarter of this year, thus accounting for nine-tenths of the overall surplus. The rest came from identified capital transactions and from current operations. The trade account yielded a surplus of DM 7.3 milliard, DM 1.2 milliard more than in the corresponding period a year earlier, with both exports and imports showing gains of about 18 per cent. The deficit on invisibles reached DM 6.6 milliard, DM 0.4 milliard more than a year before, so that the current balance shifted from a small deficit into a DM 0.7 milliard surplus.

France. The French current-account surplus closed last year at Fr.fr. 1.4 milliard, only about half that recorded in 1971, because of a further deterioration on invisibles which, however, was largely due to special factors. Net long-term capital flows moved from approximate balance into a substantial deficit of Fr.fr. 3.6 milliard. Furthermore, the inflow of short-term funds shrank, so that the overall surplus fell from Fr.fr. 11.2 to 2.1 milliard.

Merchandise exports continued to expand rapidly, rising in value terms by 15½ per cent., with only a 1½ per cent. increase in unit values. In the second half of the year, however, the volume rise decelerated and the price influence increased. Agricultural exports rose particularly fast, by 20½ per cent. in value and 13½ per cent. in volume, but other groups also showed good increasess. In line with the buoyant trend of economic activity and also as a result of some narrowing of the margins of spare capacity, imports went up in 1972 by 16 per cent., compared with 10 per cent. in 1971, the acceleration in volume terms being even more pronounced — 13½ per cent. against 7½ per cent.

On services account the net surplus, amounting to Fr.fr. 2.4 milliard, was lower than in 1971. Shipping showed only a slight improvement in spite of the normalisation of Franco-Algerian relations and the consequent use of shorter routes by tankers. On the other hand, net income from capital fell by one-half to Fr.fr. 0.9 milliard, chiefly as a result of the increase in the net foreign liabilities of French banks during the last two years. Despite a rise in net receipts from the European Agricultural

France: Balance of payments.[1]

Items	1970	1971	1972 Year	1972 1st quarter	1972 2nd quarter	1972 3rd quarter	1972 4th quarter
	in millions of French francs						
Merchandise trade (f.o.b.)							
Exports	100,075	114,465	132,075	30,875	34,280	29,490	37,430
Imports	98,255	108,325	125,510	31,070	31,790	27,955	34,695
Trade balance	+ 1,820	+ 6,140	+ 6,565	− 195	+ 2,490	+ 1,535	+ 2,735
Services and transfers							
Services	+ 3,005	+ 3,685	+ 2,400	+ 305	+ 1,295	+ 480	+ 320
Transfers	− 4,440	− 6,910	− 7,585	− 1,725	− 1,455	− 2,030	− 2,375
Total	− 1,435	− 3,225	− 5,185	− 1,420	− 160	− 1,550	− 2,055
Current balance	+ 385	+ 2,915	+ 1,380	− 1,615	+ 2,330	− 15	+ 680
Long-term capital							
Official	− 970	− 975	− 240	− 520	− 315	− 185	+ 780
Private	+ 1,540	+ 995	− 3,350	− 625	− 555	+ 205	− 2,375
Total	+ 570	+ 20	− 3,590	− 1,145	− 870	+ 20	− 1,595
Basic balance	+ 955	+ 2,935	− 2,210	− 2,760	+ 1,460	+ 5	− 915
Short-term capital[2]	+ 5,980	+ 7,410	+ 3,415	+ 160	+ 1,250	+ 1,930	+ 75
SDR allocations	+ 920	+ 890	+ 880	+ 880	—	—	—
Overall balance	+ 7,855	+ 11,235	+ 2,085	− 1,720	+ 2,710	+ 1,935	− 840

[1] Vis-à-vis the franc and non-franc area; on a transactions basis. [2] Including errors and omissions.

Guidance and Guarantee Fund, transfer payments showed a sharp deterioration as a result of a further expansion in workers' remittances and increased assistance to developing countries. Government transfers in fact include a large special transaction connected with the writing-off of Fr.fr. 1.1 milliard in respect of debts of certain African countries. This amount was booked in the fourth quarter as a transfer payment, while the settlement of the credit was recorded as a long-term official capital inflow.

The large long-term capital outflows reflected significant changes for all categories of borrowers. In the private sector, receipts from non-residents, at Fr.fr. 8.1 milliard, were marginally higher than in 1971, while outflows on the part of residents reached Fr.fr. 7.6 milliard, an increase over the year of Fr.fr. 0.8 milliard. Portfolio and direct investment abroad expanded sharply, especially in the fourth quarter, whereas commercial credits declined. Banks' long-term operations moved from approximate balance in 1971 to a deficit of Fr.fr. 3.9 milliard as a result of a sharp increase in trade and other long-term credit. Finally, in spite of substantial outflows to the IDA and the IBRD, the public sector's deficit was reduced by Fr.fr. 0.7 milliard to Fr.fr. 0.2 milliard because of the special transaction mentioned above.

Short-term capital movements (including errors and omissions), after heavy inflows in 1971, were more or less in balance during the quarter following the Smithsonian realignment. The crises affecting the pound sterling and the Italian lira in the second quarter resulted in renewed demand for the French franc, and significant inflows continued into the third quarter. With the temporary strengthening of the US dollar in the fourth quarter only a small surplus was realised and the gap between the financial and the official franc disappeared.

Italy. Balance-of-payments developments were dominated last year by large-scale capital outflows. Thus, despite a large current-account surplus and significant net compensatory borrowings by public and semi-public authorities, the overall balance of monetary movements showed a deficit of Lit. 680 milliard, which represented an adverse swing of Lit. 1,235 milliard from the previous year.

Current transactions yielded net receipts amounting to Lit. 845 milliard in 1972, or Lit. 135 milliard less than in the previous year. The deterioration, however, was brought about wholly by two special factors. First, imports of non-monetary gold went up by about 65 per cent., to Lit. 475 milliard, without any correspondingly large expansion in exports of manufactured gold. This sharp rise for the second consecutive year (in the sixties imports had averaged some Lit. 30 milliard) was partly due to the rise in the price of gold, but may also have been influenced by expectations that with the introduction of VAT in 1973 the purchase of gold would also become taxable. Second, the introduction on 27th June of a regulation prohibiting the crediting to non-resident capital accounts with Italian banks of the proceeds of repatriated lira bank-notes resulted in an increase in their discount on exchange markets abroad. The resultant shift of exchange transactions to foreign centres led to net invisible receipts in respect of both tourism and emigrants' remittances in the second half of the year being under-recorded by an estimated Lit. 200 milliard. (Correspondingly, unrecorded capital outflows should be that much higher than those given in published statistics.)

According to customs statistics imports rose by 13½ per cent., compared with 6 per cent. in 1971, while exports recorded a gain of 15½ per cent., or 2 percentage points more than in 1971. The gains in volume terms were only slightly less, since both import and export prices rose by about 1½ per cent. The traditional deficit on food products widened further, by Lit. 240 milliard, to reach Lit. 1,560 milliard. The surplus on non-food products, on the other hand, rose by Lit. 350 milliard, or about one-half. According to some estimates Italy exported about 40 per cent. of its industrial output last year. Whereas domestic industrial output rose by only about 4 per cent., exports of industrial products expanded by some 15 per cent. The import expansion was led by non-food consumer goods, which rose by 23½ per cent., and by food products (18½ per cent.), while imports of investment goods grew by 9 per cent.

Trade transactions on a balance-of-payments basis, including imports of non-monetary gold, showed a balanced account in 1972, compared with a surplus of Lit. 70 milliard in 1971. Customs figures, on the other hand, showed an improvement of Lit. 110 milliard on the previous year. Net receipts from invisible transactions came to Lit. 845 milliard last year, Lit. 65 milliard less than in 1971. However, this outcome too is something of a statistical artifact for reasons already mentioned.

With growing expectations of a devaluation of the lira and easy monetary policy, net capital outflows, including errors and omissions, amounted, according

Italy: Balance of payments.[1]

Items	1970	1971	1972	1971[2] 1st half	1971[2] 2nd half	1972[2] 1st half	1972[2] 2nd half
	in milliards of lire						
Merchandise trade (f.o.b.)							
Exports	8,195	9,275	10,720	4,425	4,850	5,210	5,510
Imports	8,435	9,205	10,720	4,610	4,595	5,055	5,665
Trade balance	− 240	+ 70	—	− 185	+ 255	+ 155	− 155
Services and transfers							
Travel	+ 570	+ 655	+ 655	+ 240	+ 415	+ 380	+ 275
Workers' remittances	+ 615	+ 685	+ 700	+ 330	+ 355	+ 365	+ 335
Other	− 470	− 430	− 510	− 210	− 220	+ 20	− 530
Total	+ 715	+ 910	+ 845	+ 360	+ 550	+ 765	+ 80
Current balance	+ 475	+ 980	+ 845	+ 175	+ 805	+ 920	− 75
Current balance unadjusted	+ 475	+ 980	+ 845	+ 25	+ 955	+ 760	+ 85
Capital movements							
Residents	− 1,450	− 1,360	− 1,905	− 620	− 740	− 870	− 1,035
Non-residents	+ 1,305	+ 940	+ 560	+ 990	− 50	− 90	+ 650
Errors and omissions	− 105	− 70	− 245	− 140	+ 70	− 125	− 120
Total	− 250	− 490	− 1,590	+ 230	− 720	− 1,085	− 505
SDR allocations	+ 65	+ 65	+ 65	+ 65	—	+ 65	—
Overall balance	+ 290	+ 555	− 680	+ 320	+ 235	− 260	− 420

[1] On a transactions basis. [2] Data in the current account are seasonally adjusted.

to published data, to Lit. 1,590 milliard for the year as a whole, or more than three times as much as in the previous year. In fact the underlying deterioration was much sharper; whereas in 1971 there had been a net repayment of some Lit. 140 milliard of compensatory borrowings taken up in previous years by public and semi-public enterprises, in 1972 there was again net borrowing of some Lit. 350 milliard. In addition, allowance must be made for the under-recording of capital outflows in the second half of the year of some Lit. 200 milliard. These two factors had a very strong impact on the time profile of capital outflows during the year. The official figures show that the overall capital outflow dropped from Lit. 1,085 milliard in the first half of the year to Lit. 505 milliard in the second half. However, in the first half net repayments of compensatory borrowings totalled some Lit. 260 milliard, while in the second half the policy was reversed so that new compensatory borrowings brought in some Lit. 610 milliard. Thus, net of compensatory capital transactions, and including unrecorded outflows in the latter part of the year, capital transactions in the first six months showed a deficit of about Lit. 825 milliard, which widened to Lit. 1,315 milliard in the second six months. The main source of the capital outflow in 1972 was an adverse development of leads and lags, which gave rise to net losses of some Lit. 1,050 milliard. There was also a very sharp expansion of Italian portfolio investment abroad.

Net of compensatory capital transactions, the overall balance last year therefore showed an "autonomous" deficit of Lit. 1,030 milliard, compared with a surplus of Lit. 700 milliard in 1971.

With capital outflows surging, the overall balance went deep into deficit early in 1973, prompting the authorities to introduce a two-tier market on 22nd January. When the dollar was devalued it was decided to allow the commercial rate for the lira to float as well, and by end-May the lira had depreciated by nearly 10 per cent. vis-à-vis other currencies. For the first four months of 1973 the overall balance showed a deficit of some Lit. 550 milliard. Two-thirds of this occurred in January, mostly as a result of net capital outpayments — notably residents' heavy buying of foreign securities; the remainder, spread over February–April, was mainly ascribable to a changeover of the current balance into deficit. Imports expanded sharply in volume following a recovery in economic activity and an acceleration in stock-building. In value terms the increase was even more marked because of rising world commodity prices and the depreciation of the lira. Exports, on the other hand, were held back by strikes in the metal-working and engineering sectors.

Belgium-Luxemburg Economic Union. It is sometimes difficult to evaluate the components of the BLEU balance of payments, as it is presented on a partly cash rather than a full transactions basis. Last year, however, the shifts in leads and lags probably did not play a very significant rôle. The trade account showed net receipts of B.fr. 46 milliard, while customs data on an adjusted f.o.b. basis (plus the net surpluses on trade arbitrage transactions abroad and non-monetary gold) recorded a surplus of B.fr. 52 milliard. The corresponding figures for 1971 were B.fr. 41 and 23 milliard respectively. But, while on a transactions basis the trade balance no doubt showed a sharp improvement, the foregoing customs figures may overstate it; exports were probably under-recorded in 1971 because of the imposition of an export tax, which was abolished early in 1972.

Exports rose by 14 per cent. in value and only slightly less in volume, the biggest increases being those in metal, chemical and agricultural products. Imports went up by 9 per cent. in value terms and 10½ per cent. in volume, the latter reflecting a slight acceleration in line with the modest recovery in domestic demand. The terms-of-trade improvement last year came to 2 per cent., offsetting the deterioration recorded in 1971.

The improvement on current account was outweighed by a sharp rise in net capital outflows, which reached B.fr. 30.8 milliard in 1972. Private long-term net outpayments, in particular, more than doubled, to give a deficit of B.fr. 17.4 milliard. This increase was chiefly accounted for by larger purchases of foreign securities by residents, principally prompted by yield considerations. In addition, foreign direct investment inflows declined by B.fr. 4.5 milliard. The Belgian Treasury continued to reduce its short-term indebtedness in foreign currencies and gold.

The B.fr. 22.5 milliard overall surplus last year was therefore B.fr. 6.4 milliard less than in 1971.

In the first quarter of 1973 the overall balance recorded a surplus of B.fr. 5.3 milliard. There was a sharp increase in net identified capital outpayments and a deterioration in merchandise transactions on a customs basis; net receipts were thus largely attributable to inflows resulting from leads and lags.

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

Items	1971	1972					1973
		Year	1st quarter	2nd quarter	3rd quarter	4th quarter	1st quarter
	in milliards of Belgian francs						
Merchandise trade[2]							
Exports	528.1	586.5	139.5	141.1	143.4	162.5	167.0
Imports	486.7	540.4	128.2	130.3	133.0	148.9	154.5
Trade balance	+ 41.4	+ 46.1	+ 11.3	+ 10.8	+ 10.4	+ 13.6	+ 12.5
Services and transfers	+ 0.1	+ 3.7	+ 1.2	− 1.2	+ 0.1	+ 3.6	+ 2.5
Current balance	+ 41.5	+ 49.8	+ 12.5	+ 9.6	+ 10.5	+ 17.2	+ 15.0
Net capital movements[3]	− 16.1	− 30.8	− 16.8	− 2.9	− 0.6	− 10.5	− 9.7
SDR allocations	+ 3.5	+ 3.5	+ 3.5	—	—	—	—
Overall balance	+ 28.9	+ 22.5	− 0.8	+ 6.7	+ 9.9	+ 6.7	+ 5.3

[1] On a partly cash basis. [2] Exports and imports are partly c.i.f. [3] Including errors and omissions.

Netherlands. The slackening of domestic demand, coupled with higher foreign demand and a 2 per cent. improvement in the terms of trade, last year brought about a Fl. 4.3 milliard turn-round in the current account, which moved from deficit into substantial surplus. This movement was, however, largely offset by a broadly equivalent swing in long-term capital transactions, so that the overall balance closed with a surplus of Fl. 2.5 milliard, about the same as the year before.

Despite the revaluation of the guilder, exports expanded at a fairly high rate, though both the 12½ per cent. increase in value and the 11 per cent. growth in volume were less than those recorded in 1971. Imports rose by 6 per cent. in volume but by only 4½ per cent. in value, since average prices fell. Imports of consumer goods showed a growth of 10 per cent., well below average, while those of investment goods fell by 13 per cent. The trade balance therefore closed with a surplus of Fl. 1.2 milliard, against a deficit of Fl. 2.4 milliard in 1971.

The surplus on invisible transactions also improved, increasing by Fl. 0.6 to 2.2 milliard. Half of the change came from larger receipts from transportation and merchandise insurance. Net investment income also went up sharply, and there was a contraction in the tourism deficit. After two years of deficit the current balance therefore recorded a sizable surplus of Fl. 3.4 milliard.

Three-fifths of the overall Fl. 3.9 milliard swing from net receipts to net out-payments in the long-term capital account stemmed from security transactions. The introduction of the "closed bond circuit" led to a drying-up of net sales abroad of Dutch bonds in stock-exchange dealings, whereas in 1971 these had given rise to an inflow of Fl. 1.2 milliard. This was only partly offset by an expansion in non-residents' acquisitions of Dutch shares. Residents too, however, sharply increased their purchases of foreign (mainly US) securities. Direct investment showed a net deficit of Fl. 0.2 milliard, against a surplus of Fl. 0.5 milliard in 1971. Dutch investment abroad grew sharply, while there was a small contraction in foreign inflows. Long-term credits also shifted into deficit, with a Fl. 0.4 milliard swing from 1971. A further Fl. 0.2 milliard deterioration took place on government transactions.

Total short-term capital transactions, mainly unrecorded movements related to leads and lags, continued to show a sizable surplus, only slightly down from 1971, in spite of relatively low domestic short-term interest rates.

Netherlands: Balance of payments.[1]

Items	1970	1971	1972	1971		1972	
				1st half	2nd half	1st half	2nd half
	in millions of guilders						
Merchandise trade (f.o.b.)							
Exports	39,625	44,455	50,115	21,765	22,690	24,305	25,810
Imports	42,850	46,895	48,920	23,470	23,425	24,160	24,760
Trade balance	− 3,225	− 2,440	+ 1,195	− 1,705	− 735	+ 145	+ 1,050
Services and transfers	+ 1,345	+ 1,570	+ 2,205	+ 370	+ 1,200	+ 720	+ 1,485
Current balance	− 1,880	− 870	+ 3,400	− 1,335	+ 465	+ 865	+ 2,535
Long-term capital	+ 1,895	+ 1,315	− 2,580	+ 870	+ 445	− 765	− 1,815
Basic balance	+ 15	+ 445	+ 820	− 465	+ 910	+ 100	+ 720
Short-term capital[2]	+ 1,555	+ 1,575	+ 1,390	+ 1,650	− 75	+ 900	+ 490
SDR allocations	+ 315	+ 270	+ 270	+ 270	—	+ 270	—
	+ 1,885	+ 2,290	+ 2,480	+ 1,455	+ 835	+ 1,270	+ 1,210

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

Switzerland. Both the current and the capital accounts were broadly in balance last year, the overall surplus being only $135 million. In 1971, in contrast, total monetary inflows, stemming almost entirely from capital movements, had been nearly $2.7 milliard. (The two years' data are not strictly comparable owing to changes in the statistical treatment of the banks' trustee account funds.)

The trade deficit widened last year, despite an improvement of almost 3½ per cent. in the terms of trade resulting largely from the Smithsonian realignment. The growth of imports in value terms accelerated from 6½ to 9 per cent., with about four-fifths of the increase in both 1971 and 1972 being in volume. The rise in exports reached 11 per cent. in value terms, of which more than half was the result of higher prices. Imports of consumer goods recorded the strongest rise, about 15 per cent., reflecting the buoyancy of domestic consumer demand. The largest increase on the exports side was in the category raw materials and semi-finished goods, which rose by some 17½ per cent.

The $85 million current-account surplus was about the same as in 1971, since the $155 million deterioration in visible trade was virtually offset by an improvement on invisibles account. The surpluses on investment income and from tourism increased substantially, while there was a certain rise in net transfer payments, mainly reflecting an increase in foreign workers' remittances resulting from higher wages.

Capital flows were strongly affected by measures taken by the authorities to promote capital exports and prevent inflows. Recorded capital outflows rose from $1.2 milliard in 1971 to over $2 milliard in 1972 owing to the rise in placements abroad by investment trusts and in net acquisitions of foreign bonds. Unidentified net capital inflows are therefore estimated to have been about $2.1 milliard last year.

Austria. With domestic expansion continuing at a rapid rate, the current-account deficit rose last year by $80 million to $170 million. The trade deficit widened further, but was largely offset by the growing surplus on invisibles. In the case of Austria a large part of net unidentified inflows is believed to stem from current, rather than capital, transactions. Official estimates suggest that, if adjustments are made to take account of such inflows, the current account would have been in near-balance both in 1971 and in 1972.

The value of merchandise imports rose by 15 per cent., or slightly more than in 1971. The gain of 16 per cent. in volume terms was, however, twice as high as in the previous year, since average import values fell by 1 per cent., after rising by 4½ per cent. in 1971. Reflecting the economy's broadly-based growth in demand, imports of consumer and investment goods increased roughly at the same rate.

The export rise of 13½ per cent. was also due entirely to volume changes. For the second year running Austrian exporters managed to keep their prices stable, or even to reduce them, in terms of domestic currency. The export expansion was concentrated in the second half of the year, when it showed a tendency to accelerate. This was due partly to the economic upswing experienced by some of Austria's main trading partners, notably Germany, and partly to the effects of the reciprocal tariff cuts vis-à-vis EEC countries introduced in October following the conclusion of an interim agreement — which also contributed to the increase in the rate of growth of imports.

As in 1971, gross receipts from tourism expanded at a rate of 22 per cent. Since there was an acceleration in expenditure, however, the surplus rose by 18 per cent., against 25 per cent. in 1971. The net balance on tourism account, equivalent to $1,130 million, comprised almost all of the invisibles surplus, which in terms of dollars again recorded a considerable increase.

On capital account the most significant development was the turn-round on long-term transactions from net outpayments of $20 million in 1971 to net receipts of $85 million last year, owing both to a large increase in new borrowing abroad by the private sector and to large-scale purchases of Austrian securities by non-residents. With some unidentified inflows attributable to short-term capital and the SDR

Other European countries: Balances of payments.[1]

Countries	Years	Trade balance (f.o.b.)	Services and transfers	Current balance	Net capital movements[2]	SDR allocations	Overall balance
		in millions of US dollars					
Austria	1971	— 1,075[3]	+ 985	— 90	+ 150	+ 20	+ 80
	1972	— 1,380[3]	+ 1,210	— 170	+ 290	+ 30	+ 150
Denmark	1971	— 685	+ 255	— 430	+ 565	+ 30	+ 165
	1972	— 420	+ 315	— 105	+ 280	+ 30	+ 205
Finland	1971	— 460[3]	+ 120	— 340	+ 525	+ 20	+ 205
	1972	— 275[3]	+ 125	— 150	+ 335	+ 20	+ 205
Greece	1971	— 1,320[3]	+ 980	— 340	+ 525	+ 15	+ 200
	1972	— 1,605[3]	+ 1,200	— 405	+ 910	+ 15	+ 520
Iceland	1971	— 50	+ 5	— 45	+ 55	+ 5	+ 15
	1972	— 25	+ 5	— 20	+ 20	+ 5	+ 5
Ireland	1971	— 385	+ 180	— 205	(+ 530)	+ 15	(+ 340)[4]
	1972	— 330	+ 160	— 170	+ 175	+ 15	+ 20
Norway	1971	— 1,555[3]	+ 1,045	— 510	+ 655	+ 25	+ 170
	1972	— 1,130[3]	+ 1,010	— 120	+ 260	+ 30	+ 170
Portugal[5]	1971	— 600	+ 805	+ 205	+ 155	—	+ 360
	1972	— 595	+ 1,080	+ 485	— 100	—	+ 385
Spain	1971	— 1,600	+ 2,455	+ 855	+ 430	+ 40	+ 1,325
	1972	— 2,365	+ 3,020	+ 655	+ 980	+ 40	+ 1,675
Sweden	1971	+ 395[3]	— 205	+ 190	+ 45	+ 35	+ 270
	1972	+ 660[3]	— 405	+ 255	+ 320	+ 35	+ 610
Switzerland	1971	— 1,465[3]	+ 1,545	+ 80	(+ 2,590)	—	(+ 2,670)[6]
	1972	— 1,620[3]	+ 1,705	+ 85	+ 50	—	+ 135[6]
Turkey	1971	— 495[3]	+ 385	— 110	+ 495	+ 15	+ 400[8]
	1972	— 680[3]	+ 630[7]	— 50[7]	+ 175[7]	+ 20	+ 145[8]
Yugoslavia[9]	1971	— 1,315[3]	+ 840	— 475	+ 425	+ 20	— 30[8]
	1972	— 1,035[3]	+ 1,140	+ 105	+ 440	+ 20	+ 565[8]

[1] On a transactions basis. [2] Including errors and omissions. [3] Imports c.i.f. [4] Changes in commercial banks' net external position from May to December only, owing to banking dispute. [5] Metropolitan Portugal vis-à-vis the rest of the world. [6] Owing to major changes in coverage for Swiss commercial banks' net external position (inclusion of trustee accounts), data for 1971 and 1972 are not comparable with each other. [7] Estimated. [8] Equals change in net official assets only. [9] Data on a cash basis.

allocation, the overall balance yielded a surplus of $150 million, compared with $80 million in 1971.

Spain. In spite of the strong cyclical upswing last year, Spain's current-account surplus, at $655 million, was only slightly less than in 1971. Imports did in fact go up by more than 30 per cent. in value terms, against 5 per cent. in 1971, but exports also continued to rise, at a rate of about 25 per cent. Thus, compared with 1971, when imports already exceeded exports by $1,600 million, the trade deficit rose by $765 million last year. This deterioration was, however, largely offset by the $565 million improvement on invisibles, ascribable mainly to the good results on tourism account and also to an increase in workers' remittances.

The most dynamic sector of trade was again non-agricultural products, and in particular transport equipment; imports of such equipment approximately doubled, while exports increased by about 40 per cent.

Net long-term capital inflows in 1972 increased to a total of $755 million, of which nearly 85 per cent. was accounted for by direct and real-estate investment. Short-term capital transactions yielded another $225 million. Thus the overall surplus came to $1,675 million, against $1,325 million in 1971 and $860 million in 1970. Just how strong Spain's external position has been in recent years is seen by comparing these figures with those for the period 1965–69, when there was an average yearly deficit of $130 million.

Denmark. Last year a significant improvement on current account more than offset a sharp reduction in net capital receipts, so that the overall balance closed with a surplus of $205 million, $40 million higher than in 1971.

In line with the economic upswing experienced by several key trading partners, exports rose by 13 per cent. in value; three-fifths of the rise represented an increase in volume, since export prices went up by 5 per cent. The export expansion was broadly based, affecting both agricultural and industrial products. Imports rose by 4 per cent. both in value and in volume terms. Hence a large part of the improvement in the trade balance can be attributed to the 5 per cent. improvement in the terms of trade. The growth of imports was uneven in 1972; during the first half imports were actually lower than during the corresponding period of the previous year because of slack domestic demand and the import surcharge introduced in October 1971. They recovered strongly in the second half of the year in response to the quickening of economic activity and the reduction in the import surcharge.

As to invisibles, net receipts from shipping and tourism continued to expand at a rapid pace and the increase was only partially offset by a rise in interest payments on foreign debt and in aid to developing countries.

Although domestic interest rates remained comparatively high throughout the year, private capital movements fluctuated sharply, reflecting shifts of confidence in the krone arising from uncertainties about Denmark's future relations with the EEC. Net inflows in the first quarter were followed by outflows during the summer, but there was a reversion to net receipts in the autumn after the confirmation of entry into the EEC. For the year as a whole, however, total net private capital imports (including errors and omissions) amounted to \$75 million, or \$200 million less than in 1971. The overall drop in capital inflows was further accentuated by a \$80 million decline in public borrowing abroad after a long period of increase, as the authorities turned from foreign to domestic sources of finance.

Norway. While the growth of domestic demand, which had been very strong in 1971, weakened considerably last year, foreign demand for Norwegian products picked up sharply. As a result the visible trade deficit contracted by \$425 million to stand at \$1,130 million.

This improvement was principally due to the development of trade in ships: exports of vessels nearly doubled, after a fall in 1971, while imports fell by 8 per cent. in contrast to the rise of 27 per cent. in 1971. In dollar terms net ship exports produced a surplus of \$10 million, against net imports of \$270 million in 1971. Other merchandise exports also did well; there was an overall increase of about 12 per cent. in value and 13 per cent. in volume. The expansion affected a wide range of goods, with the largest gain being shown by machinery and transport equipment (18 per cent.). Imports were virtually unchanged in terms of both value and volume, a fall in those of raw materials being offset by a rise in other major product groups, especially manufactured goods. The balance of trade (including ships) by areas shows very large gains vis-à-vis the United States and the United Kingdom; imports from both countries fell, while exports rose by 30 and over 20 per cent. respectively.

The surplus on services and transfers amounted to about \$1,000 million, approximately the same as in 1971. Transfers and services other than shipping performed less well but the deterioration was practically made good by an improvement on the shipping account, with net receipts of \$1,140 million last year.

With long-term interest rates relatively low and stable at home, the incentive to borrow abroad diminished as the year progressed. The demand for funds was also smaller owing to reduced imports of ships. As a result, net long-term capital inflows totalled \$300 million, or \$50 million less than in 1971.

The basic balance showed a \$340 million swing from deficit into surplus. The overall balance, however, did not change, recording net receipts of \$170 million for the second year in succession. The net short-term capital inflows of 1971, which had been mainly motivated by exchange rate uncertainty, gave way last year to net outflows, essentially because of interest rate considerations.

Sweden. The slow recovery of domestic activity goes far towards explaining the krona's strong external position last year. In particular, the good trade results owe much to the reduction in stocks, which in Sweden have an import content of about 40 per cent. Even so, it appears that the gradual underlying improvement in the external position continued, so that the cyclically-adjusted current balance was more or less in equilibrium. This accorded with the official aim of a trade surplus offset by an invisibles deficit, mainly on tourism account.

The trade surplus last year reached $660 million, compared with $395 million in 1971. The value of exports rose at the same rate as in 1971 (9 per cent.), while that of imports rose by 6 per cent. after remaining static during the previous year. The terms of trade improved by about 1 per cent., with export prices rising by 3½ per cent. and import prices by 2½ per cent. In value terms the export expansion appeared to be broadly based, but the growth in exports of engineering products was wholly the result of price increases while that of pulp, metals and foodstuffs was entirely due to changes in volume. Although the recovery in investment was much stronger than that in private consumption, it was the volume of imports of consumer goods and related raw materials that showed the sharpest rise, while that of investment goods was much lower. Imports of passenger cars rose by about 35 per cent. in value terms.

In spite of a record trade surplus, the current balance closed last year with a surplus only $65 million higher than in 1971. The main counterbalance was a rise in travel outlays of 18 per cent., compared with 12 per cent. the year before. In 1971 there had been a comparable rise in tourist receipts, but in 1972 these rose by only a small amount.

The capital balance, including errors and omissions, showed net receipts of $320 million last year, compared with $45 million in 1971. In the main the difference is explained by two factors: with borrowing conditions relatively easy, Swedish bond issues abroad were increased sharply from about $85 million to $220 million; in addition, a favourable shift in the timing of payments relating to shipping accounted for a $125 million swing. At $610 million, the overall surplus was more than twice as high as that recorded in 1971.

Finland. The overall surplus of $205 million in 1972 was the same size as that recorded in the preceding year. Despite a 5 per cent. deterioration in the terms of trade, the trade balance contributed to a sharp improvement on current account, but this was offset by a reversal in the balance of short-term capital flows.

Merchandise exports rose last year by 22 per cent. in value terms. Since average prices went up by 4 per cent., three-quarters of the gain was in volume. A number of factors contributed to this gain: (i) foreign demand increased steadily; (ii) the markka effectively depreciated by about 5 per cent. between May 1971 and end-1972; and (iii) metal and engineering exports, catching up after being held back by strikes, jumped by 40 per cent. With domestic industrial investment weak and average import prices going up by 10 per cent., imports rose in volume by only 2 per cent. However, imports of consumer goods grew by 26 per cent. in value, those of passenger cars, in particular, rising by 47 per cent. This large increase resulted in part from the abolition at the beginning of 1972 of the 15 per cent. supplementary sales tax on consumer durables introduced in 1971 — which shifted some imports from 1971 to 1972 — and from the cancellation in June of the restrictions on import credits. Imports of investment goods remained stagnant in value terms but fell by 9 per cent. in volume.

The trade deficit recorded last year was therefore $185 million lower than in 1971. The surplus on invisibles was, in contrast, about the same as in the previous year. Growing net receipts on tourism and transport account were offset by an expansion in outpayments on investment income.

Despite the low level of investment activity, the easy conditions prevailing in international capital markets induced substantial long-term foreign borrowing, which brought in $730 million, compared with $655 million a year earlier. Thus, notwithstanding the rise in amortisations and in extensions of long-term export credits, the long-term capital account closed with a surplus of $370 million, about the same as in 1971. Short-term capital, on the other hand, showed a $185 million swing from surplus into deficit. This was mainly due to a shift in export credits and prepayments.

Other European countries.

In *Iceland* net outpayments on current account were approximately halved last year, reaching $20 million. Despite a 2½ per cent. deterioration in the terms of trade the trade deficit contracted sharply, mainly because of a vigorous expansion of exports of aluminium products and fish, but also because of a slowing-down in import growth reflecting essentially a decline in gross fixed-asset formation. Net capital inflows also dropped markedly, from $55 million in 1971 to $20 million last year, as a result of measures to limit foreign suppliers' credits and of a reduction in foreign finance for aluminium smelter plant. The overall surplus of $5 million was therefore mainly due to the SDR allocation.

In *Ireland,* too, almost the whole of last year's surplus of $20 million was attributable to the SDR allocation. The sharp drop in net overall receipts from an estimated $340 million in 1971 was entirely due to a contraction in capital inflows, which fell from some $500 million in 1971 to $175 million last year. On the other hand, the deficit on current account narrowed by $35 million. All of the change was in merchandise trade, helped by an 8½ per cent. improvement in the terms of trade. Exports advanced by 20 per cent. in value, with two-thirds of the gain deriving from a rise in unit values. Industrial exports were the most dynamic, growing by 28½ per cent. Imports rose by 15 per cent., over two-thirds of the expansion representing an increase in volume. Consumer goods showed the sharpest rise (24 per cent.).

Portugal's overall balance of payments vis-à-vis the rest of the world last year recorded net receipts of $385 million, or slightly more than in 1971. Despite a strengthening of domestic demand there was a marginal contraction in the trade deficit, since, as in the case of Ireland, the terms of trade improved by nearly 9 per cent. Exports rose by 17½ per cent. in value and by 4 per cent. in volume, while the corresponding increases for imports were 14½ and 10½ per cent. Thanks to a continuing rise in emigrants' remittances and tourist receipts the surplus on invisibles account amounted to $1,080 million, an increase of $275 million on 1971. The current surplus thus came to $485 million, against $205 million in the preceding year. Largely offsetting this improvement was a deterioration on capital account, which swung into deficit, the inflow in respect of short-term credit transactions having fallen off, while on medium and long-term account there was a $200 million turn-round, mainly due to the sharp increase in the deficit of the public sector vis-à-vis the escudo area.

The further acceleration in *Greece's* economic growth led to a $285 million deterioration in the trade deficit, which reached $1,605 million last year. In absolute terms the rise in imports was much larger than that in exports, though in percentage terms the reverse was the case: imports rose by 20 per cent. while exports showed a gain of nearly 35 per cent. In particular, industrial exports advanced by over 50 per cent., to account for two-fifths of total exports; ten years ago they represented only 6 per cent. of overall export receipts. Receipts from tourism, shipping and remittances from workers abroad continued to expand, so that the surplus on invisibles came to $1,200 million, or $220 million more than in 1971. The continuing strong expansion of the economy gave rise to and was in part helped by substantial capital inflows. Net receipts on long and short-term account were as high as $910 million — nearly twice the amount recorded in the preceding year. The overall balance therefore closed with a surplus of $520 million, compared with one of $200 million in 1971 and a deficit of $10 million in 1970.

In *Turkey* also the continuing economic expansion led to a rise in the trade deficit, which came to $680 million last year. Exports went up by 30 per cent., or at nearly the same rate as imports. Exports of industrial products rose particularly sharply, so that they now account for about one-third of total exports. Imports of industrial products also expanded rapidly, but those of agricultural products contracted. The main feature of the invisibles account was a $260 million rise in workers' remittances, which last year totalled $730 million. The $50 million surplus on tourism was also larger than in the previous year. The improvement in the current balance was more than offset, however, by the decline in net capital inflows (including commercial-bank movements, which are, however, a relatively minor item); these totalled $175 million in 1972, about one-third of the amount for the previous year. The overall surplus therefore came to $145 million, compared with $400 million in 1971.

In *Yugoslavia* the slowing-down of economic expansion last year, together with two devaluations of the dinar in 1971 and selective measures to improve the trade balance, help to explain the turn-round on current account from substantial deficit into surplus. On a cash basis the swing amounted to nearly $600 million. On a transactions basis the improvement appears to have been larger still. Customs statistics show an 18 per cent. rise in exports and a 5 per cent. fall in imports, whereas according to payments figures imports rose. The improvement on trade balance was paralleled by a $300 million rise in the surplus on invisibles, mainly due to an expansion in emigrants' remittances and receipts from tourism, bringing the total to $1,140 million. Net capital inflows amounted to $440 million, or about the same as in 1971: repayment of short-term liabilities was more than offset by substantial net long-term borrowing. The overall balance closed therefore with a $565 million surplus, against a small deficit the year before.

Eastern Europe. The trade balance of the eastern European countries vis-à-vis the rest of the world changed from a surplus of about $1 milliard in 1971 to a deficit of $0.3 milliard last year. On the one hand, the Soviet Union experienced an adverse swing of some $2 milliard as a result of a sharp increase in imports accompanied by only a small advance in exports. On the other hand, the group as a whole apart from the Soviet Union showed a $0.7 milliard movement in the opposite direction,

Eastern Europe: Merchandise trade.

Countries	Exports 1971	Exports 1972	Imports 1971	Imports 1972	Trade balance 1971	Trade balance 1972
	annual changes in values of national currencies, in percentages*				in millions of US dollars	
Bulgaria	8.9	10.1	15.8	11.0	60	55
Czechoslovakia	10.2	12.9	8.5	7.1	170	460
German Democratic Republic	10.8	12.5	2.3	11.5	115	200
Hungary	7.9	21.2	19.3	— 2.9	— 490	140
Poland	9.1	17.2	11.9	21.6	— 165	— 405
Rumania	13.5	13.7	7.3	14.3	—	— 15
USSR	7.9	2.5	6.3	18.5	1,325	— 685
Total	9.1	9.6	8.4	13.7	1,015	— 250

* In the German Democratic Republic, Hungary and Poland in foreign trade accounting units.
Sources: UN Economic Commission for Europe. *Economic Survey of Europe in 1972* and United Nations, *Monthly Bulletin of Statistics.*

with exports generally rising faster than imports. The bulk of this latter shift appears to be attributable to the six countries' trade with the Soviet Union, which apparently moved from approximate balance in 1971 into substantial surplus in 1972. Debt repayments by a number of eastern European countries and their growing participation in raw-material development projects in the Soviet Union apparently played a rôle in this context.

Intra-area trade among the centrally-planned economies — which accounts for the larger part of their trade turnover — appears to have increased rapidly again last year. However, both exports to and imports from industrialised market economies — mainly western Europe, North America and Japan — seem to have grown in some cases even more than intra-area trade. In Poland, the Soviet Union, the German Democratic Republic and Rumania imports from the market economies — primarily machinery and other industrial equipment, but also grain — rose substantially in relation to exports, and trade deficits with those economies increased. In Bulgaria and Czechoslovakia the expansion of exports and imports was more balanced, so that deficits with industrial countries remained approximately at 1971 levels. Hungary, on the other hand, reduced its deficit by a strong increase in exports. In all, the deficit of Comecon members as a group vis-à-vis industrialised market economies rose sharply. In consequence, borrowing on western financial markets or from those countries' export-financing institutions was quite substantial. As to trade with non-industrialised market countries, preliminary data suggest that a large surplus was again recorded and was partially financed by credit-granting.

In the *Soviet Union* the main factor causing the big jump in imports was the purchase abroad of grain and other foodstuffs. Moreover, a sharp rise in industrial investment led to a considerable expansion in imports of advanced machinery and equipment, particularly from market economies. Export performance was hampered partly by the set-backs experienced in the agricultural sector, but also to some extent by the slower growth of industrial output. It also appears that aid to other Comecon countries has been tapering off and that a compensatory flow of merchandise imports has begun.

In the *German Democratic Republic* the more rapid increase in foreign trade was facilitated by the faster growth in overall output. Since domestic demand was purposely held in check, net exports rose considerably and enabled the country to repay debts to other Comecon countries. The situation was similar in *Czechoslovakia,* which had also accumulated intra-area debt in the past. It appears also that imports of consumer goods declined as the domestic supply was improved. In *Hungary,* too, internal demand was restricted — particularly for investment — in order to shift resources to exports. In addition, import control was tightened and a good harvest permitted a reduction in purchases of foodstuffs abroad.

In *Poland* an expansionary policy resulted in a faster rise in domestic demand than in output. Consequently imports of consumer and investment goods rose sharply. At the same time, however, exports expanded considerably, mainly reflecting increased sales of foodstuffs and raw materials. As in the past, part of the large trade deficit was covered by a surplus on services account. In *Rumania* a slow-down in imports of agricultural products appears to have been more than offset by an acceleration in imports of intermediate and consumer goods. Since exports again expanded strongly the trade balance was kept close to equilibrium. In *Bulgaria* imports of foodstuffs were reduced because of good harvests, but imports of machinery continued to rise rapidly. The expansion of exports was largely due to a marked increase in sales of capital goods.

IV. GOLD, RESERVES AND FOREIGN EXCHANGE.

Gold production, markets and reserves.

After having declined by 40 tons in 1971, world gold production (excluding that of the USSR, other eastern European countries, mainland China and North Korea) contracted by a further 70 tons in 1972, to a total of 1,180 tons. At that level it was 10 per cent. below its 1970 peak and scarcely above what it had been ten years previously. Practically the whole of the 1972 decline was accounted for by South Africa, whose production fell by 68 tons. The only other individual changes of any significance were the further drop of 6 tons in Canadian output and the increases of 4 and 3 tons respectively in Australian and Japanese production.

World gold production.

	1929	1940	1946	1953	1968	1969	1970	1971	1972
	in metric tons								
South Africa . . .	323.9	436.9	370.9	371.4	969.5	972.8	999.9	976.6	908.7
Canada	60.0	165.9	88.5	126.1	85.3	79.2	74.9	69.7	63.2
United States . . .	64.0	151.4	48.9	60.9	46.0	53.9	54.2	46.5	44.4
Japan.	10.4	27.0	1.2	8.0	19.1	21.1	22.0	24.0	27.7
Australia	13.3	51.1	25.6	33.4	24.3	21.7	19.4	20.9	24.9
Ghana	6.4	27.6	18.2	22.7	22.6	22.0	21.9	21.7	22.5
Philippines	5.1	34.9	—	14.9	16.4	17.8	18.7	19.9	20.2
Rhodesia	17.4	25.7	16.9	15.6	15.5	14.9	15.6	15.6	15.6
Colombia	4.3	19.7	13.6	13.6	7.5	6.8	6.3	5.9	5.8
Zaire	4.9	17.4	10.3	11.5	5.3	5.5	5.5	5.3	4.7
Mexico	20.4	27.4	13.1	15.0	5.5	5.6	6.2	4.7	4.4
Total listed .	530.1	985.0	607.2	693.1	1,217.0	1,221.3	1,244.6	1,210.8	1,142.1
Other countries . .	40.4	180.0	59.3	61.1	43.3	40.5	42.7	36.8	35.6
Estimated world total*	570.5	1,165.0	666.5	754.2	1,260.3	1,261.8	1,287.3	1,247.6	1,177.7

* Excluding the USSR, eastern Europe, mainland China and North Korea.

The 7 per cent. decline in South Africa's gold production last year was made up of a 2.1 per cent. reduction in the amount of ore milled and a 4.8 per cent. drop in the average gold content of the ore. The shift to the mining of less rich ores was certainly related to the rise in the gold price — the average price received by the South African industry per ounce of gold increased between 1971 and 1972 by 38 per cent. — which naturally reduces the minimum gold content necessary to make the mining of ore profitable. In the case of South Africa the geological structure of the gold deposits affords considerable scope for reducing the gold content of the ores mined as the price of gold rises; and this natural consequence of a rising price is reinforced both by the progressive scale of taxes on mining profits and by the government's policy of trying to ensure that the country's gold deposits are used to the best advantage. South Africa's gold output continued to decline during the first four months of 1973 when, at 285 tons, it was 5.3 per cent. lower than in the corresponding period of 1972.

The effect of the decline in western gold production on the total supplies of new gold appears to have been more than offset by an increase in gold sales from the USSR and other eastern European countries. These may be estimated at 205 tons for the year 1972, as against 90 tons in 1971. Total new supplies of gold last year, therefore, may be put at 1,385 tons, about 3 per cent. higher than the 1971 figure. The amount of gold coming onto western markets, however, was considerably less than in 1971 — 1,290 tons as against 1,425 tons in 1971. This was because South Africa's balance of payments turned from deficit into surplus between the two years, with the result that its market sales of gold went down by nearly one-third, from 1,050 to 715 tons. Market sales of gold by other countries (excluding the USSR and the rest of eastern Europe) appear to have increased by some 85 tons last year, to an estimated total of 370 tons.

Estimated sources and uses of gold.

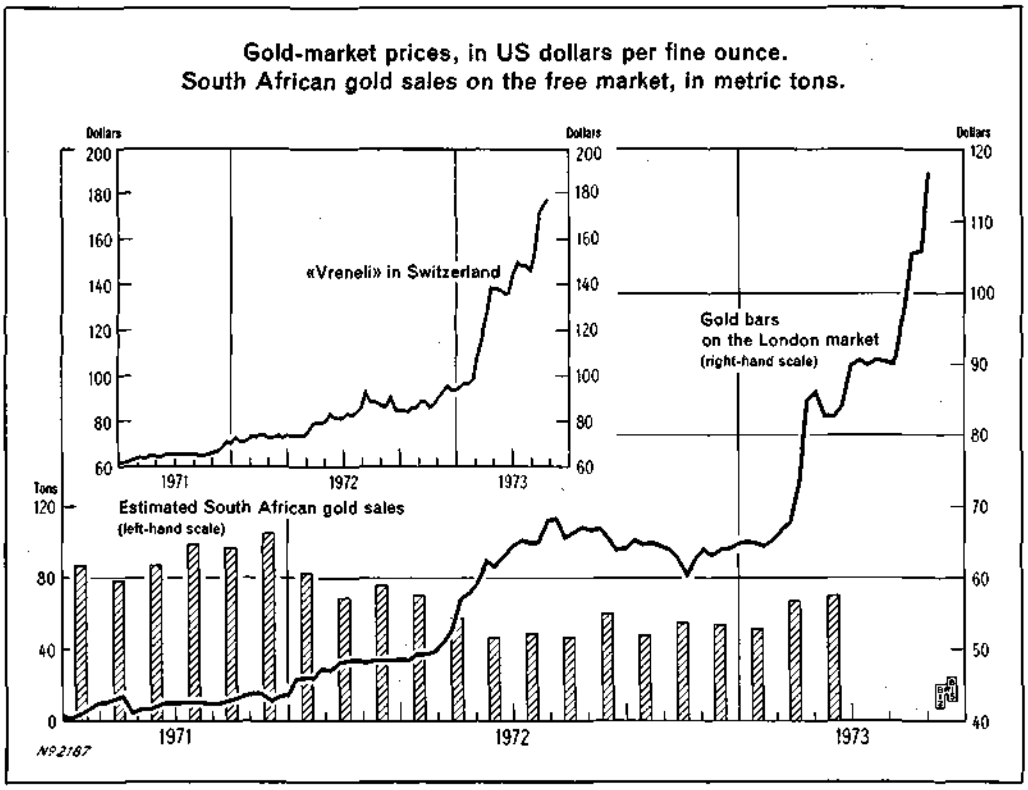
Items	1968 April-December	1969	1970	1971	1972
	in metric tons				
Production	940	1,260	1,290	1,250	1,180
Estimated sales by communist countries	-	5	50	90	205
Total	940	1,265	1,340	1,340	1,385
Change in western official gold stocks	595	110	290	— 85	95
Sales on the free market*	345	1,155	1,050	1,425	1,290

* Residual figures.

The decline in the amount of gold marketed last year was accompanied by a strong non-monetary demand. Investment demand for gold — including probably an increase in the stocks of gold-using industries — appears to have expanded sharply in 1972, owing partly to the precarious international monetary situation and partly to the prospects for gold as a commodity in a world of rapid economic growth and inflation. In addition there was a further increase in the industrial use of gold in developed countries. Purchases by traditional gold-hoarding areas, such as India and the Far East, appear, however, to have declined quite sharply.

The combination of the decline in the amount of new gold marketed and of the strong non-monetary demand for the metal produced a hitherto unprecedented 50 per cent. rise in its market price during 1972, to $65 per ounce. This, however, was put quite in the shade by the much sharper rise that has occurred so far in 1973, to over $120 per ounce, despite an increase in market sales both by South Africa and the USSR.

The year 1972 opened with the market price of gold at about $43.50 per ounce. It then rose to a peak of a little over $49 in early February, reflecting partly the Smithsonian devaluation of the dollar and partly a reduction in South African supplies as the balance of payments began to improve. After dropping slightly



from the early-February peak, quotations then remained in the $48–48.50 range until mid-April. At that point South Africa began, for the first time since 1969, to add to its gold reserves out of current production, which by that time was running at well below the 1971 level; in addition there appears to have been a temporary suspension of Soviet sales. One consequence of this tightening of supplies was to stimulate investment and speculative demand and the interaction of the two factors brought the market price up from $48.50 per ounce on 11th April to $66.75 on 8th June.

There was subsequently some reaction, but this was short-lived and following the floating of sterling and the renewed movement out of the dollar, the price rose again to $65 per ounce early in July. Towards the end of that month rumours that the EEC might adopt a new, higher, gold price for official settlements within the Common Market pushed quotations up further and on 2nd August a price of $70 per ounce was reached — which proved to be the peak for the year.

Reports that the USSR might have to sell gold to finance grain purchases then produced a renewed drop in the price to around $65 per ounce by mid-August. Quotations subsequently fluctuated on either side of that level until November, when they fell in mid-month to about $60 — probably in response to the strengthening of the dollar that had taken place since the summer. Towards the end of the year, however, demand for gold increased again, partly in anticipation of the introduction of value added tax on purchases of gold in France and Italy and partly as a result of fears about the outcome of the French parliamentary elections scheduled for March 1973.

1973 opened with the price at about $65 per ounce and conditions remained fairly quiet until the re-emergence of the crisis in the exchange markets towards the end of January. Demand for gold then increased again, pushing the price above its August 1972 peak in mid-month and up to $89 per ounce on 23rd February — a 35 per cent. rise within four weeks, although by then South Africa was again marketing virtually all of its production and there were quite substantial sales too by the USSR. After fluctuating erratically for some days, the market then began to calm down, quotations declining to $80 per ounce in mid-March. By the end of that month, however, the price had risen to $90 per ounce. Beginning in the second week of May, renewed lack of confidence in the dollar produced a further sharp rise in the demand for gold which carried the market up to over $120 per ounce in early June. Beginning in March 1973, market demand for gold was reinforced by a sharp rise in Japanese purchases in advance of the easing on 1st April 1973 of restrictions on the import of gold bars into Japan.

Valued at $38 per ounce, western gold reserves went up by $115 million in 1972, to a total of $44,905 million at the end of the year. South Africa added $235 million to its reserves out of current gold production while in the rest of the world reported stocks declined by $120 million. Uruguay reported market sales of gold out of its reserves amounting, at $38 per ounce, to $40 million.

World gold reserves.

Countries or areas	Changes in 1970 (at $35 an ounce)	Changes in 1971 (at $38 an ounce)	Changes in 1972 (at $38 an ounce)	Holdings at end-1972
	in millions of US dollars			
United States	− 785	− 940	− 595	10,485
United Kingdom	− 125	− 625	− 40	800
Other western Europe	− 435	+ 545	+ 40	21,475
Canada	− 80	+ 5	− 30	835
Latin America	− 10	− 55	+ 5	1,125
Middle East	− 80	+ 30	− 5	1,085
Other Asia	+ 140	+ 100	—	1,520
South Africa	− 450	− 275	+ 235	680
Other countries	− 70	+ 30	—	860
Total for all countries[1]	−1,895	−1,185	− 390	38,865
International institutions	+2,220	+1,080	+ 505	6,040
of which				
BIS	*+ 200*	*+ 645*	*− 120*	*215*
European Fund	*− 10*	*+ 10*	*− 15*	*45*
IMF	*+2,030*	*+ 425*	*+ 640*[2]	*5,780*[2]
Grand total	+ 325	− 105	+ 115	44,905

[1] Excluding the USSR, eastern Europe, mainland China and North Korea. [2] Excluding $50 million gold subscription received from Rumania.

With the dollar inconvertible and the gap between the official and market prices increasing, there was little monetary use of gold in 1972. By far the largest monetary transfer of gold was the repurchase by the IMF in January, at the request of the US Government, of the remaining $435 million of gold originally sold to the US

Treasury in 1956–60. Also in January 1972 the Fund withdrew from the Federal Reserve Bank of New York and the Bank of England $155 and 30 million respectively of gold deposited with these institutions to offset their gold sales to other countries in connection with the 1965 increase in IMF quotas. In addition the Bank of England effected $30 million of its $1.2 milliard April 1972 repayment to the Fund (see page 128) with gold repurchased from the Bank of Canada. In the rest of the world there was little movement in gold reserves.

Global reserves.

1972 was the third successive year of massive expansion in global reserves. Countries' total official holdings of gold, foreign exchange and special drawing rights, together with their IMF reserve positions, increased by a further $24.4 milliard, or 18½ per cent. Following the 1970 and 1971 pattern (except for the effects of the revaluation of gold in dollar terms), the whole of this was accounted for by foreign exchange and SDR reserves, which expanded by $21.9 and 3.1 milliard respectively — the latter figure corresponding roughly to the total of the year's SDR allocations. Gold reserves and Fund reserve positions both declined very slightly.

The $21.9 milliard increase in total foreign exchange reserves during 1972 was affected by a number of special factors, which on balance certainly held the rise below what it would otherwise have been — probably by several milliard dollars.

Changes in global reserves.*

Areas and periods	Gold	Foreign exchange	IMF reserve positions	SDRs	Total
	in millions of US dollars				
Group of Ten					
1970	− 920	+ 8,480	+ 540	+ 2,340	+10,440
1971	+ 1,670	+25,830	− 835	+ 2,470	+29,135
1972	− 675	+ 7,275	− 80	+ 2,060	+ 8,580
Amounts outstanding at end-1972	*31,410*	*57,255*	*4,910*	*6,870*	*100,445*
Other developed countries					
1970	− 800	+ 1,685	+ 60	+ 300	+ 1,245
1971	+ 105	+ 5,375	+ 30	+ 270	+ 5,780
1972	+ 290	+ 7,665	+ 45	+ 400	+ 8,400
Amounts outstanding at end-1972	*3,950*	*19,885*	*955*	*970*	*25,760*
Developing countries					
1970	− 175	+ 1,965	+ 370	+ 485	+ 2,645
1971	+ 230	+ 4,140	+ 5	+ 515	+ 4,890
1972	− 5	+ 6,935	− 45	+ 590	+ 7,475
Amounts outstanding at end-1972	*3,505*	*24,525*	*950*	*1,590*	*30,570*
All countries					
1970	− 1,895	+12,130	+ 970	+ 3,125	+14,330
1971	+ 2,005	+35,345	− 800	+ 3,255	+39,805
1972	− 390	+21,875	− 80	+ 3,050	+24,455
Amounts outstanding at end-1972	*38,865*	*101,665*	*6,815*	*9,430*	*156,775*

* Including valuation changes.

It is true that the total increase was inflated by the fact that the amount of foreign exchange held temporarily in the Swiss National Bank's reserves as a result of end-year swaps with the Swiss commercial banks rose from virtually zero in 1971 to $1.2 milliard last year. This was much more than offset, however, by the effects of the various measures taken by the Japanese authorities — mainly deposits and swaps with the commercial banks but also some purchases of longer-term US securities — to hold down Japan's reserve increase. Furthermore, the depreciation of sterling between June and December 1972 had the effect of reducing the end-1972 total of sterling reserves measured in US dollars by $0.7 milliard.

As in the two preceding years, the US payments deficit was the predominant influence behind the rapid expansion of exchange reserves. Nearly half of the total increase, or $10.3 milliard, was in foreign official holdings of dollars in the United States. Of the other $11.6 milliard, only a small proportion can be clearly identified: the $1.2 milliard held by the Swiss National Bank over the year-end, which was placed outside the United States, and $0.4 milliard added during the year to official holdings of Deutsche Mark in Germany. Sterling reserves held in the United Kingdom showed a small rise, in dollar terms, of $0.1 milliard. There thus remains an amount of about $10 milliard of last year's increase in total exchange reserves for which statistics are not available, either by currencies or by the countries in which the funds were placed.

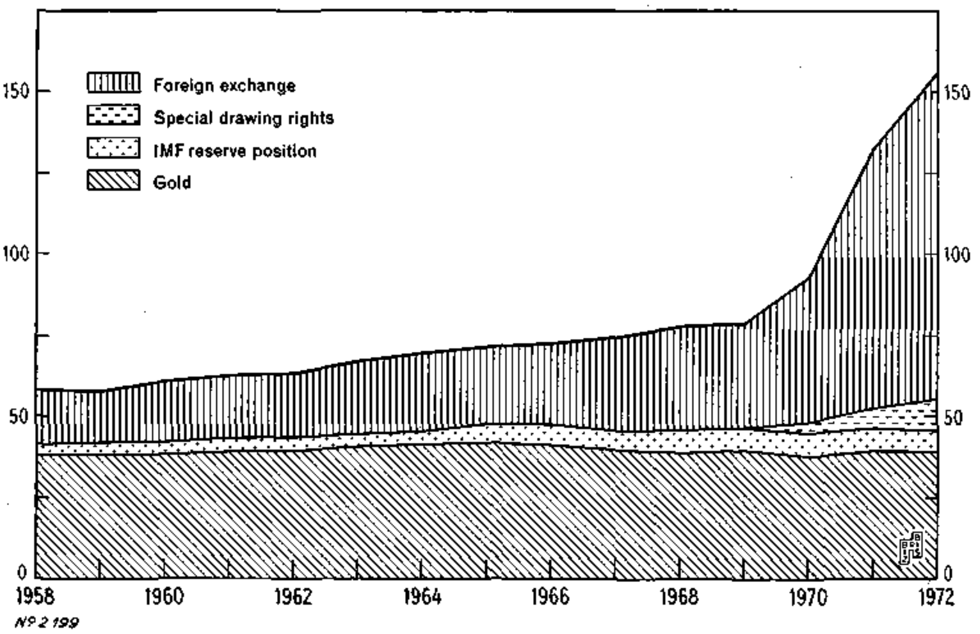
No doubt much of this $10 milliard, perhaps some $7–8 milliard's worth, went to increase the total of official holdings in the Euro-dollar and other Euro-currency markets. In addition, however, this remainder figure appears to contain some increases in holdings of currencies other than US dollars, sterling and Deutsche Mark in the countries of issue of the currencies concerned, as well as some investment of reserves at longer term.

In one respect the 1972 increase in global reserves differed considerably from those recorded in the two preceding years: it was much more broadly distributed between different countries, the Group of Ten's share dropping from 73 to 35 per cent. between 1971 and 1972 while the share of other countries rose correspondingly. In absolute terms the rise in the Group of Ten countries' reserves was 70 per cent. smaller than the year before — to a large extent because of the reversal in the United Kingdom's position — while the gains of other developed countries and of developing countries were respectively 45 and 53 per cent. higher than in 1971. The increased share of non-Group of Ten countries in overall reserve growth helps to explain why, though global reserves went up much less than in 1971, Euro-currency placements seem to have risen considerably more. A significant part of the rise in Euro-currency placements is accounted for by developing countries redepositing in the Euro-market the proceeds of their residents' Euro-currency borrowings.

Within these three broad groups of countries the distribution of reserve increases was less evenly balanced. In the Group of Ten, Germany and Japan again showed much the biggest gains — $5.2 and 3 milliard respectively — followed by France ($1.8 milliard) and the Netherlands ($1 milliard). The United Kingdom's reserves, on the other hand, declined by $3.2 milliard, after their meteoric $6 milliard rise in 1971, and those of Italy by $0.7 milliard. In the group of other developed countries, much the largest reserve increases were registered by Australia and Spain, with \$2.8 and 1.8 milliard respectively. In addition, substantial gains occurred in South Africa and Turkey (\$0.6 milliard each), Yugoslavia and Greece (\$0.5 milliard), and Austria and Portugal (\$0.4 milliard).

The increase in the reserves of developing countries was much less heavily concentrated on the oil-producing countries than before. In fact, they accounted for \$2.1 milliard of the total rise of \$7.5 milliard in this group, compared with \$3 milliard of a \$4.9 milliard total increase in 1971. In the oil-producing areas, the largest reserve gain was registered by Saudi Arabia (\$1.1 milliard); Libya's reserves, on the other hand, went up by only \$0.3 milliard, after a \$1.1 milliard increase the year before. Outside the oil group, not far short of half of the combined reserve gains of other developing countries was accounted for by Brazil alone, with \$2.4 milliard — a rise of 140 per cent. The remaining \$3 milliard was spread fairly widely over a number of other developing countries with Israel, whose reserves rose by \$0.5 milliard, registering the biggest increase.

Global reserve developments, 1958–1972.
End-of-year figures, in milliards of US dollars.



As a result of last year's massive further increase, global reserves amounted at the end of 1972 to \$156.8 milliard, having almost exactly doubled in three years. During those three years foreign exchange reserves had slightly more than trebled, from \$32.3 to 101.7 milliard, their share in the overall total rising from 41 to 65 per cent. The counterpart to the increased share of foreign exchange in global reserves was the decline in gold's share, despite its 8.6 per cent. revaluation in dollar terms, from 50 to 25 per cent. The remaining \$9.4 milliard came from the first three annual allocations of SDRs. Despite this, however, and despite the reserve effects of the

1970 increase in Fund quotas, the share in total reserves of claims on the International Monetary Fund increased only very slightly over the three years, from a little less to a little more than 10 per cent. The SDR allocations, instead of providing the principal element as envisaged in the calculations on which the decisions to allocate were based, accounted for only 12 per cent. of the 1970–72 increase in reserves. No further SDR allocation has been agreed upon for 1973.

Apart from the sheer size of their growth, the other feature of reserve developments during 1970–72 has been the manner in which exchange reserves have grown and in particular the extent to which this growth has taken non-traditional forms. Total exchange reserves at the end of 1969 amounted to $32.3 milliard, of which $23 milliard could be identified as being held in the form of US dollars in the United States and sterling in the United Kingdom. During the following three years total exchange reserves, measured in dollar terms, increased by $69.4 milliard, of which $44 milliard can be identified as having been placed in these forms. The remaining $25.4 milliard was invested in non-traditional ways, mainly in the Euro-currency market and the national markets of certain European countries, but also to some extent in longer-term dollar and other fixed-interest securities and even possibly, in some cases, in equities. The great bulk of the "non-traditional" investment of exchange reserves during these three years took place outside the Group of Ten. In fact, of the $27.8 milliard increase in non-Group of Ten countries' exchange reserves during 1970–72 — more than half of which occurred in 1972 alone — only $7 milliard, or one-quarter, was in the form of identifiable holdings of dollars in the United States and sterling in the United Kingdom.

In the first quarter of 1973 global reserves, mainly under the impact of the currency crisis, showed another very large expansion. If gold and gold-guaranteed assets are valued in dollars on the basis of the presumed new gold content of the dollar the increase, on the basis of preliminary figures, may be put at $20 milliard. Of this amount, $14.8 milliard was accounted for by the Group of Ten while the holdings of other developed countries and of developing countries went up by $2.2 and $3 milliard respectively. Revaluation effects accounted for about $3.5 milliard of the $13.6 milliard growth in the official reserves of Group of Ten countries other than the United States; the remaining increase of some $10 milliard was the same size as the US official settlements deficit for the quarter. As in 1972, Germany experienced the largest reserve accrual, viz. $8.6 milliard, of which $6 milliard occurred in February alone. Other large gains were recorded by the Netherlands ($1.3 milliard), France ($1.2 milliard), Belgium ($1.1 milliard) and Sweden ($0.5 milliard).

International Monetary Fund.

With member countries' gross drawings and repurchases almost balancing, the net use of the Fund's resources, which had declined quite considerably in 1971, showed a slight increase of $50 million last year. New drawings amounted to $1,749 million and repurchases to $1,699 million.

On the drawings side three countries — the United States, the United Kingdom and Argentina — accounted for two-thirds of the total, while the United Kingdom

International Monetary Fund: Drawings and repurchases in 1972.

Countries or areas	Drawings	Repurchases*	Net drawings
	in millions of US dollars		
United States	217		217
United Kingdom	634	1,083	— 449
Continental Europe	35	129	— 94
of which			
Turkey	—	98	— 98
Middle East	27	132	— 105
Asia	236	114	122
of which			
Bangladesh	68	—	68
Pakistan	91	16	75
Africa	114	92	22
Latin America	486	149	337
of which			
Argentina	308	—	308
Colombia	—	58	— 58
Peru	67	37	30
Total	1,749	1,699	50

* Includes repurchases by other members' drawings (United Kingdom: $268 million) less repurchases of charges paid in currency (United Kingdom: $217 million) and repurchases on subscription account ($10 million).

alone accounted for almost two-thirds of total repurchases. The US drawing, in April 1972, was made to help extinguish the United Kingdom's outstanding debt to the Fund of $1,249 million by reducing correspondingly the Fund's holdings of sterling. At the same time the United Kingdom itself directly repurchased the remaining $1,031 million, thus fully restoring its gold tranche position for the first time since 1964. In July 1972 the United Kingdom made a drawing of $634 million for the purpose of repaying part of the support given to sterling in late June by EEC member countries.

Twelve different currencies were used in drawings and repurchases during 1972. The principal currencies drawn were the Deutsche Mark ($448 million), the pound sterling (279), the Japanese yen (214) and the French franc (157), while those most used for repurchases were the Deutsche Mark (366), the Belgian franc (132), the French franc (131), the Japanese yen (117) and the Dutch guilder (116). For the first time in the Fund's history the US dollar was not used either in drawings or in repurchases. On the other hand, $387 million of SDRs were used in drawings and $537 million in repurchases.

In 1972 five more countries — Bangladesh, Bahrain, Qatar, the United Arab Emirates and Rumania — joined the IMF, raising total membership to 125 and the total of Fund quotas by $391 million to $31,668 million.

The third allocation of SDRs, on 1st January 1972, amounted to $3.2 milliard, bringing the total allocated in the first basic period to $10.1 milliard. Total gross use of SDRs in 1972 was $1.6 milliard, of which participating countries accounted for $1.2 milliard and the Fund's General Account for the remaining $0.4 milliard. Most of the use of SDRs during the year was related to transactions between the United Kingdom and the Fund. In April the United Kingdom transferred $461 million of SDRs to the Fund as part of its currency repurchase, while in July the

Fund transferred $317 million to the United Kingdom as part of its drawing and the United Kingdom in turn at once transferred these SDRs to Belgium, France, Germany, the Netherlands and Norway in part-settlement of its debts to them arising out of the support for sterling in late June.

On a net basis the pattern of SDR flows in 1972 was the same as in earlier years, developing countries using a net amount of $221 million, while the Fund and developed countries accepted net amounts of $152 and 69 million respectively. During the three years 1970–72 seventy members of the Fund, headed by the United States with $533 million and the United Kingdom with $436 million, were cumulative net users of SDRs for a total of $2,142 million; of this amount, $1,459 million was accepted by twenty-four other members of the Fund whose holdings of SDRs at the end of 1972 were therefore in excess of their allocations, and the remaining $683 million by the Fund. Easily the most important net accepting countries were the Netherlands, Belgium and Germany with $449, 341 and 304 million respectively. Developed countries as a group held 104 per cent. of their cumulative allocations at the end of 1972 and developing countries as a group 62 per cent.

As regards future allocations of SDRs, no proposal has so far been submitted to the Board of Governors of the IMF concerning either the duration of the next basic period or the amounts that might be allocated in the course of it.

During the first four months of 1973 IMF transactions, both traditional and in SDRs, were on a very small scale.

Monetary movements.

United States. In the United States the deterioration of the combined net external monetary position of the official and banking sectors in 1972 was $12.9 milliard — large enough, but rather less than two-thirds of the $20.7 milliard figure recorded the year before. The deterioration in the net official position, however, was little more than one-third of what it had been in 1971 — $10.3 against $29.8 milliard — thanks to an $11.6 milliard turn-round in the banking sector, from a $9.1 milliard outflow in 1971 to a $2.5 milliard inflow last year.

The turn-round in the US banks' net external position was almost entirely the result of the fact that, after dropping by $6.7 milliard the year before, the banks' liabilities to non-official foreigners rose last year by $4.8 milliard. For this there were several reasons. First and foremost, after their reduction in 1971 there was little scope for any further decline in US banks' liabilities to their foreign branches; in fact they increased a little, by $0.5 milliard, to $1.4 milliard, during the course of 1972. Secondly, the Japanese authorities prompted their banks to reduce their net indebtedness to banks in the United States; mainly as a consequence of this, US bank liabilities to non-official Japanese holders went up by some $1.6 milliard last year. Thirdly, the rise in US money-market rates moved some interest rate differentials in favour of the United States in the middle part of the year. The US banks' short-term claims on non-residents rose by $2.2 milliard in 1972, virtually the same as the year before. Most of the increase was in lending to Latin American

United States: External monetary movements.

Items	1971	1972 Year	1972 1st quarter	1972 2nd quarter	1972 3rd quarter	1972 4th quarter	1973 1st quarter
	in millions of dollars (+ = increase in assets, decrease in liabilities)						
Reserves	− 2,345	− 30	+ 100	+ 55	− 120	− 65	− 220
of which							
Gold	− 865	− 545	− 545	−	−	−	−
Foreign exchange	− 380	− 35	− 65	+ 245	− 135	− 80	− 235
SDR allocations	+ 720	+ 710	+ 710	−	−	−	−
SDR transfers	− 470	− 5	−	− 5	−	−	−
IMF gold tranche position	− 1,350	− 155	−	− 185	+ 15	+ 15	+ 15
Liabilities to foreign official agencies	−27,415	−10,310	−2,610	− 800	−5,465	−1,435	− 9,785
of which							
Liquid	−27,615	−9,715	−2,110	− 775	−5,350	−1,480	−8,605
Non-liquid	+ 200	− 595	− 500	− 25	− 115	+ 45	−1,180
Net official position	−29,760	−10,340	−2,510	− 745	−5,585	−1,500	−10,005
Short-term claims on foreigners	+ 2,375	+ 2,245	+ 775	− 480	+ 370	+1,580	+ 2,590
Liabilities to foreign non-official institutions and persons	+ 6,690	− 4,785	− 590	−2,190	− 265	−1,740	+ 1,835
Banks' net position	+ 9,065	− 2,540	+ 185	−2,670	+ 105	− 160	+ 4,425
Total including SDR allocations	−20,695	−12,880	−2,325	−3,415	−5,480	−1,660	− 5,580
Total *excluding* SDR allocations	−21,415	−13,590	−3,035	−3,415	−5,480	−1,660	− 5,580

Note: The figures for the second quarter and the year 1972 exclude the effects on reserves of the devaluation of the dollar.

and European countries. Lending to Japan showed very little change for the year as a whole, declining by \$0.8 milliard in the first nine months and then rising by \$0.7 milliard in the last quarter.

Virtually the whole of last year's official settlements deficit was financed by a further increase in liabilities to foreign official agencies, which by the end of the year stood at \$61.6 milliard. On the assets side, there was almost no change overall. SDR holdings went up by \$0.7 milliard as a result of the 1972 allocation; at the same time the gold stock dropped by \$0.6 milliard as a result of the return of gold to the IMF (see pages 119–120) and the Fund reserve position by \$0.2 milliard, essentially through a drawing of sterling.

The \$10.3 milliard increase in official liabilities was mostly the result of the February–March and June–July runs on the dollar; in fact during those two periods official liabilities rose by \$1.7 and 5.8 milliard respectively. Once the second of these episodes was over and market sentiment began to shift in favour of the dollar, official liabilities increased during the last four months of the year by only \$0.9 milliard.

Within the overall increase of \$10.3 milliard in official liabilities there were a number of different movements. Certain kinds of liabilities, for instance, declined. Those under US swap drawings were reduced by \$1.3 milliard, chiefly through repayments of $0.7 and 0.4 milliard respectively to the United Kingdom and Switzerland; $0.3 milliard of Deutsche Mark bonds held by the Deutsche Bundesbank were paid off by the US Treasury; and in addition the gold transfers to the Fund had a counterpart in reduced liabilities. Other types of official liability, i.e. unguaranteed dollar liabilities, therefore rose by $12.6 milliard. Rather more than half of this took the form of purchases by the Deutsche Bundesbank, for a further $6.3 milliard, of special non-marketable US Government bonds and notes with maturities ranging from four to seven years — nearly all of which, however, can be cashed at short notice in case of payments need.

In the first quarter of 1973 the net official position of the United States deteriorated by a further $10 milliard, of which $9.8 milliard took the form of a continued rise in official liabilities. Most of the deterioration was in the crisis month of February, when the net official deficit came to $7.8 milliard, of which $4.6 milliard was the result of an outflow through the banks. Bank short-term lending to non-residents rose by $2.7 milliard in that month and in addition non-residents other than official agencies drew down their balances at US banks by $1.9 milliard. In March there was a further official settlements deficit of $2.8 milliard, but very little further outflow of funds through the banks.

United Kingdom. The United Kingdom's net reserve position, after strengthening by $8.2 milliard in 1971, weakened in 1972 by $2.7 milliard. While the $6 milliard deterioration in the balance of payments was the largest element in this dramatic turn-round, the change in banking flows, from an inflow of nearly $4 milliard to an outflow of almost $1 milliard, was hardly less substantial.

Although the balance-of-payments deficit was largest in the final quarter of the year, the reserve loss was concentrated in the third week in June, when there was a $2.8 milliard outflow of funds. Developments in that week dominated the second quarter, in which a $0.8 milliard payments deficit and a $1.9 milliard net outflow through the banks produced a $2.7 milliard net reserve loss. The loss of confidence in sterling that produced the outflow can be clearly seen in a number of the monetary items: in the $0.8 milliard switch by the banks from sterling into foreign currencies, which no doubt reflected partly operations on their own initiative and partly the spot counterpart of forward sales to their customers of foreign exchange; in the $0.5 milliard increase in non-resident borrowing of sterling from UK banks; and in the $0.5 milliard withdrawals of non-sterling-area balances. While sterling-area balances showed little change for the second quarter as a whole, they too declined in the June crisis, but had previously been increasing in April and May.

The $2.7 milliard net reserve loss for the second quarter was essentially financed by $2.6 milliard of short-term support received from EEC countries and Norway. That support accounts for the greater part of the $3.9 milliard deterioration in the position vis-à-vis "other monetary authorities". In addition this item was reduced by the transfer to the reserves of $1.1 milliard of dollars previously swapped out with other monetary authorities. Despite this transfer, however, the reserves proper only rose by $0.3 milliard during the quarter since they were drawn on for

United Kingdom: External monetary movements.

Items	1971	1972					1973
		Year	1st quarter	2nd quarter	3rd quarter	4th quarter	1st quarter
	in millions of US dollars (+ = increase in assets, decrease in liabilities)						
Official financing							
Gold and foreign exchange reserves . .	+3,385	−1,090	+ 135	+ 285	−1,040	− 460	+ 305
SDR allocations	+ 360	+ 325	+ 325	—	—	—	+ 120
SDR transfers	+ 15	− 310	+ 35	− 395	+ 35	+ 15	− 50
IMF	+1,345	+ 890	+ 55	+1,270	− 635	—	+ 15
Other monetary authorities	+3,060	−2,330	− 50	−3,865	+1,585	—	—
Total	+8,165	−2,705	+ 500	−2,705	− 55	− 445	+ 390
Other monetary movements							
Sterling balances (gross) of overseas-sterling-area holders							
official	−1,215	− 910	− 390	− 120	− 30	− 370	
private	− 905	+ 400	+ 20	+ 145	+ 15	+ 220	
of non-sterling-area holders							− 385
official[1]	− 510	+ 100	− 145	+ 240	+ 30	− 25	
private	− 845	− 145	− 25	+ 290	− 10	− 400	
Sterling claims of UK banks[2]	+ 40	+ 820	+ 280	+ 535	+ 15	− 10	− 295
Foreign currency transactions of UK banks[3] .	− 510	+ 660	+ 170	+ 785	− 10	− 285	+ 310
Total	−3,945	+ 925	− 90	+1,875	+ 10	− 870	− 370
Overall balance. .	+4,220	−1,780	+ 410	− 830	− 45	−1,315	+ 20
Overall balance excluding SDR allocations . . .	+3,860	−2,105	+ 85	− 830	− 45	−1,315	+ 20

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

$0.2 milliard to support sterling during the June crisis, as well as for $0.5 milliard to repay Fund indebtedness in April. The $0.4 milliard second-quarter reduction in SDR holdings also went to repay Fund indebtedness, which altogether declined by $1.2 milliard — $1 milliard through direct UK repayments and the remainder through a drawing of sterling by the United States.

Apart from the June crisis, net monetary movements in 1972 were on a much smaller scale. In the first quarter of the year both the overall surplus and the reserve increase were largely attributable to receipt of the third SDR allocation. In the third quarter non-official monetary movements were very small, while in the official sector the movements that occurred were essentially the result of the repayment of the $2.6 milliard support given to sterling in the June crisis. In effect, $2 milliard was repaid from the reserves and $0.6 milliard by drawing on the Fund; but the actual decline in reserves was only $1 milliard and the improvement in the position with "other monetary authorities" only $1.6 milliard, since a further $1.1 milliard previously swapped out with other monetary authorities was transferred to reserves. In the fourth quarter, although sterling was still floating, the reserves fell by $0.4 milliard. About half of this can be accounted for by the end-year North American debt payments. The last quarter also saw a fairly substantial inflow of funds through the banking system, including a $0.4 milliard rebuilding of non-sterling-area balances and $0.3 milliard of inward switching by the banks.

During the first quarter of 1973 the United Kingdom's net reserves increased by $0.4 milliard and there was a net inflow of the same size through the banking system. Half of the reserve gain was due to the revaluation of non-dollar reserve assets in February, the counterpart to which is found in the overall balance of payments which, if this item were excluded, would show a $0.2 milliard deficit for the quarter. So far as the banking inflows are concerned, seasonally large receipts of oil-producing countries accounted for much of the $0.4 milliard rise in sterling balances, while high interest rate levels probably influenced the $0.3 milliard drop in the banks' external sterling lending. Partly offsetting these inflows, the banks' net foreign currency liabilities declined by $0.3 milliard during the quarter. In April reserves rose by $0.1 milliard and in May by $0.6 milliard. About half the large May increase represented the proceeds of foreign borrowing by public corporations.

Germany. In 1972, for the third successive year, Germany's reserves increased very substantially, net official monetary assets going up by $5.1 milliard. The great bulk of this increase was in exchange reserves, which rose by a further $4.6 milliard; in addition, Germany added $0.4 milliard to its SDR holdings, half of which came from its 1972 allocation. During the year Germany purchased a further $6.3 milliard of US Government non-marketable dollar securities, bringing its total holdings of such paper to $11.3 milliard, or a little under two-thirds of its total dollar reserves at the end of the year.

The whole of last year's increase in reserves came from balance-of-payments inflows; in fact, taking the year as a whole, there was a very small net $0.1 milliard outflow through the banking system, owing in part to the increasing severity of reserve requirements on the banks' foreign liabilities. During the course of the year, however, the banks' net foreign position showed quite large fluctuations.

The 1972 increase in reserves was concentrated in two periods, January–February and June–July. In the first of these periods, reserves rose by $1.3 milliard, despite a seasonal outflow of $2 milliard through the banks. In the second of them, the increase was $4.9 milliard; roughly one-third of this came in through the banks, mainly as a result of non-residents adding some $1.1 milliard to their Deutsche Mark balances at German banks. The increase in reserves came to an end in mid-July and from then until the end of the year reserves in fact declined by $1.3 milliard. Their decline would have been much larger but for the seasonal inflow of funds through the banks in December, which may be put at around $1.1 milliard.

During the first quarter of 1973 Germany's net official position showed a further enormous increase of $7.1 milliard. Official reserve assets rose by $8.6 milliard, of which some $8 milliard came from inflows during the February–March currency crisis and $0.7 milliard from the revaluation of non-dollar reserve assets following the second dollar devaluation. Movements of funds through the banking sector,

Continental European countries, Canada and Japan: External monetary positions.[1]

Countries	End of year	Gold, SDRs and net foreign exchange	Net IMF and GAB position	Total official assets (net)	Commercial banks (net)	Total foreign assets (net)	Changes (+ = increase in assets, decrease in liabilities) Official: Including SDR allocations	Changes Official: Excluding SDR allocations	Changes: Banks
		in millions of US dollars							
Austria	1971	2,085	145	2,230	— 345	1,885	+ 475	+ 455	— 295
	1972	2,495	135	2,630	— 595	2,035	+ 400	+ 370	— 250
Belgium-Luxemburg . .	1971	2,740	650	3,390	— 990	2,400	+ 565	+ 485	— 140
	1972	3,265	560	3,825	—1,350	2,475	+ 435	+ 360	— 360
Denmark	1971	620	50	670	— 60	610	+ 210	+ 180	— 45
	1972	725	70	795	40	835	+ 125	+ 90	+ 100
Finland	1971	570	70	640	— 55	585	+ 180	+ 160	+ 35
	1972	685	70	755	35	790	+ 115	+ 95	+ 90
France	1971	7,145	475	7,620	—2,815	4,805	+ 3,730	+ 3,540	—1,470
	1972	8,875	500	9,375	—4,150	5,225	+ 1,755	+ 1,580	—1,335
Germany	1971	17,395	1,170	18,565	—4,335	14,230	+ 5,030	+ 4,830	— 890
	1972	22,400	1,240	23,640	—4,620	19,020	+ 5,075	+ 4,890	+ 130[2]
Greece	1971	470	35	505	5	510	+ 200	+ 185	—
	1972	995	35	1,030	15	1,045	+ 525	+ 505	+ 10
Iceland	1971	55	5	60	— 10	50	+ 20	+ 15	— 5
	1972	65	5	70	— 15	55	+ 10	+ 5	— 5
Ireland	1971	955	40	995	45	1,040	+ 300	+ 285	.
	1972	1,085	45	1,130	— 70	1,060	+ 135	+ 120	— 115
Italy	1971	6,310	355	6,665	— 125	6,540	+ 1,145	+ 1,040	— 215
	1972	5,600	335	5,935	— 635	5,300	— 730	— 835	— 510
Netherlands . . .	1971	3,055	700	3,755	220	3,975	+ 545	+ 455	+ 380
	1972	4,080	600	4,680	290	4,970	+ 925	+ 845	+ 70
Norway	1971	1,080	65	1,145	— 65	1,080	+ 345	+ 315	— 165
	1972	1,230	75	1,305	— 55	1,250	+ 160	+ 130	+ 10
Portugal	1971	1,830	30	1,860	200	2,060	+ 360	+ 360	—
	1972	2,275	30	2,305	220	2,525	+ 445	+ 445	+ 20
Spain	1971	3,130	105	3,235	— 165	3,070	+ 1,440	+ 1,400	— 115
	1972	4,890	115	5,005	— 190	4,815	+ 1,770	+ 1,715	— 25
Sweden	1971	960	90	1,050	155	1,205	+ 350	+ 310	— 10
	1972	1,425	95	1,520	290	1,810	+ 470	+ 435	+ 135
Switzerland . . .	1971	6,930	—	6,930	3,165	10,095	+ 1,745	+ 1,745	.
	1972	6,995	—	6,995	3,235	10,230	+ 65	+ 65	+ 70
Turkey	1971	485	— 70	415	.	.	+ 405	+ 385	.
	1972	530	30	560	.	.	+ 145	+ 125	.
Canada	1971	5,195	330	5,525	160	5,685	+ 895	+ 775	—1,380
	1972	5,605	345	5,950	— 570	5,380	+ 425	+ 280	— 730
Japan	1971	14,635	490	15,125	—1,470	13,655	+ 10,335	+ 10,205	—2,530
	1972	17,425	620	18,045	510	18,555	+ 2,920	+ 2,760	+ 1,980

[1] For Group of Ten countries, plus Switzerland, the figures are those used for multilateral surveillance. They do not in most cases correspond exactly to published reserve figures. In addition, the procedures adopted since the end of 1971 for converting non-dollar assets and liabilities into US dollars are not consistent. [2] Owing to accounting distortions, this figure does not correspond to the difference between the German banks' outstanding net foreign positions at the end of 1971 and 1972.

the major part of which represented additions to non-residents' Deutsche Mark balances, contributed substantially to the February–March inflows. Official liabilities also rose substantially during the quarter, from $0.9 to 2.4 milliard, largely as the result of an increase in foreign monetary authorities' Deutsche Mark balances at the Deutsche Bundesbank. By the end of March 1973 Germany's monetary reserves stood at $33.2 milliard. Excluding valuation changes due to the two dollar devaluations, this represented an increase of some $24 milliard, or nearly 300 per cent. since end-1969 and one of $13 milliard for the period between the Smithsonian realignment and the abandonment of a fixed exchange rate for the Deutsche Mark against the dollar in March 1973. When the exchange markets reopened after the February–March crisis, there was, not surprisingly, some outflow of funds from Germany. Net official monetary assets fell by $0.3 milliard during April–May.

Japan. After Germany, Japan had the largest recorded reserve increase of any country in 1972. Net official assets rose by $2.9 milliard, of which $2.6 milliard came from payments inflows and the remaining $0.3 milliard from the year's SDR allocation and the revaluation of the gold stock and gold-based reserve assets. Apart from these minor items, the increase in reserves was entirely added to official holdings of marketable US Government bonds and notes; the first-line exchange reserves showed hardly any change for the year as a whole. The increase in net official monetary assets considerably understates the gross inflow to Japan's reserves last year since during its course the authorities made substantial amounts of foreign exchange available to the banks through deposits and swaps. Partly reflecting these transactions, the banks exported a net amount of $2 milliard in 1972. The recorded overall external monetary surplus for the year was therefore $4.9 milliard, virtually as big as Germany's.

Looking at developments through the course of the year, in the first quarter net official assets rose by $1.4 milliard, despite some depositing of dollars with Japanese commercial banks. Beginning in April, therefore, the authorities began to place larger amounts of exchange with the banks, and reserves in fact fell during the second quarter by $0.8 milliard concurrently with a net outflow of $1.3 milliard through the banks. In the third quarter the banks exported a further amount of $0.9 milliard but the reserves began to rise again, by $0.7 milliard. During the last quarter they increased strongly, by $1.9 milliard, and there was, on balance, no further outflow of funds through the banks.

In the first five months of 1973 Japan's net official monetary assets declined by $2.4 milliard. At the end of February, following a quite substantial inflow during that month, they were $0.8 milliard above their end-1972 level; but in the following three months they dropped by $3.2 milliard. The banks' net foreign assets declined by $0.5 milliard in the first four months of 1973.

Spain. With an increase of $1.8 milliard, or 55 per cent., in net official monetary assets, Spain had the second largest reserve growth of any European country last year. Unlike other countries that experienced large payments surpluses in 1972, Spain's was very largely on basic account and did not include any significant element of short-term inflow deriving from the weakness of the dollar. Exchange reserves went up \$1.7 milliard during the year and in addition the revaluation of the gold stock and gold-guaranteed official monetary assets added \$0.1 milliard to reserves. The overall payments surplus continued into 1973, reserves going up by a further \$0.2 milliard during the first quarter.

France. As in Germany, the 1972 increase of \$1.8 milliard in France's net official monetary assets essentially took the form, apart from the \$0.2 milliard SDR allocation in January, of a \$1.5 milliard rise in foreign exchange reserves. Unlike what happened in Germany, however, the rise in exchange reserves was, despite the dual exchange market system, very largely the result of an inflow of funds through the banking sector. The banks' net foreign liabilities in fact went up by \$1.3 milliard in the course of the year. This movement contained two different elements, both of them related to the prevailing currency uncertainties: a \$0.7 milliard expansion of the banks' net foreign exchange liabilities, as the counterpart to an increase in their lending of foreign exchange to French importers; and a growth of \$0.6 milliard in their net French franc liabilities to non-residents. The latter in fact added no less than \$1.2 milliard to their franc balances at French banks during the year; at the same time, however, their franc borrowings from French banks went up by \$0.6 milliard. Both the expansion of reserves and the banking inflow were heavily concentrated in the June–July currency crisis period, when they amounted to \$1.4 and 1 milliard respectively.

In the first quarter of 1973 net official assets, measured in dollar terms, increased by \$1.1 milliard and the banks' net foreign liabilities by \$1.1 milliard. Both these figures are substantially affected by the devaluation of the dollar in February. This added \$0.5 milliard to the dollar value of France's non-dollar reserves, mainly gold; it also increased the dollar value of the banks' total net foreign liability position by an amount which may be estimated at about \$0.3 milliard. Apart from these valuation changes, the main change in the external monetary position during the quarter came at the beginning of March when there was a \$0.5 milliard inflow to the exchange reserves. When markets reopened on 19th March the franc was relatively strong in the European snake. France's reserves increased by a further \$0.4 milliard in April–May.

Netherlands. The \$1 milliard overall external monetary surplus of the Netherlands in 1972 was almost entirely in the official sector. Dollar reserves, which at the end of 1971 had accounted for only \$0.2 milliard out of total reserves of \$3.8 milliard, rose by \$1.1 milliard. Although for the year as a whole there was very little change in the banks' foreign position — in fact their net foreign assets showed a rise of \$0.1 milliard — most of the increase in reserves last year came in March and July, during both of which months there were net inflows through the banks of \$0.3 milliard, in the form of bank sales of dollars to the Nederlandsche Bank. A further inflow of \$0.5 milliard took place through the banks during the February 1973 exchange crisis, more than half of it in the form of an increase in non-residents' guilder balances, which had been declining during most of 1972; for the first quarter as a whole, however, the banks accounted for only a quarter of the \$1.3 milliard rise in net official assets. When the exchange markets reopened on 19th March the guilder was relatively weak and net official assets declined by \$0.3 milliard in April.

Belgium–Luxemburg Economic Union. During 1972 the BLEU's net official reserve position rose by something over $0.4 milliard. At the same time, however, there was an increase of not quite $0.4 milliard in the banks' net foreign liabilities, so that the overall monetary position showed only a small surplus. In fact, if allowance is made for the third SDR allocation the change in official reserves matches precisely the increase in the banks' net foreign liabilities.

As in a number of other European countries, the increase in reserves — apart from the SDR allocation — was essentially in dollar reserves, and was concentrated in the two periods of currency unrest. In fact, in February and again in June–July net reserves rose by $0.1 and 0.5 milliard respectively. A good part of these increases appears to have resulted from inflows of funds through the banks via the regulated exchange market, the banks' total net external liabilities (including positions in the regulated market and in the financial market) rising by over $0.2 milliard in each of these periods.

During the first four months of 1973 the BLEU's net official position increased by a further $1.1 milliard. $0.3 milliard came from the revaluation of non-dollar reserve assets and $0.3 milliard from an increase in dollar reserves; the balance represented a rise in non-dollar foreign exchange reserves, largely as a result of support operations within both the EEC and the Benelux exchange rate arrangements. As to the banks, their net foreign liabilities increased by $0.9 milliard in the first quarter, their net Belgian franc liabilities rising by $0.3 milliard and those in foreign currencies by $0.6 milliard.

Canada. In spite of the overall payments deficit, a net $0.7 milliard inflow of funds through the banks produced a rise of $0.4 milliard in Canada's net official monetary assets last year, most of which was added to dollar reserves. During the first eight months of 1972, with Canadian short-term interest rates above those in the United States, the inflow through the banks amounted to $1.4 milliard and net official assets went up by $0.6 milliard. Beginning in late August, however, this interest rate pattern was reversed: during the last four months of the year there was a $0.7 milliard outflow through the banks so that, although the balance of payments had moved into surplus, net official assets declined by $0.1 milliard. Reserves continued to fall slightly in the first four months of 1973, despite a renewed inflow of funds through the banks which, for the first quarter, amounted to $0.4 milliard.

Austria. Austria's official external monetary surplus for 1972 and the first quarter of 1973 derived to a large extent from inflows of funds through the banking system. During those fifteen months net official monetary assets increased by $0.5 milliard and the banks' net foreign liabilities by $0.3 milliard. The banks' foreign currency liabilities rose as the counterpart to an increase in their foreign exchange lending to residents and in addition they sold foreign exchange spot to match forward purchases of currencies from Austrian exporters. The reserves rose by $0.6 milliard in the first three quarters of 1972 and then declined by $0.2 milliard in the final quarter, after restrictions had been imposed on foreign borrowing by residents and investment in Austria by non-residents. They rose again by $0.1 milliard in the first quarter of 1973, in line with a further inflow through the banks.

Portugal. Contrary to the experience of most European countries, Portugal's reserves rose more in 1972 than the year before. About one-fifth of the $0.4 milliard growth of net official assets resulted from the revaluation of the gold reserve in dollar terms and the remainder from an increase in exchange reserves, which went up by a further $0.2 milliard in the first quarter of 1973.

Sweden. Between the end of 1971 and April 1973 Sweden's monetary reserves doubled, from $1.1 to 2.2 milliard. Like Portugal, Sweden had a larger reserve gain in 1972 than the year before and this was followed in the first four months of 1973 by further gains even larger than those recorded for the whole of 1972. The 1972 increase in net official assets, amounting to $0.5 milliard, was accompanied by a $0.1 milliard increase in the banks' net foreign assets, so that the overall surplus for the year was $0.6 milliard. That was also the amount by which the reserves went up during January–April 1973. Although the rise occurred mainly in the crisis months of February and March, it continued in April — probably because Sweden did not accept the full devaluation of the dollar in February.

Norway. Norway's net official assets rose by $0.2 milliard in 1972, only about half as much as in 1971: the difference is accounted for by the absence of the previous year's inflow of funds through the banks. There was a further $0.1 milliard increase in reserves in the early months of 1973.

Denmark. The overall balance-of-payments surplus for 1972, at $0.2 milliard, was the same size as it had been in 1971. It was reflected about equally in net official monetary assets and in the banks' foreign positions. During the course of the year the reserves fluctuated quite markedly, rising in the early months, falling rather sharply just before the Danish decision to join the EEC — when Norway had already pronounced against entry — and subsequently rising again during the rest of the year. As in Sweden, the reserve gains became more pronounced in early 1973, amounting to $0.2 milliard for the first quarter. Unlike Sweden, however, Denmark accepted the February 1973 dollar devaluation in full and the strength of its balance of payments this year seems to be related to its entry into the EEC.

Finland. The external monetary counterpart to the 1972 overall payments surplus of $0.2 milliard was divided about equally between an improvement in the banks' foreign position and additions to reserves. After increasing by $0.2 milliard during the first nine months of the year, the reserves began to fall in the final quarter and continued to do so in the first quarter of 1973.

Italy. Italy was the only European country, apart from the United Kingdom, to show a payments deficit in 1972 and this continued into 1973. In 1972 net official assets fell by $0.7 milliard (after taking into account a $0.1 milliard SDR allocation) and the fall would have been much more pronounced had the authorities not once again resorted to foreign borrowing by public agencies and the banking sector in order to help finance the deficit.

Developments during the period under review can, in fact, be divided into three phases. During the first of these, which covered the period January–May 1972, reserves declined by \$0.3 milliard; but this was essentially the result of advance redemption of foreign loans taken up by public agencies in 1971, and the lira did not need to be supported in the exchange market.

The second phase began with the sterling crisis in June, which immediately brought the lira under heavy pressure that continued on and off until it too was allowed to float in February 1973. From the beginning of June 1972 to 13th February 1973 total official intervention in the market amounted to the enormous sum of \$5.2 milliard, equal to nearly four-fifths of Italy's reserves at the beginning of that period. Net reserves, however, declined by no more than \$1.2 milliard over those eight and a half months. The remaining \$4 milliard of official support came from \$1.5 milliard unwinding of dollars swapped out with the Italian banks, \$0.9 milliard of dollars taken in from the banks under swaps, and \$1.6 milliard of special compensatory foreign borrowing by public agencies.

Since the lira began to float on 13th February, some further official intervention has been necessary to prevent the exchange rate depreciating too far. But this has been covered by further compensatory borrowing on the part of public agencies, so that up to the end of May there was on balance no further decline in the reserves.

Switzerland. There was little change in the overall external monetary position of Switzerland during 1972. Furthermore, net foreign assets of both the official and the private banking sectors showed only very slight movements for the year as a whole. Not reflected in these changes is an amount of \$0.6 milliard absorbed from Swiss banks by the Swiss National Bank over the end of the year in the form of dollar swaps and redeposited by it with Swiss banks, since this transaction did not affect the net foreign asset position of either the official sector or the banks. In addition, however, the National Bank absorbed a further \$0.6 milliard from the banks at the end of the year and placed the dollars with banks outside Switzerland. This transaction did have the effect of temporarily transferring the ownership of foreign assets from the commercial banks to the Swiss National Bank. Without it, therefore, the net foreign assets of the banks would have recorded an increase of \$0.7 milliard during 1972 and those of the official sector a decline of \$0.6 milliard. During the course of the year the Federal Reserve reduced its swap debt to the Swiss National Bank by \$0.4 milliard.

There were fairly large fluctuations in the foreign positions of the official and banking sectors during the year. In the first five months the banks exported a net amount of \$1 milliard, while net official assets fell by \$0.6 milliard. During the following two months of renewed currency turmoil an increase of \$1.1 milliard in reserves — official purchases of dollars in the market totalled \$1.3 milliard in the first two weeks of July — was matched by inflows through the banks. In June the banks' gross foreign liabilities rose by \$0.8 milliard; and while in July a tightening of official measures against inflows of foreign funds produced a \$1.8 milliard reduction in their foreign liabilities, at the same time they repatriated \$2.7 milliard of foreign assets, so that on balance there was a further net inflow through this channel of

\$0.9 milliard during the month. These movements in June and July were largely reversed during the rest of the year when, excluding the effects of the end-year swaps, the official reserve position contracted by \$1 milliard and the banks rebuilt their net external assets by the same amount.

In the first two months of 1973 Switzerland's overall external monetary position showed a large surplus of \$1.7 milliard, with the banks' net external assets increasing by a further \$1 milliard and net official assets by \$0.7 milliard. The increase in reserves came mostly from a \$0.5 milliard revaluation in dollar terms of Switzerland's gold stock and its holdings of non-marketable US Government bonds denominated in Swiss francs. In March the reserves put on another \$0.2 milliard but this was followed in April by a decline of the same size.

Other European countries. In *Greece* net official assets more than doubled in the fifteen months to March 1973, from \$0.5 to 1.1 milliard; during 1972 there was also a small outflow through the banks. Most of the increase in reserves was in foreign exchange holdings. In *Turkey* net official assets rose by \$0.1 milliard during 1972; in this case, however, most of the increase went to improve Turkey's IMF position. A further \$0.2 milliard increase in reserves during the first quarter of 1973 mostly showed up in foreign exchange holdings. In *Ireland* the 1972 increase of \$0.1 milliard in net official monetary assets was associated with an inflow of almost the same size through the banks, all of it in the last quarter of the year. In the first quarter of 1973 reserves declined by nearly as much as they had risen during 1972, partly owing to an outflow through the banks. Finally, in *Iceland* the \$5 million increase in reserves during the fifteen-month period to March 1973 was entirely due to banking inflows.

Foreign exchange markets.

A general picture of developments in foreign exchange markets, so far as they affected the US dollar or the international monetary system, has already been given in Chapter I. A more detailed account of the movements of leading individual currencies is given in the following pages.

Exchange-market arrangements among members of the European Economic Community. On 24th April 1972 the EEC countries put into operation the scheme, subsequently often known as "the snake in the tunnel", whereby neither the fluctuations between any two participating currencies over time, nor the distance between any two at a point in time, could exceed those possible between any member currency and the dollar — namely 4½ and 2¼ per cent. respectively (see 42nd Annual Report, pages 131–132). Shortly after the scheme's inception three prospective EEC members joined it — the United Kingdom and Denmark on 1st May and Norway on 23rd May. At the outset the French franc was the strongest currency in the snake, closely followed by the Belgian franc, with the lira the weakest. The snake itself was positioned high in the tunnel and by early June was against the roof. When the speculative attack on sterling broke out at mid-month the intervention mechanism was called into operation for the first time, sterling being supported by all other participant currencies except the Danish krone and the lira. These interventions held sterling well above its dollar floor, while pulling the snake down in the tunnel. When sterling left the snake and began to float, Italy negotiated a temporary dispensation whereby the lira could be held in the snake through intervention in dollars, whether or not it was at its dollar floor. At the same time Denmark also withdrew from the scheme.

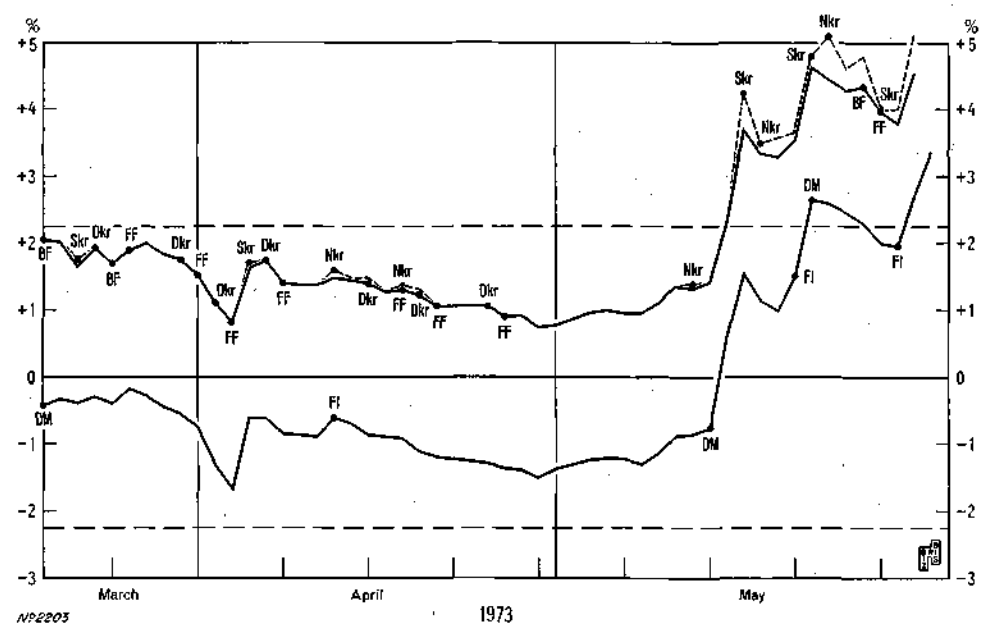
When foreign exchange markets reopened on 28th June the currencies remaining in the snake, except for the lira, returned quickly to their dollar ceilings, at or near to which they remained until the second half of July. While some of them came away from their upper limits in the third week of July, the snake itself did not move significantly away from the roof of the tunnel until late September. Denmark rejoined the scheme on 11th October, reserving the right to intervene within the limits of the snake and to do so in dollars.

At the end of 1972 the dispensation permitting the Italian authorities to support the lira exclusively in dollars expired and there was at the same time some general relaxation of the rules regarding intervention and settlement. Nevertheless, reactivation of Community support for the lira immediately brought the snake lower in the tunnel. The dollar's acute weakness early in February sent the other currencies in the snake to or close to their dollar ceilings, but the lira, despite the splitting of the official exchange market, was still in need of support. Italy then withdrew from the scheme.

Following the devaluation of the dollar those currencies still in the snake opened quite weak, but by 1st March all were at the roof of the tunnel again. Arrangements for a joint float against the dollar were concluded on 11th March between Belgium-Luxemburg, Denmark, France, Germany and the Netherlands and put into operation on 19th March. Norway and Sweden decided to participate in the joint float, while the United Kingdom, Ireland and Italy expressed their intention to do so as soon as conditions allowed. The same arrangements as before apply to interventions in participants' currencies but there is of course no longer any obligation to intervene in dollars at set limits. However, the possibility of dollar interventions is not excluded and they may take place by general agreement among the members of the group. Responsibility for the concerted action necessary to ensure the proper functioning of the scheme and for the multilateralisation of resulting positions between EEC central banks and of intra-Community settlements now rests with the newly-created European Monetary Co-operation Fund which was established in April this year and began operations on 1st June (see Chapter VII).

Conditions were generally calm during the first eight weeks of the joint float; the European currency band had moved down by over 1 per cent. against the dollar by the end of April but regained about half of that ground during the first two weeks of May. The Deutsche Mark and the guilder were alternately the weakest participating currencies, each requiring some support. In mid-May the situation changed abruptly as the dollar came under pressure again and the snake moved out of what would, on the former basis, have been the tunnel. On 1st June the weakest of the participating currencies, the guilder, was about 4½ per cent. and the strongest, the Swedish krona, nearly 7 per cent. above its nominal central rate against the dollar.

Joint float of European currencies against the US dollar.
Daily spot quotation of lowest and highest quoted currency as percentage above (+) or below (—) central or middle rates as from 19th March 1973.



Note: The continuous lines indicate the movements of EEC currencies and the broken lines those of non-EEC currencies.

Sterling. In the early months of 1972 sterling strengthened quite appreciably against the dollar, from about 2 per cent. below its Smithsonian parity at the turn of the year to a little above it in mid-April. It was still slightly above par on the dollar on 14th June, when confidence suddenly evaporated and the run on sterling began that led on 23rd June to the decision to allow the rate to float. The crisis was sparked off by the imminent prospect of a national dock strike; its fundamental causes, however, were more general fears about industrial strife, receding hopes that existing policies would succeed in containing inflation and consequent growing uneasiness about prospects for the balance of payments — even though the current external account for the second quarter of 1972 was still in surplus at an annual rate of over $1 milliard.

At the end of the crisis week sterling was still 1 per cent. above its lower limit vis-à-vis the dollar, thanks to $2.6 milliard support from EEC countries; the three-month forward discount, however, had widened to over 8 per cent. per annum. And when the float began the spot rate quickly fell to about 7 per cent. below par at the beginning of July. It subsequently stabilised at a discount of some 6 per cent. for about two months, being supported well into September by covering on the part of some who had sold sterling three months forward during the June crisis.

This support came to an end at the same time as rumours began to circulate that sterling might be repegged. The spot rate then began to decline again in the last week of September; this movement accelerated in the second half of October as it became clear that the government's attempts to introduce a voluntary prices and incomes policy had failed. On 30th October the rate reached a low point of around \$2.33, which was 10½ per cent. below the Smithsonian parity. The announcement of the price/wage freeze, however, halted the slide and the rate recovered a little, the discount on the Smithsonian parity fluctuating fairly narrowly around 10 per cent. until the end of the year.

Since the beginning of 1973 sterling has recovered most of the ground lost against the dollar in 1972. To a considerable extent, of course, this has reflected the dollar's weakness rather than any particular strength of sterling, which has in fact depreciated further against most European currencies and the yen, and which is still floating even against its partner currencies in the Common Market. Sterling's recovery against the dollar began early in January and by 9th February, just before the dollar devaluation, the rate was about 8½ per cent. below the Smithsonian parity. When the markets reopened after devaluation the gap narrowed to less than 6½ per cent. and by the time the markets all closed again on 2nd March it was rather over 3½ per cent. Following the second reopening of markets, on 19th March, sterling was quoted at some 5½ per cent. below the Smithsonian parity; it soon began to strengthen again, however, and by the beginning of May the gap had narrowed to 4½ per cent. In the renewed run out of the dollar that followed, sterling again appreciated quite sharply to within little more than 1 per cent. of its Smithsonian dollar parity at the beginning of June.

During the first half of 1972, until sterling was floated, the rate for the dollar in the London investment currency market — where UK residents purchase foreign currency for portfolio and, if access to the official market is not granted, other foreign investments and where they dispose of 75 per cent. of the proceeds of the sale of such investments — fluctuated between 18 and 35 per cent. above the rate in the official exchange market, standing at a 30 per cent. premium on 22nd June. Exchange control measures introduced the next day broadened the investment currency market to include portfolio investment transactions with overseas sterling countries. The price of investment dollars fell over the next week to a premium of only 13 per cent. above the considerably depreciated rate in the official market, no doubt owing in part to profit-taking by holders of overseas sterling securities. By the end of the year, however, the premium of the investment dollar had increased again to some 25 per cent. In the first months of 1973 the gap between the two rates narrowed again, reflecting the weakness of leading overseas stock markets as well as some profit-taking after Australia's end-1972 revaluation. During May 1973 the premium was in the range of 10–15 per cent. and the absolute price of investment dollars in terms of sterling the lowest for any sustained period since the 1967 devaluation of sterling.

Deutsche Mark. During 1972 and the first part of 1973 the performance of the Deutsche Mark in the exchange markets to a considerable extent reflected, though with the signs reversed, the varying fortunes of the US dollar. At the beginning of 1972 the Deutsche Mark, in the wake of the Smithsonian agreement, was still about 1½ per cent. below its central rate on the dollar in the spot market; it moved above the central rate in mid-January and was in heavy demand during the February–March

Exchange rates for the US dollar, 1971-73.

Currencies	Parity at 5th May 1971	Changes between: 5th May 1971 and Smithsonian realignment	Smithsonian realignment and 19th March 1973[1]	19th March 1973[1] and 1st June 1973	Cumulative change 5th May 1971 to 1st June 1973	Closing market rate on 1st June 1973
	Currency units per US dollar	Percentage appreciation (+) or depreciation (—) against US dollar				Currency units per US dollar
Deutsche Mark . .	3.66	+ 13.6	+ 14.4	+ 5.2	+ 36.8	2.6755
French franc[2] . .	5.55419	+ 8.6	+ 11.1	+ 6.4	+ 28.3	4.3275
Belgian franc[2] . .	50	+ 11.6	+ 11.1	+ 6.1	+ 31.6	37.999
Dutch guilder . . .	3.62	+ 11.6	+ 11.1	+ 4.5	+ 29.6	2.7925
Danish krone . . .	7.5	+ 7.4	+ 11.1	+ 5.5	+ 25.9	5.9550
Norwegian krone .	7.14286	+ 7.5	+ 11.1	+ 6.5	+ 27.2	5.615
Swedish krona . .	5.17321	+ 7.5	+ 5.5	+ 6.9	+ 21.3	4.2650
Austrian schilling .	26	+ 11.6	+ 13.6	+ 4.9	+ 33.0	19.545
Pound sterling . .	2.40[3]	+ 8.6	— 5.6	+ 4.6	+ 7.3	2.5745[3]
Italian lira[2]	625	+ 7.5	+ 1.7	— 1.1	+ 8.1	578.225
Swiss franc	4.372825	+ 13.9	+ 18.1	+ 5.6	+ 42.1	3.07625
Japanese yen . . .	360	+ 16.9	+ 16.7	— 0.3	+ 36.0	264.70

[1] Nominal central or middle rates for first eight currencies listed; closing market rates for last four (20th March for lira). [2] Commercial rate where two-tier market exists. [3] US dollars per pound.

movement out of the dollar. Although the rate did not quite reach the upper limit during that phase the authorities bought quite substantial amounts of dollars. Subsequently it settled down in the range 1–1½ per cent. above the central rate, until being pulled down by the decline of sterling in the third week of June. When sterling withdrew from the snake the Deutsche Mark at once went to its upper limit against the dollar. It then remained there until, following the EEC Finance Ministers' meeting on 17th–18th July and the resumption of exchange-market operations in Deutsche Mark by the Federal Reserve System on 19th July, it became clear that no change in the exchange rate was imminent.

For the remainder of 1972 and into the first days of 1973 the Deutsche Mark, in common with other European currencies, was somewhat easier against the dollar. From mid-August 1972 it was rarely more than 1 per cent. above its Smithsonian central rate, while in October and again in January 1973 it declined almost to the central rate. In the February–March 1973 currency crisis the Deutsche Mark bore the brunt of the flight from the dollar. The spot rate was at its upper limit from 1st to 9th February and the three-month forward rate went to a premium of 8 per cent. per annum. After the devaluation of the dollar the spot Deutsche Mark at first declined to its new lower limit, but as the second phase of the crisis developed it rose to the new upper limit vis-à-vis the dollar on 1st March and to over 4½ per cent. above its new central rate on the following day, just before the markets were closed.

Before the markets reopened on 19th March the Deutsche Mark was revalued by 3 per cent. Not surprisingly after the enormous inflows of funds that had come to Germany in February and the beginning of March, the Deutsche Mark was at first the weakest of the jointly floating currencies, being more than 1½ per cent.

below its nominal dollar parity in early April and receiving some support from other participants in the joint float. In the forward market, however, it continued to be strong against the dollar. The spot rate reacted to the renewed weakness of the dollar in May, rising from nearly 1 per cent. below to 5 ¼ per cent. above the nominal parity on 1st June.

French franc. Following the Smithsonian realignment the commercial French franc moved above its middle rate vis-à-vis the dollar early in February 1972 and touched its upper limit during the March currency disturbances. It then eased somewhat but became very firm again in early May, being close to its upper limit from the middle of that month until pulled down by sterling in the third week of June. Meanwhile the financial franc, thanks to substantial non-resident purchases of French securities, had risen to a premium of over 6 per cent. on the commercial rate just before the sterling crisis.

Following the UK decision to float the pound the commercial franc rebounded to its upper limit and was the last of the European currencies to move away from it. At the end of September it was still within ½ per cent. of its upper limit, with the financial rate some 2½ per cent. higher. During the last quarter of 1972 the franc underwent an abrupt change of fortune. The commercial rate eased, at first gradually but then more sharply in December, going just below par on the dollar at the end of the year. The financial rate slipped below the commercial rate during November, although never far. The three-month forward rate, which had shown a small premium over the commercial spot rate since early June, swung in October to a discount, which reached 2 per cent. per annum in December. Among the influences contributing to the weakening of the franc were the October decline of sterling, uncertainty about the outcome of the March 1973 general elections and concern about inflation.

Early in 1973 the franc turned firmer. In the commercial market it was near its Smithsonian ceiling before the dollar devaluation, and against its new dollar ceiling on 1st March. During that period the financial rate remained close to the commercial one, while the three-month forward rate reverted to a premium late in February. The joint float began shortly after the general elections had confirmed the political status quo and the commercial franc settled in the upper half of the European snake. In early May the franc became temporarily the strongest participating currency, with the commercial rate about 1 per cent. above the nominal dollar parity and the financial rate very close to it. At the beginning of June the franc was about 6½ per cent. above its nominal central rate against the dollar in the commercial exchange market and some ¾ per cent. higher than that in the financial market.

The Belgian franc and the Dutch guilder. Following the December 1971 currency realignment the commercial Belgian franc and the Dutch guilder remained for a considerable period well within the band of 1½ per cent. on either side of their cross parity that had been agreed on in August 1971. The Belgian franc was the firmest European currency in the immediate post-Smithsonian period, with the guilder not far behind. Both were against their dollar ceilings at times in February and early March 1972, subsequently easing somewhat until the eve of the sterling crisis, when the franc was again close to its upper limit with the guilder ¾ per cent. lower. After declining during the third week of June, both rose to their upper limits against the dollar as soon as sterling began to float.

Subsequently the movements of the two currencies began to diverge. The guilder came away from its ceiling in the second half of July; it then eased steadily to around its central rate for much of October and rarely rose more than ½ per cent. above it for the rest of 1972. The Belgian franc, on the other hand, only moved away from its upper limit against the dollar in mid-August, at which time the Federal Reserve System sold some francs in the market; nor did it decline as far as the guilder, remaining generally about 1 per cent. or a little more above parity on the guilder for the rest of the year. On occasions this gap was wider and during September and October the Benelux intervention arrangements were put into operation, with the Netherlands incurring indebtedness towards Belgium. The relative strength of the Belgian currency at that time was attributable to Belgium's strong current balance of payments, together with a tightening of monetary policy, while in the Netherlands there was some unwinding of earlier favourable leads and lags.

In early January 1973 both the franc and the guilder eased against the dollar as a consequence of the weakening of the lira. Subsequently both currencies rose to their upper limits against the dollar in early February and again, to their new limits, at the beginning of March, with the guilder in fact going to nearly 2½ per cent. above its new dollar central rate on 1st March.

When the joint float began the guilder was the second weakest participating currency, while the franc was one of the strongest. Both eased substantially over the following six weeks, in relation to the other participants in the joint float and vis-à-vis the dollar. For much of the time since early April the guilder has been the weakest currency in the snake; furthermore the Benelux support mechanism has again had to be put into operation. Both the commercial Belgian franc and the guilder strengthened against the dollar during May and on 1st June they were respectively 6 and 4½ per cent. above their nominal dollar central rates.

In the free (financial) market the Belgian franc was — except for two periods in March–early April and July–early August — within ½ per cent. of its position in the regulated exchange market during 1972. A premium developed in both phases of the February–March 1973 currency disturbances, reaching about 2 per cent. on 1st March, but this had disappeared by end-April.

Lira. After the Smithsonian realignment the lira stayed below its new central rate for a number of months, except during early March 1972. Early in June it stood ½ per cent. above that rate before drifting downwards again. Following the sterling crisis and the decision to float the pound the lira came under strong pressure and, as mentioned earlier, Italy was allowed temporarily to support the lira in the snake by intervention in dollars. For much of the rest of 1972 such support proved to be necessary on a very substantial scale, the lira being continuously at or close to its maximum allowable distance from other participating currencies. With these well in the upper part of their possible range against the dollar the lira was held well above its dollar floor.

When, from 1st January 1973 onwards, Italy began to conform again to the EEC exchange-market intervention arrangements, the lira was supported against the Belgian franc and the Danish krone. This had the effect of dragging the EEC band down, the lira falling from just under its central rate at the end of December to 1 per cent. below by 19th January. On 22nd January the authorities announced the splitting of the official exchange market into two parts: for commercial transactions the market would continue as before, although action was taken to limit the scope for leads and lags, while financial transactions were diverted to a separate market where the lira would be free to find its own level. The commercial lira then became firmer and was just above its central rate immediately before the devaluation of the dollar; by that time the rate in the financial market, which had at first fallen to an 8 per cent. discount, had recovered to within less than 4 per cent. below the central rate.

After the devaluation of the dollar Italy decided to leave the commercial rate also free to float, thereby withdrawing from the EEC arrangements. Both rates were firmer against the dollar when markets reopened on 14th February and they rose further during the second phase of the currency crisis. After mid-March, however, the lira lost ground again and in early May the commercial rate was about 1¾ per cent. and the financial rate some 3¼ per cent. below the Smithsonian central rate. With the renewed weakening of the dollar, however, by the beginning of June the two rates were respectively ½ per cent. above and some 2½ per cent. below that rate.

Since the splitting of the official exchange market the discount on lira bank-notes, which had emerged in other countries following the prohibition in June 1972 of the crediting of repatriated notes to non-resident accounts at Italian commercial banks, has dropped markedly; from 9 per cent. in early January it had come down to 5 per cent. on the commercial rate by 1st June.

Swiss franc. The Swiss franc appreciated against the dollar more than any other currency during the period under review — essentially since it began to float in late January 1973. Its strength so far this year contrasts strongly with its relative weakness in the first part of 1972. In fact, following the Smithsonian realignment the Swiss franc was, except for a few days in early March, consistently below its new middle rate vis-à-vis the dollar until early June. As soon as sterling began to float, however, the franc went to its upper limit; the authorities then withdrew from the market and the rate went a little higher, to about 3 per cent. above the middle rate.

Official intervention was resumed on 3rd July and by mid-month, despite new controls to discourage inflows of funds, the authorities had had to buy $1.3 milliard from the market at the upper limit. Together with some other European currencies the franc eased against the dollar from mid-July onwards and at the beginning of October the rate was a little less than 1 per cent. above the middle rate. At that point the authorities sold some dollars to the market, partly to absorb domestic liquidity, and the rate subsequently declined no further.

From mid-November onwards the franc became firmer again, mainly as a result of a tightening of monetary policy. It was practically at its upper limit again by mid-January 1973, soon after which the splitting of the Italian exchange market touched off a big demand for francs that led the authorities, after purchasing fairly substantial amounts in the market, to let the franc float as from 23rd January in order to protect domestic liquidity from the dangers of massive further inflows.

By the end of the first phase of the ensuing currency crisis, on 9th February, the franc had appreciated to more than 9 per cent. above its former middle rate vis-à-vis the dollar; following the devaluation of the dollar it rose again, more sharply than before, and by 2nd March had climbed to 23 per cent. above its Smithsonian middle rate, that is almost 11 per cent. over and above the second dollar devaluation. From that peak it fell 5 per cent. when markets reopened on 19th March. After fluctuating rather narrowly against the dollar until mid-May, the Swiss franc then appreciated again strongly, to a level nearly 25 per cent. above its Smithsonian middle rate on 1st June.

Yen. The yen went close to its Smithsonian ceiling in February and March 1972 but from then until the June–July exchange crisis it was mostly in the range of 1–1½ per cent. above its central rate. When the dollar came under pressure after sterling began to float the yen moved swiftly to its ceiling and remained there until the end of the year. The rate edged away from the upper limit at the beginning of 1973 and remained below it during January. At the beginning of February, however, it went back to the ceiling and the authorities purchased $1.1 milliard before closing the exchange market on 10th February. When the dollar was devalued Japan announced that the yen would be allowed to float temporarily. After the market reopened the yen rose to some 15½ per cent. above its Smithsonian central rate on 1st March. For most of the time since then it has remained at that level, with the Japanese authorities selling quite substantial amounts of dollars in the exchange market from mid-March onwards. By the beginning of June, however, the yen had appreciated by a further 1 per cent. against the dollar.

Canadian dollar. The Canadian dollar fluctuated within the range US $0.99–1.03 during the period under review. At the beginning of 1972 it was slightly below par with the US dollar. Over the following months it rose, assisted by the strength of the external current account and by the level of domestic short-term interest rates, to a peak of US $1.02¾ in June, while at the same time official intervention in the market produced a quite substantial increase in reserves. In June the authorities took steps to hold down interest rates and the dollar eased to somewhat below US $1.02. Over the next four months there was little change either in the exchange rate or in official reserves. From late October to mid-December the Canadian dollar fell quite sharply, in large part owing to a swing of short-term interest rate differentials in favour of the US dollar, and the authorities intervened again in November, this time to sell US dollars to the market. So far in 1973 the Canadian dollar has moved narrowly around par on the US dollar, with little net movement in reserves. The Canadian currency was not greatly affected by the events of February–March, when the authorities made it clear that they did not wish to see an appreciation relative to the US dollar, although the rate was temporarily bid up by about 1 per cent.; nor was it significantly influenced by the weakness of the US dollar in May.

Austrian schilling. The schilling moved above its Smithsonian central rate in January 1972 and remained in the upper half of its permitted range against the dollar for the next twelve months, though without ever reaching its ceiling. It did, however, move up to that ceiling immediately before the dollar devaluation in February 1973, and then, on 1st March, to its new ceiling. On 13th March the schilling was revalued by 2¼ per cent. and at the end of that month the Austrian authorities decided that, although Austria would not participate in the joint European float, they would intervene in the market as necessary in order to keep the schilling within 2¼ per cent. of its average cross rate with the currencies of the participating countries, weighted according to their importance in Austria's trade.

Other currencies. Following the Smithsonian agreement the Swedish krona moved above its new central rate against the dollar in mid-January, followed by the Norwegian krone about a month later and the Danish krone temporarily in early March and more durably in May. The Danish currency weakened markedly in sympathy with sterling during June but subsequently went above its central rate at the end of that month; it then remained there for the rest of the year. The Norwegian and Swedish currencies were also firm throughout this period, the former being very close to its upper limit for some time following the floating of sterling but falling almost to its central rate towards the end of September — when the Norwegian electorate rejected entry into the EEC. All three currencies were at their ceilings immediately before the dollar devaluation in February 1973. The central rate for the Swedish krona was then lowered by 5 per cent. and the krona soon moved to its new ceiling. The Danish currency, but not the Norwegian, was also at its upper limit against the dollar on 1st March. Subsequently all three were amongst the firmest currencies in the joint European float. At the beginning of June the Swedish krona was almost 7 per cent. above its nominal central rate against the dollar, while the Danish and Norwegian currencies were respectively 5½ and 6½ per cent. above theirs. Finland, following Sweden, lowered the central rate for its currency by 5.4 per cent. immediately after the dollar devaluation in February 1973.

The Spanish peseta remained at its Smithsonian floor until mid-March 1972. It then rose to slightly below its middle rate, where it remained until after the sterling crisis in June. From then on it stood mostly at some 1½ per cent. above its middle rate up until the devaluation of the dollar in February 1973. After that the peseta opened somewhat below its new central rate, but soon moved up to that level and has since remained close to it.

The Portuguese escudo moved above its Smithsonian central rate in February 1972 and later appreciated a little further, being mostly some 1 per cent. above that rate during the second half of the year. After going still higher before the dollar's devaluation the central rate for the escudo was itself then lowered by 3.8 per cent. At the beginning of June the escudo was 6 per cent. above its nominal central rate against the dollar.

Other exchange developments.

The most important single exchange development during the period under review was certainly the 10 per cent. devaluation of the US dollar on 13th February

1973. In their reactions to this decision other countries may be divided, on the basis of available information, into four groups. One group consisted of those countries which maintained their par values or central rates unchanged in terms of gold and SDRs: these were Algeria, Australia, Austria, Bahrain, Belgium-Luxemburg, Botswana, Burma, Burundi, Cyprus, Denmark, Egypt, Ethiopia, France and the countries of the French franc area, Germany, Ghana, Guinea, Hong Kong, Iran, Iraq, Jordan, Kuwait, Lesotho, Libya, Malaysia, Morocco, the Netherlands, New Zealand, Norway, Pakistan, Qatar, Rumania, Saudi Arabia, Singapore, South Africa, Spain, Swaziland, Tunisia, the USSR, the Yemen and Zambia. A second group consisted of those which devalued with the dollar: they were Argentina, Bolivia, Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, El Salvador, Greece, Guatemala, Haiti, Honduras, Iceland, Indonesia, Israel, Jamaica, Kenya, the Khmer Republic, South Korea, Laos, Liberia, Mexico, Nicaragua, Nigeria, Panama, Paraguay, Peru, the Philippines, Rwanda, the Sudan, Surinam, Syria, Tanzania, Thailand, Turkey, Uganda, Uruguay, Venezuela, South Vietnam, Yugoslavia and Zaïre. A third group, consisting of Brazil, Finland, Nepal, Portugal, Sweden and Taiwan, devalued, but by less than the United States. Fourthly, certain countries either continued to float against the US dollar or began to do so: these were Bangladesh, Canada, the Gambia, Guyana, India, Ireland, Italy, Japan, Malawi, Malta, Mauritius, Sierra Leone, Sri Lanka, Switzerland, Trinidad and Tobago, and the United Kingdom. This group was joined on 19th March by Austria, Belgium-Luxemburg, Denmark, France, Germany, the Netherlands, Norway, Portugal and Sweden.

Apart from the exchange rate developments already described, the period under review was chiefly notable in the exchange field for the various administrative measures adopted to try and keep the international payments disequilibrium within certain limits, so as not to threaten the Smithsonian structure of exchange rates. In practice that meant that with each successive post-Smithsonian run on the US dollar — in February–March 1972, June–July 1972 and February–March 1973 — the surplus countries added to their already impressive armoury of controls directed against inflows of funds, in some cases supplementing them by measures designed to stimulate outflows of funds from their markets. While this ever-increasing paraphernalia of restrictions did not prevent the rather widespread abandonment of fixed exchange rates in March 1973, floating rates have so far not brought about any significant dismantling of those restrictions.

In *Germany* the first important measure taken in 1972 against inflows of funds was the activation on 1st March of the Bardepot (cash-deposit) law, aimed essentially at controlling the foreign borrowing of German non-bank corporations, with the Bardepot ratio fixed at 40 per cent. Certain categories of foreign credits — those directly connected with the normal settlement of transactions in goods and services, borrowing to refinance exports or to cover them forward and borrowing to finance investment abroad, as well as all credits of DM 2 million or less — were exempt from the requirement but had to be reported to the authorities. The ratio was raised to 50 per cent. in July 1972 and the threshold for its application reduced in that month to DM 500,000 and again in January 1973 to DM 50,000. The raising of the Bardepot ratio in July was accompanied by increases in the minimum reserve ratios applicable to both the total and the post-November 1971 growth of the banks' deposit liabilities to non-residents. The effect of this measure was to increase the required reserve ratio on such liabilities to between 90 and 100 per cent.

One effect of the application of the Bardepot was to shift inflows of funds into other channels, particularly through security transactions; accordingly, in late June 1972 all sales to non-residents of domestic fixed-interest securities were made subject to official authorisation, which in practice was not given. This measure was modified in September to allow German banks to sell bonds with maturities of more than four years to individual customers provided that there was no increase in the overall total of German bonds held by their non-resident customers.

In February 1973 still further restrictive measures were taken. The controls on non-resident purchases of fixed-interest securities were extended to purchases of German equities; all non-resident investments of over DM 500,000 in enterprises operating in Germany were made subject to official authorisation; and the taking-up by residents of foreign loans or credits in excess of DM 50,000 was also brought under official control, it being understood that in general no credits subject to the Bardepot would be allowed.

In *Belgium-Luxemburg* three new administrative measures were taken during the period under review to discourage inflows of funds. Firstly, in March 1972, the banks were instructed not to allow any further increase in their net spot foreign liabilities, whether in Belgian francs or foreign currencies, on the regulated exchange market. At the same time they were asked not to incur substantial overall net foreign liability positions, spot and forward combined, on the regulated exchange market. Secondly, at the height of the exchange-market disturbances at the beginning of March 1973, the use by non-residents of their convertible Belgian franc accounts was temporarily restricted solely to making payments for purchases of goods and services from BLEU residents. Thirdly, when the exchange markets reopened on 19th March 1973 a negative interest charge of 0.25 per cent. per week was applied to all balances on non-residents' convertible Belgian franc accounts in excess of the average fourth-quarter 1972 level.

In the *Netherlands* the authorities reacted to the March 1972 inflow of funds by banning the payment of interest on non-residents' guilder demand deposits and by withdrawing the general licence for non-residents to place guilders on time deposit with banks in the Netherlands. In July residents were prohibited from taking up financial credits abroad and at the same time steps were taken to restrict the terms of payment for Netherlands imports and exports to those customary in the various sectors of industry. Following the decision to let the guilder float against the dollar in March 1973 a 50 per cent. reserve requirement — subsequently raised in April to 80 per cent. — was imposed on any net liability position in guilders of banks in the Netherlands vis-à-vis non-residents. At the same time a negative interest charge of 0.25 per cent. per week was applied to any further increase in non-residents' guilder deposits. This measure was withdrawn in early May but the ban on the payment of interest on non-resident deposits remains in force.

In *Japan* further measures were taken in 1972 and the first part of 1973 both to restrict inward movements of funds to Japan and to encourage outflows. So far as controls on inflows are concerned, the first step taken was to reintroduce in February 1972 the restriction (abolished very shortly after the Smithsonian agreement) on the conversion of advance export receipts into yen. At the same time foreign banks operating in Japan were prohibited from making any further conversions of dollars into yen. In June a 25 per cent. reserve requirement was imposed on increases in banks' free yen liabilities to non-residents and in July the reserve ratio was raised to 50 per cent. Other measures taken immediately following the floating of sterling included a renewed tightening-up of restrictions on the conversion of advance export receipts as well as restrictions on advance conversions by non-residents of foreign currencies into yen for the purpose of buying Japanese securities. This was followed in October by a decision to prohibit any further increase in overall non-resident holdings of Japanese securities, new non-resident security purchases being allowed only to the extent of non-resident security sales.

As to measures designed to promote outward movements of funds, in May 1972 all residents were allowed to retain indefinitely foreign exchange earned in transactions with non-residents — previously only banks and shipping, trading and insurance companies had been allowed to do so — and to open freely foreign currency accounts with banks. Later the same month the regulations governing foreign portfolio investment were eased and in June all restrictions on residents' direct investments and purchases of real estate abroad were lifted. In August non-resident issuers of yen bonds were required to convert 90 per cent. of the proceeds into foreign currency immediately after issue.

Switzerland took a number of quite severe new measures to control inflows of funds in the period immediately following the floating of sterling. Foreign investment in domestic securities, mortgages and real estate were prohibited; a negative interest charge of 2 per cent. per quarter was applied to increases in non-resident Swiss franc deposits over Sw. fr. 50,000; the taking-up of foreign credits of over Sw. fr. 1,000,000 (reduced in April 1973 to Sw. fr. 50,000 except for credits not converted into Swiss francs) by non-bank residents was made subject to official authorisation; and the banks were obliged to balance daily their overall spot and forward foreign currency positions. This last measure was suspended in October 1972 but reintroduced early in 1973.

During the course of 1972 the Swiss authorities also modified on a number of occasions the rules governing the conversion into foreign currency of Swiss franc loans raised by non-residents. From late February onwards at least 25 per cent. of the proceeds of such loans had to be converted into dollars at the Swiss National Bank at its official selling rate of Sw.fr. 3.9265; in May the conversion quota was raised to 40 per cent. and the exchange rate changed to Sw.fr. 3.88; in July the rate was raised to Sw.fr. 3.80 and in September the conversion quota to 50 per cent. for loans of up to five years and 60 per cent. for longer-term loans. In January 1973 the obligation to convert at the National Bank was abolished. Moreover, in February 1972 non-resident subscriptions to privately-placed medium-term Swiss franc notes were limited to 40 per cent. of the total of any such placement — in July this limit was extended to Swiss franc bond issues by non-residents — and foreign banks were no longer allowed to subscribe to them at all.

In *France* most of the controls on inflows of funds that had been introduced between August and December 1971 were abolished following the Smithsonian realignment and in addition a number of restrictions on outward transfers of funds were relaxed (see 42nd Annual Report, page 143). Nor were any new measures introduced during either the February–March or the June–July 1972 exchange market disturbances. In mid-March 1973, however, following the decision to participate in the joint European float against the dollar, new measures against possible future inflows were introduced: the remuneration of newly-opened non-resident French franc accounts, except those with a fixed term of more than six months, was prohibited; non-residents' financial franc accounts could no longer (with some minor exceptions) be used to purchase short-term money-market paper or for transfers to savings accounts; a marginal reserve requirement of 100 per cent. was applied to increases in the banks' franc liabilities to non-residents above the level of 4th January 1973 (in July the reserve requirements on the banks' total franc liabilities had been increased from 10 to 12 per cent. in respect of sight liabilities and from 4 to 6 per cent. for other liabilities); the banks were prohibited from entering into, or renewing, swap operations involving forward sales of French francs to non-residents against spot purchases; and in addition they were instructed not to increase their net forward asset positions in foreign exchange beyond the end-February levels. In early April the remaining restrictions on forward purchases of exchange by French importers were removed, as was the ban on exporters granting credits of more than six months to their foreign customers.

Austria, too, took further measures during the period under review to restrain inflows of funds. At the end of November 1972 limits were placed both on non-resident purchases of Austrian securities and real estate and on residents' freedom to borrow abroad for financing imports or domestic investment, as well as for refinancing export claims. The gentleman's agreement between the banks and the Austrian National Bank, providing for the placing on non-interest-bearing accounts at the National Bank of 75 per cent. of any increase in the banks' schilling liabilities to non-residents over and above their mid-August 1971 level, has remained in force.

In *Spain* further measures designed to curb the increase in non-residents' peseta accounts were taken during the period under review. Already in October 1971 the banks had been subjected to a 100 per cent. reserve requirement on any further increase in non-residents' convertible peseta accounts at less than 90 days' notice; in July 1972 a 50 per cent. reserve requirement was imposed on any further increases in non-residents' convertible peseta accounts at 90 days' notice or more and in early February 1973 the required reserve was raised to 100 per cent. Following this, in mid-March it was made impossible for non-residents to repurchase foreign exchange with pesetas previously acquired through the sale of foreign exchange and at the same time payment of interest on non-resident peseta accounts was prohibited.

In *Sweden* there were a number of relaxations of exchange controls during 1972. These included a raising of the limits on the banks' foreign exchange holdings, the removal of restrictions on capital exports of up to S.kr. 100,000 by Swedish emigrants and the extension from one to two years of the maximum period for which residents may obtain forward cover in respect of payments for imports, freights and charter rents. In March 1973 a number of measures were taken to stem the large inflows of funds to Sweden that were taking place: non-residents whose holdings of kronor with Swedish banks went up above the average level for January 1973 were threatened with a negative interest charge on the excess; and it was announced that until further notice 10 per cent. of the proceeds of all bank sales of foreign exchange to the central bank would have to be deposited in non-interest-bearing accounts for six months.

In *Denmark* the ban on the acquisition of Danish shares by non-residents was lifted at the beginning of 1973 and the restrictions on their purchases of Danish bonds were eased. Some further easing of exchange control was announced in March 1973. It included complete freedom for trade credits of up to five years between residents and non-residents, as well as some greater freedom for inward and outward direct investment, and for property investment abroad by residents.

In *Finland* the requirement introduced in November 1970 that cash be paid in advance of customs clearance for certain categories of goods, accounting for about one-quarter of the country's total imports, was abolished in June 1972. Since the beginning of 1973 Finnish residents have no longer been required to surrender all foreign exchange earnings but may now hold them in foreign exchange accounts with banks.

In *Italy*, apart from the exchange rate measures mentioned on page 143, a number of other steps were taken during the period under review both to stem capital outflows and to encourage inflows of funds. At the end of June 1972 the banks were authorised to incur net liability positions vis-à-vis non-residents, while still being prohibited, as they had been since September 1971, from establishing net foreign asset positions. As an inducement to them to borrow abroad, in December 1972 the Italian Exchange Office offered the banks facilities for swapping dollars against lire at par for periods of three months.

In late January 1973, at the same time as the official foreign exchange market was split, the authorities attempted to limit the scope for unfavourable leads and lags by reducing the maximum periods authorised for advancing import payments and deferring export receipts from 90 to 30 days and from one year to 90 days respectively. The maximum period for which residents were permitted to hold foreign exchange eligible for sale on the commercial exchange market was also reduced, from 180 to 30 days. In addition, in the second half of February the maximum period for which residents were permitted to hold foreign exchange eligible for sale on the financial exchange market was reduced from 30 to 7 days. At the beginning of February 1973 the foreign travel allowance for Italian residents was reduced from Lit. 1 million to Lit. 500,000 per trip.

In the *United Kingdom* the decision to allow sterling to float in June 1972 was accompanied by measures to control current payments and outflows of capital to sterling-area countries with the exception of the Republic of Ireland and, subsequently, Gibraltar. As regards capital movements, direct investments by UK residents in sterling-area countries were made subject to prior official authorisation and portfolio investment was shifted from the official exchange market to the investment dollar market. The whole of the proceeds of the sale of sterling-area securities, however, may be converted in the investment dollar market, whereas in the case of sales of non-sterling-area securities 25 per cent. of the proceeds is still required to be sold on the official exchange market. In May 1973 the rule, introduced in March 1972, whereby domestic companies controlled by residents of EEC countries could finance new direct investment in the United Kingdom by borrowing sterling from UK sources was extended to apply to investments of this kind made by all non-resident-controlled domestic companies.

In *Canada,* with effect from 1st April 1972, the restraints on capital outflows to countries other than the United States, introduced in 1966 and extended in 1968 in order to prevent outflows of funds from the United States through Canada to other countries, were modified to exclude all new export credits granted by Canadian residents as well as loans made to, or guaranteed by, governments or central banks of developing countries.

In the *United States* no change was made during the period under review in the various controls on capital outflows. At the time of the dollar devaluation in February 1973, however, the US authorities announced their intention of phasing the controls out by the end of 1974.

In the *sterling area,* reactions to the United Kingdom's decision to float the pound sterling may be divided into three main groups. First, some countries whose currencies were already pegged on the dollar made no change in their dollar exchange rates: they were Australia, Ghana, Iceland, Jordan, Kenya, New Zealand, Nigeria, Pakistan, Tanzania, Uganda, Western Samoa and Zambia. Secondly, several countries that were previously pegged to sterling also maintained their dollar exchange rates, thus switching to pegging on the dollar: they were Cyprus, Hong Kong, Kuwait, Malaysia, Oman and Singapore. Thirdly, a number of countries chose to float with sterling; these were Bangladesh, Barbados, Botswana, Fiji, the Gambia, Guyana, India, Ireland, Jamaica, Lesotho, Malawi, Mauritius, Sierra Leone, South Africa, Swaziland, and Trinidad and Tobago. To these may be added Sri Lanka, which switched back from being pegged on the dollar to being pegged on sterling. Malta opted for a managed, unilateral float. Finally, Iraq, though not in the sterling area, pegged its currency to sterling shortly before the float began.

There were several other significant developments in the sterling area during the period under review. In *Australia* a number of measures were taken in late September to hold down the increase in official reserves and to limit the growth of foreign control over domestic companies: on the one hand, restrictions on foreign portfolio investment by residents were eased and the guide-lines limiting foreign companies' borrowing in Australia were abolished; on the other, the Reserve Bank withdrew approval for all overseas borrowing by residents exceeding A$100,000 per year and repayable, or carrying options to repay, within two years. To reinforce this measure, the existing exemption for borrowing in Australian dollars from sterling-area residents was terminated. In addition, in late October interim legislation was introduced to prevent foreign take-overs that were not regarded as being in the public interest, including any that would result in a foreign holding of 15 per cent. or more by a single entity, or 40 per cent. or more in aggregate, of the voting shares of a domestic company. With effect from 22nd December, the Australian dollar was revalued by 4.85 per cent. against gold, the new parity being fixed at 1.04360 grammes of fine gold. Against the dollar, however, the revaluation amounted to 7.5 per cent. (see 42nd Annual Report, page 146). At the same time, the measures restricting capital inflows were tightened: in particular a variable deposit requirement was introduced in respect of new overseas borrowing, other than trade credit, at terms of over two years and exceeding A$100,000 in any twelve months; the rate was initially fixed at 25 per cent.; no interest is paid on the deposits. On 1st February 1973 the scope of controls on inflows of funds was further extended to include restrictions on the deferment of payments for imports and certain invisibles, as well as limitations on advance receipts from exports.

After initially floating in line with sterling, *South Africa* fixed a new par value for the rand of 1.0455 grammes of fine gold, effective 24th October 1972, and the rand was repegged to the US dollar. The change in par value represented a devaluation of 4.2 per cent., but against the dollar the rand was revalued by some 4 per cent., in relation to its floating market rate shortly beforehand. In February 1973 the rand appreciated against the dollar by 11.1 per cent. as a result of the latter's devaluation. Then, in early June, the authorities decided that the rate of exchange for the dollar would no longer be maintained within the permissible margins on either side of par. At the same time new buying and selling rates for the dollar were announced, amounting to a further appreciation of the rand by some 5 per cent.

In *Iceland* the króna was devalued by 10.7 per cent. with effect from 19th December 1972; then in February 1973 it was devalued again, along with the dollar, by 10 per cent.; in April, however, Iceland revalued by 6 per cent., giving a central rate of I.kr. 92.98 = US $1.

In *Pakistan* a comprehensive exchange reform took place on 11th May 1972, when the multiple exchange system was replaced by a unitary rate, involving a devaluation of 57 per cent. vis-à-vis gold. The new par value for the rupee was fixed at 0.0744103 grammes of fine gold.

With effect from 17th January 1973 *Jamaica* cut loose its currency from sterling and pegged it to the US dollar. At the same time the currency was devalued by 15.6 per cent. against gold, the new par value being 0.900364 grammes of fine gold and the new exchange rate against the US dollar being J$0.91 = US $1.

Those sterling-area currencies which were still floating in parallel with sterling at the time of the devaluation of the dollar in February 1973 continued to do so. Of those that were already pegged to the dollar, some accepted the dollar devaluation, thereby appreciating against the dollar by 11.1 per cent. before repegging, while others devalued along with the dollar: this last category included Iceland, Jamaica, Kenya, Nigeria, Tanzania and Uganda.

Although there were significant movements in the exchange rates against the US dollar of some of the principal Latin American currencies during the twelve months to end-May 1973, the number of rates remaining constant was the greater.

In *Argentina* the official exchange rate remained at Pesos 5 = US $1 during the period under review and the financial rate was fairly steady at almost twice that figure. During July and August 1972, however, the proportion of export receipts that had to be surrendered in the official market, and of payments for imports in the most essential category that could be made through it, was twice reduced, from 36 to 26 per cent. — equivalent to a devaluation of almost 6 per cent. — and in February 1973 the proportion for certain exports was lowered further to 10 per cent. Other categories of imports can only be financed through the financial market and in October new regulations imposed a six-month ban on certain non-essential imports. Meanwhile, in September the tax on the purchase in the financial market of foreign currency for travel purposes was raised from Pesos 0.5 to 2 per US dollar. The amount of foreign currency allowed for travel was reduced and regulations on making remittances abroad and repayments of borrowing from abroad were tightened. From April 1973 export receipts from western Europe, Canada and Japan must be taken in the currency of the respective countries, without the option, as before, of accepting US dollars.

In *Brazil* the exchange rate stood at Cruz. 606/610 = US $1 at end-May 1973, having been devalued by only 3 per cent. against the dollar over the preceding twelve months. In *Chile* there were devaluations ranging from 37 to 69 per cent. across the full spread of the multiple exchange rate system in August 1972. The highest and lowest rates then stood at Esc. 20 = US $1 for imports of essential foods and petroleum and for exports of minerals other than iron ore, and Esc. 85 = US $1 for purchases of foreign currency for travel abroad. This latter rate was also subject to a surcharge of over 50 per cent. and after two further adjustments in March and April 1973 the effective price of foreign currency for foreign travel stood at Esc. 325 = US $1, i.e. sixteen times the basic rate of exchange.

Venezuela reduced the bolivar against the US dollar by about 2¼ per cent. following the dollar devaluation in February. The new exchange rates are Bs. 4.20 and 4.30 = US $1 for oil and other extractive operations and for all other transactions respectively. In October *Bolivia* declared a new par value to the IMF of Pesos 20 = US $1, representing a 40 per cent. depreciation from the effective rate of exchange which had ruled since 1959; freedom for all current and capital transactions is being maintained. In *Uruguay* the peso in the official market was devalued twelve times over the twelve months to end-May 1973, by a total of 37 per cent., to Pesos 862 = US $1. This brought the official rate roughly in line with the free market rate, which had remained fairly steady over the same period. In December the ban on capital goods imports imposed in May 1971 was removed but such imports must be financed from abroad.

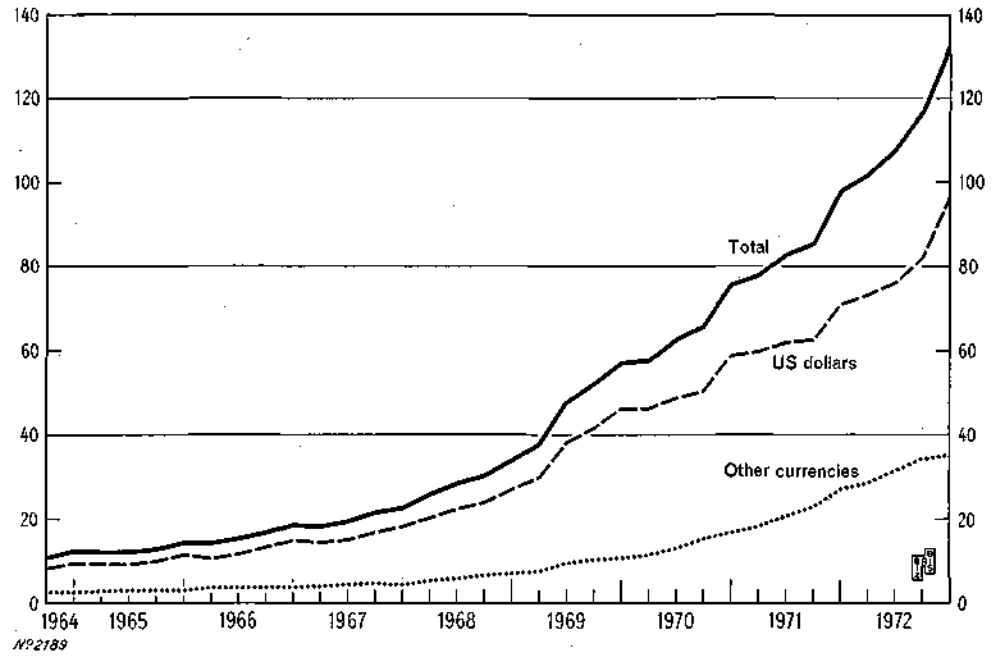
Under the dual rate system established in February 1972 in *Costa Rica* both exchange rates remained steady during the past twelve months, but in October the list of imports that can be financed through the official market was further reduced and only half the proceeds of non-traditional exports have since then had to be surrendered at the official rate. In *Guatemala* all restrictions on current and capital transactions were removed early in 1973, thereby returning the currency to complete convertibility at Quetzal 1 = US $1.

V. THE EURO-CURRENCY AND EURO-BOND MARKETS.

The Euro-currency market.

For the fifth successive year, the Euro-currency market expanded rapidly in 1972. The external foreign currency assets reported by the banks of eight European countries rose by \$31.7 milliard to \$131.8 milliard and their liabilities by \$34.2 milliard to \$131.9 milliard. These were the largest increases yet recorded, although in percentage terms they fell short of the 50 and 60 per cent. gains in 1968 and 1969. Net of certain kinds of double counting but including positions vis-à-vis residents, the outstanding foreign currency credit intermediated by this group of banks may be estimated to have gone up by roughly \$20 milliard to \$91 milliard and its dollar component by about \$16 milliard to \$70 milliard.

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



Developments in 1972 followed the usual seasonal pattern. In the first quarter the expansion of the market was relatively moderate, in the second quarter it accelerated, and in the fourth there was the customary end-of-year spurt. Interest rates tended to fall in the earlier part of the year, and although they went up again later they remained well below their 1971 highs.

The fact that Euro-currency deposit rates were on average considerably lower than in 1971 suggests that the impetus behind the growth of the market came primarily from the supply side. As in previous years, one significant expansionary influence was the large US payments deficit. It both contributed to easier monetary conditions outside the United States, thereby stimulating the supply of private funds, and also boosted the amount of dollars in official hands, thus swelling the flow of central-bank funds into the market. In this context it was not only the size of the US deficit but also the geographical distribution of the surpluses which was important. In 1971 the surpluses had accumulated mostly in the Group of Ten countries, which have agreed among themselves not to increase their placements of reserves in the Euro-currency market. In 1972, partly as a result of the sharp rise in raw-material prices, a much larger share of total surpluses was gained by countries outside the Group of Ten, which tend to deposit quite a large proportion of their dollar accruals in the Euro-market.

In addition, the weakness of both the dollar and sterling led central banks to diversify official reserves into other currencies, such as the Deutsche Mark and the Swiss franc; and, with the further tightening of controls against placements of funds by foreigners in the domestic markets of these countries, a large part of the increased reserves was placed in the Euro-market. These same factors also stimulated, of course, the flow of private non-dollar funds to the market. A further expansionary influence on the supply side of the market, particularly during the first half of 1972, was the policy of monetary ease pursued in several industrial countries to overcome the slack in the domestic economy.

Apart from these more general influences, there were also some special expansionary factors acting on the supply of Euro-currency funds last year. One of these was the record volume of Euro-bond issues, totalling $6.5 milliard, some of the proceeds of which were deposited in the Euro-market at short term pending their final use. Secondly, there seem to have been, largely for confidence reasons, sizable flows of private non-bank funds from the United Kingdom and Italy to the Euro-currency market.

On the demand side, an important influence last year came through a $6 milliard turn-round in the Euro-banks' gross asset positions vis-à-vis the United States. In 1971 US banks had made large repayments to their foreign branches in the Euro-market, but in 1972 there was some drawing-back of money by banks in the United States, especially the US agencies and branches of foreign banks.

On the other hand, sluggish investment activity, easy domestic credit conditions and restrictions on foreign borrowing, such as the Bardepot in Germany, led to a substantial reduction in loan demand from European corporate borrowers. Moreover, the Euro-banks in a number of countries were prevented by regulations from borrowing funds in the Euro-currency market for domestic use.

Having ample supplies of new funds and faced with the closure of many of their usual lending outlets, the Euro-banks had to look actively for new borrowers. As a result a large increase occurred in lending to developing countries, mostly to public and semi-public entities, and also to eastern European countries. However, a substantial part of the funds lent to the developing countries tended to flow back to the market through official reserve placements. Many of the loans seem to have been made for the financing of fairly long-term projects and to have been rather long-dated. In fact, warnings have been sounded that the keen competition between banks for new borrowers has sometimes tempted Euro-banks into excessive maturity transformation and has squeezed profit margins to levels which leave little room for risk premiums. On the other hand, a shift towards lending to developing countries may in itself be considered useful.

As on the supply side, a number of special factors were at work on the demand side of the market. In order to offset the outflows of private non-bank funds, Italian public and semi-public entities as well as the Italian banks were encouraged by the authorities to take up funds in the Euro-currency market. Japanese banks likewise borrowed quite heavily in the market. UK non-bank residents had substantial recourse to Euro-currency credit, employing the funds largely to finance investment abroad. And there also seems to have been an increase in Euro-currency borrowing for the financing of large-scale projects, such as the development of the oilfields in the North Sea.

Finally, the rapid increase in the European banks' foreign currency liabilities and assets, the major part of which was accounted for by the growth of interbank positions, has to be viewed against the background of the more rapid expansion of the banks' domestic balance sheets. With inflation becoming more intense, the rates of growth of the monetary aggregates in many industrial countries reached record levels in 1972. In view of the increasing rôle of the Euro-currency market as an interbank money market there can be no doubt that these developments also contributed to the renewed spurt in the market's expansion last year.

Whereas in 1972 the growth of the market and its currency composition were not influenced greatly by the performance of the dollar in the exchange markets, in the first quarter of 1973 Euro-currency developments were largely dominated by the renewed dollar crisis. Even though Euro-currency flows do not seem to have been a key factor in the crisis, the demand for dollars for conversion into strong currencies pushed up Euro-dollar rates and depressed Euro-deposit rates for other currencies. However, the rise in Euro-dollar deposit rates was more moderate than in the summer of 1971, especially after allowance is made for the simultaneous increase in US interest rates.

Complete Euro-currency statistics for the first quarter of 1973 are not yet available, but preliminary evidence suggests that, in contrast to the usual seasonal pattern, the market expanded at a very rapid pace. As was to be expected, this was particularly true of the non-dollar component, but in contrast to August 1971 the banks' dollar liabilities continued to rise quite strongly, although the increase in their dollar assets was much lower. All in all, the banks' foreign currency assets and liabilities seem to have expanded by about \$10–15 milliard each, and net of double counting the volume of Euro-currency credit outstanding at the end of March 1973 was probably close on \$100 milliard.

Faced with a large supply of forward dollars from their customers, the banks apparently covered themselves by borrowing dollars in the Euro-currency market and selling them spot. In fact the decline in the banks' net position in dollars in the

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

Countries	End of month	Liabilities: Domestic currency	Liabilities: Foreign currencies	Assets: Domestic currency	Assets: Foreign currencies	Net position: Domestic currency	Net position: Foreign currencies	Net position: Total
		in millions of US dollars						
Belgium-Luxemburg	1971 December	890	10,500	480	10,120	— 410	— 380	— 790
	1972 March	970	11,200	540	10,410	— 430	— 790	— 1,220
	June	1,130	12,410	640	11,560	— 490	— 850	— 1,340
	September	1,140	13,490	560	12,690	— 580	— 800	— 1,380
	December	1,160	14,760	610	14,140	— 570	— 620	— 1,190
France . . .	1971 December	1,810	13,900	570	11,950	— 1,240	— 1,950	— 3,190
	1972 March	2,510	14,660	850	12,410	— 1,660	— 2,250	— 3,910
	June	2,960	15,900	1,090	13,390	— 1,870	— 2,510	— 4,380
	September	3,190	17,240	1,140	14,630	— 2,050	— 2,610	— 4,660
	December	3,180	19,170	1,210	16,350	— 1,970	— 2,820	— 4,790
Germany . .	1971 December	6,050	3,120	2,160	2,790	— 3,890	— 330	— 4,220
	1972 March	5,180	3,060	3,260	2,880	— 1,920	— 180	— 2,100
	June	5,760	3,080	3,280	2,490	— 2,480	— 590	— 3,070
	September	5,540	3,130	2,940	2,440	— 2,600	— 690	— 3,290
	December	5,830	3,950	1,870	3,180	— 3,960	— 770	— 4,730
Italy	1971 December	890	12,410	230	12,550	— 660	140	— 520
	1972 March	1,020	11,750	260	12,010	— 760	260	— 500
	June	1,120	11,980	250	12,340	— 870	360	— 510
	September	1,020	13,080	310	13,400	— 710	320	— 390
	December	1,540	18,780	840	18,510	— 700	— 270	— 970
Netherlands .	1971 December	1,270	4,940	670	5,610	— 600	670	70
	1972 March	1,340	5,110	640	5,580	— 700	470	— 230
	June	1,140	5,430	720	5,890	— 420	460	40
	September	1,030	5,850	720	6,010	— 310	160	— 150
	December	910	6,360	870	6,550	— 40	190	150
Sweden . .	1971 December	290	640	120	950	— 170	310	140
	1972 March	300	810	120	1,130	— 180	320	140
	June	350	730	160	1,110	— 190	380	190
	September	360	710	160	1,070	— 180	360	180
	December	360	650	170	1,120	— 190	470	280
Switzerland*	1971 December	6,800	6,510	6,290	12,820	— 510	6,310	5,800
	1972 March	6,990	7,190	6,990	13,660	—	6,470	6,470
	June	6,830	7,520	7,100	14,310	270	6,790	7,060
	September	6,270	7,630	6,000	14,950	— 270	7,320	7,050
	December	5,870	8,480	6,030	15,590	160	7,110	7,270
United Kingdom .	1971 December	6,810	45,710	1,070	43,340	— 5,740	— 2,370	— 8,110
	1972 March	7,120	47,810	1,250	45,170	— 5,870	— 2,640	— 8,510
	June	6,130	50,270	1,470	48,010	— 4,660	— 2,260	— 6,920
	September	6,120	55,240	1,300	52,500	— 4,820	— 2,740	— 7,560
	December	6,090	59,780	1,420	56,400	— 4,670	— 3,380	— 8,050
Total ..	1971 December	24,610	97,730	11,590	100,130	— 13,220	2,400	— 10,820
	1972 March	25,430	101,590	13,910	103,250	— 11,520	1,660	— 9,860
	June	25,420	107,320	14,710	109,100	— 10,710	1,780	— 8,930
	September	24,670	116,370	13,150	117,690	— 11,520	1,320	— 10,200
	December	24,960	131,930	13,020	131,840	— 11,940	— 90	— 12,030
Canada . . .	1971 December	830	6,280	230	6,990	— 600	710	110
	1972 March	880	6,840	260	7,100	— 620	260	— 360
	June	890	7,750	260	7,500	— 630	— 260	— 890
	September	950	8,100	250	7,700	— 700	— 400	— 1,100
	December	950	8,140	310	8,210	— 640	70	— 570
Japan . . .	1971 December	940	6,560	60	6,820	— 880	260	— 620
	1972 March	980	7,160	90	7,120	— 890	— 40	— 930
	June	1,010	6,600	90	7,900	— 920	1,300	380
	September	970	6,690	130	9,000	— 840	2,310	1,470
	December	900	7,460	130	9,880	— 770	2,420	1,650

*Including Euro-currency assets and liabilities of the BIS.

first quarter of 1973 seems to have been much greater than that recorded in the third quarter of 1971. Moreover, there appears to have been some acceleration in the amount of new Euro-dollar credits extended to non-banks, which might be taken as an indication that the Euro-currency market this time played some part in the financing of leads and lags, and of other types of hedging or speculative activities. During the third quarter of 1971, in contrast, new dollar lending to non-banks had come to a halt.

It may be noted, however, that the sale of dollars in the exchange market by Euro-banks or the use of Euro-dollar credits for the same purpose by non-banks will add to the overall pressure on the dollar only when the funds involve net transfers from the United States. Otherwise, there has to be equivalent buying of dollars to match the selling. What may happen as a result of Euro-currency flows between countries outside the United States, of course, is that the upward pressure vis-à-vis the dollar shifts from one currency to another and becomes concentrated on certain key currencies. Preliminary figures indicate that the increase in the Euro-banks' dollar liabilities to US residents was of the order of $1.5–2.0 milliard during the first quarter of 1973, but this total does not include any net transfer to the market from the United States by foreign private or official holders of dollars.

Total foreign positions. Total external assets of the banks of the eight reporting European countries went up by $33.1 milliard and liabilities by $34.4 milliard last year. Only $1.4 milliard and $0.2 milliard of these increases were in domestic currency. The overall net debtor position of the reporting banks in domestic currencies declined by $1.3 milliard to $11.9 milliard. This change was accounted for primarily by the banks of three countries: the UK and Dutch banks' external net liabilities in domestic currency decreased by $1.1 and 0.6 milliard respectively, and the Swiss banks' position moved up by $0.7 milliard from net liabilities to assets. In the case of the UK banks the contraction was mainly due to the weakness of sterling; with the Dutch and Swiss banks the shift reflected the measures adopted by the authorities to ward off inflows of foreign funds. Similar restrictions were also the reason for the virtual stability of the German banks' external liabilities in Deutsche Mark, which had shown large increases in previous years. On the other hand, the French banks' net external liabilities in domestic currency rose by $0.7 milliard.

Of the $31.7 and 34.2 milliard increases in the reporting banks' external assets and liabilities in foreign currencies, UK banks alone accounted for over 40 per cent. Not included here are the banks' foreign currency positions vis-à-vis residents. In fact the UK banks' claims on non-bank residents went up by $1.8 milliard, with the borrowers using the funds for the financing of investment overseas.

After the UK banks, the largest increase in foreign currency positions was recorded by the Italian banks; their external assets and liabilities rose by $6.0 and 6.4 milliard respectively. At the same time, however, mainly owing to uncertainty about the lira, Italian residents other than banks made very large repayments of foreign currency credits to the Italian banks and increased their foreign currency deposits. As a result the Italian banks' net claims on residents dropped from $2.1 milliard at the end of 1971 to virtually nil. The fact that despite these large receipts of foreign currency funds from residents the Italian banks reduced their net external

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

Countries	End of month	US dollars: Liabilities	US dollars: Assets	US dollars: Net	All other foreign currencies: Liabilities	All other foreign currencies: Assets	All other foreign currencies: Net
		in millions of US dollars					
Belgium-Luxemburg . .	1971 December	5,090	4,530	— 560	5,410	5,590	180
	1972 March	5,530	4,860	— 670	5,670	5,550	— 120
	June	6,020	5,220	— 800	6,390	6,340	— 50
	September	6,410	5,760	— 650	7,080	6,930	— 150
	December	7,430	7,190	— 240	7,330	6,950	— 380
France	1971 December	10,060	8,600	—1,460	3,840	3,350	— 490
	1972 March	10,420	8,960	—1,460	4,240	3,450	— 790
	June	11,070	9,670	—1,400	4,830	3,720	—1,110
	September	12,010	10,720	—1,290	5,230	3,910	—1,320
	December	13,660	11,910	—1,750	5,510	4,440	—1,070
Germany	1971 December	2,680	2,200	— 480	440	590	150
	1972 March	2,500	2,140	— 360	560	740	180
	June	2,550	1,880	— 670	530	610	80
	September	2,670	1,960	— 710	460	480	20
	December	3,560	2,750	— 810	390	430	40
Italy	1971 December	8,150	8,660	510	4,260	3,890	— 370
	1972 March	7,570	8,170	600	4,180	3,840	— 340
	June	7,550	8,230	680	4,430	4,110	— 320
	September	8,540	9,390	850	4,540	4,010	— 530
	December	13,950	13,970	20	4,830	4,540	— 290
Netherlands	1971 December	2,450	3,170	720	2,490	2,440	— 50
	1972 March	2,780	3,280	500	2,330	2,300	— 30
	June	2,940	3,570	630	2,490	2,320	— 170
	September	3,080	3,570	490	2,770	2,440	— 330
	December	3,620	4,220	600	2,740	2,330	— 410
Sweden	1971 December	410	600	190	230	350	120
	1972 March	510	750	240	300	380	80
	June	450	710	260	280	400	120
	September	460	770	310	250	300	50
	December	420	800	380	230	320	90
Switzerland*	1971 December	5,050	9,810	4,760	1,460	3,010	1,550
	1972 March	5,200	10,270	5,070	1,990	3,390	1,400
	June	5,520	10,570	5,050	2,000	3,740	1,740
	September	4,950	10,760	5,810	2,680	4,190	1,510
	December	5,860	11,550	5,690	2,620	4,040	1,420
United Kingdom	1971 December	36,860	33,930	—2,930	8,850	9,410	560
	1972 March	38,590	35,320	—3,270	9,220	9,850	630
	June	39,830	37,340	—2,490	10,440	10,670	230
	September	44,010	41,150	—2,860	11,230	11,350	120
	December	48,230	45,610	—2,620	11,550	10,790	— 760
Total	1971 December	70,750	71,500	750	26,980	28,630	1,650
	1972 March	73,100	73,750	650	28,490	29,500	1,010
	June	75,930	77,190	1,260	31,390	31,910	520
	September	82,130	84,080	1,950	34,240	33,610	— 630
	December	96,730	98,000	1,270	35,200	33,840	—1,360
Canada	1971 December	6,010	6,680	670	270	310	40
	1972 March	6,570	6,760	190	270	340	70
	June	7,450	7,140	— 310	310	360	50
	September	7,740	7,280	— 460	360	420	60
	December	7,820	7,830	10	320	380	60
Japan	1971 December	6,320	6,220	— 100	240	600	360
	1972 March	7,000	6,570	— 430	160	550	390
	June	6,400	7,300	900	200	600	400
	September	6,490	8,340	1,850	200	660	460
	December	7,210	9,110	1,900	250	770	520

* Including Euro-currency assets and liabilities of the BIS.

position in foreign currencies by \$0.4 milliard was due to the Italian Exchange Office absorbing \$2.4 milliard through a turn-round in its dollar swaps with the banks.

The external foreign currency assets of the French banks rose by \$4.4 milliard and their liabilities by \$5.3 milliard. The resultant \$0.9 milliard increase in their external net debtor position largely corresponded to a growth in net foreign currency claims on residents from practically nil to \$0.8 milliard. The Belgium-Luxemburg banks, which are second only to the UK banks in the volume of business they undertake in Euro-currencies other than dollars, also recorded a further steep increase in their Euro-currency positions, with external assets and liabilities rising by \$4.0 and 4.3 milliard respectively.

Among the reporting banks, the Swiss banks were the only major net exporters of Euro-currency funds in 1972. Their foreign currency assets and liabilities, which include the Euro-currency positions of the BIS, went up by \$2.8 and 2 milliard respectively. Largely excluded from these figures, but included in the estimates given on page 167, however, are the positions arising out of the banks' trustee business, which seem to have declined last year. On the other hand, the increase of \$0.8 milliard to \$7.1 milliard in the banks' net external assets in foreign currency is understated by \$0.6 milliard because of swaps with the Swiss National Bank carried out over the end of the year (see page 135).

The Dutch banks reduced their external net asset position by \$0.5 milliard and the German banks increased their external net debtor position by a similar amount.

Data for the Canadian and Japanese banks are not included in the aggregates used throughout this chapter. The Japanese banks' external assets in foreign currency expanded by \$3.1 milliard and their liabilities by \$0.9 milliard. The rise in net assets partly reflected dollar funds received from the Bank of Japan in the form of deposits and swaps. In addition, the Japanese banks increased their net indebtedness towards banks in the reporting European area from \$0.7 to 2.5 milliard. The funds obtained from these two sources were used by the Japanese banks to shift their net position vis-à-vis the United States from \$0.4 milliard of liabilities to \$3.2 milliard of assets, to increase their net creditor position towards the rest of the world by \$0.3 milliard to \$1.7 milliard, and for lending to residents.

The Canadian banks drew down their net asset position vis-à-vis the United States from \$0.7 to 0.4 milliard and moved vis-à-vis the reporting European area from a net creditor position of \$0.5 milliard to net liabilities of \$0.1 milliard. Of the proceeds, \$0.2 milliard was used by the Canadian banks to reduce their net debtor position towards the rest of the world and \$0.7 milliard was switched into domestic currency.

Currency composition. Of the total increase in the reporting European banks' foreign currency assets and liabilities, about 80 per cent. was in dollars. This was considerably more than in the two preceding years, and the dollar's share in total outstanding positions, which had declined from 82 per cent. at the end of 1969 to 72 per cent. at the end of 1971, went up to 74 per cent. In 1972 there was thus no evidence of a movement of the Euro-currency market away from the dollar, despite the

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

End of		Dollars		Other foreign currencies						
		Total	*of which* Non-banks	Total	*of which* Non-banks	Deutsche Mark	Swiss francs	Sterling	Guilders	All other foreign currencies
		in millions of US dollars								
		Liabilities								
1966	December .	14,770	4,130	3,700	510	970	1,220	710	70	730
1967	December .	18,120	4,680	4,330	470	1,670	1,400	800	100	360
1968	December .	26,870	6,240	6,890	1,040	3,010	2,290	800	250	540
1969	March . . .	29,880	7,600	7,670	930	3,060	2,800	900	280	630
	June . . .	37,960	8,690	9,450	1,320	4,260	3,290	910	340	650
	September.	41,540	9,960	10,240	1,340	4,800	3,790	760	240	650
	December .	46,200	10,460	10,640	1,320	4,640	4,030	810	350	810
1970	March . . .	46,050	11,100	11,410	1,370	4,430	4,960	970	350	700
	June . . .	49,440	11,000	13,090	1,660	5,550	5,360	940	410	830
	September.	50,230	10,770	15,190	2,310	6,830	5,740	940	550	1,130
	December .	58,700	11,240	16,590	2,450	8,080	5,720	940	550	1,300
1971	March . . .	59,600	11,120	18,000	2,530	9,360	5,250	1,320	450	1,620
	June . . .	61,930	10,910	20,400	3,110	11,330	5,670	1,420	490	1,490
	September.	62,430	9,380	22,650	2,700	12,380	6,730	1,460	510	1,570
	December .	70,750	9,980	26,980	2,750	14,630	7,760	2,110	860	1,620
1972	March . . .	73,100	10,050	28,490	2,760	14,640	7,560	2,640	880	2,770
	June . . .	75,930	11,340	31,390	3,670	16,130	8,540	3,030	980	2,710
	September.	82,130	11,700	34,240	3,940	18,770	8,650	2,420	1,230	3,170
	December .	96,730	11,810	35,200	3,620	19,540	8,810	2,210	1,360	3,280
		Assets								
1966	December .	16,070	2,100	4,180	690	1,420	930	800	170	860
1967	December .	19,890	3,430	4,960	850	2,060	1,110	870	230	690
1968	December .	30,430	5,150	7,400	1,500	3,920	1,820	610	290	760
1969	March . . .	33,650	5,230	7,430	1,670	4,020	1,850	590	250	720
	June . . .	42,280	5,940	9,180	2,030	5,380	2,010	670	310	810
	September.	44,820	6,110	10,820	2,520	6,980	2,240	630	240	730
	December .	47,630	6,090	10,700	2,160	5,990	2,980	580	370	780
1970	March . . .	46,970	6,760	11,770	2,470	6,270	3,490	880	340	790
	June . . .	52,030	8,560	13,100	2,980	6,850	3,930	710	470	1,140
	September.	52,930	9,890	15,470	3,940	8,140	4,540	640	550	1,600
	December .	60,370	11,850	17,880	4,670	10,110	5,080	610	560	1,520
1971	March . . .	62,460	13,380	19,220	5,590	11,440	4,500	930	490	1,860
	June . . .	65,080	14,040	20,750	5,960	12,460	5,000	950	510	1,840
	September.	63,440	13,830	23,910	6,350	13,680	6,420	1,200	480	2,130
	December .	71,500	14,360	28,630	6,750	16,220	8,180	1,620	700	1,910
1972	March . . .	73,750	13,650	29,500	6,770	16,480	8,150	1,620	630	2,620
	June . . .	77,190	15,030	31,910	7,410	16,130	9,040	1,790	640	2,310
	September.	84,080	16,290	33,610	8,350	20,240	8,200	1,920	660	2,590
	December .	98,000	18,340	33,840	8,000	20,400	7,780	2,180	720	2,760
		Net position								
1966	December .	1,300	−2,030	480	180	450	− 290	90	100	130
1967	December .	1,770	−1,250	630	380	390	− 290	70	130	330
1968	December .	3,560	−1,090	510	460	910	− 470	− 190	40	220
1969	March . . .	3,770	−2,370	− 240	740	960	− 950	− 310	− 30	90
	June . . .	4,320	−2,750	− 270	710	1,120	−1,280	− 240	− 30	160
	September.	3,280	−3,650	580	1,180	2,180	−1,550	− 130	—	80
	December .	1,430	−4,370	60	840	1,350	−1,050	− 230	20	− 30
1970	March . . .	920	−4,340	360	1,100	1,840	−1,470	− 90	− 10	90
	June . . .	2,590	−2,440	10	1,320	1,300	−1,430	− 230	60	310
	September.	2,700	− 880	280	1,630	1,310	−1,200	− 300	—	470
	December .	1,670	610	1,290	2,220	2,030	− 640	− 330	10	220
1971	March . . .	2,860	2,280	1,220	3,060	2,080	− 750	− 390	40	240
	June . . .	3,150	3,130	350	2,850	1,120	− 670	− 470	20	350
	September.	1,010	4,450	1,260	3,650	1,300	− 310	− 260	− 30	560
	December .	750	4,380	1,650	4,000	1,590	420	− 490	− 160	290
1972	March . . .	650	3,600	1,010	4,010	1,840	590	−1,020	− 250	− 150
	June . . .	1,260	3,690	520	3,740	2,000	500	−1,240	− 340	− 400
	September.	1,950	4,590	− 630	4,410	1,470	− 450	− 500	− 570	− 580
	December .	1,270	6,530	−1,360	4,380	860	−1,030	− 30	− 640	− 520

weakness at times of that currency in the exchange markets. The only sign which could be interpreted as a link between confidence factors and the currency composition of the market was that the dollar's share in the growth of foreign currency positions was largest in the fourth quarter when the dollar was quite strong in the exchange markets. In contrast to the movement in their net position in other foreign currencies the banks' net assets in dollars rose by $0.5 milliard, and the increase would have been considerably larger but for the Italian banks' swap operations with the Italian Exchange Office and the Swiss banks' end-year swaps with the Swiss National Bank. Somewhat paradoxically there was an expansion in dollar net assets of $0.7 milliard during the third quarter when the dollar was most under pressure, which would suggest that, if anything, the Euro-dollar banks exerted on balance some stabilising influence through purchases of spot dollars.

External assets and liabilities in currencies other than the dollar went up by $5.2 and 8.2 milliard respectively, i.e. considerably less than in 1971. The Deutsche Mark alone accounted for $4.2 and 4.9 milliard of these increases. It thereby maintained its market share of roughly 15 per cent. and strengthened its position as the most important Euro-currency after the dollar. The $0.7 milliard decline in net assets in Deutsche Mark was related to the tightening of German controls against inflows from abroad. Similarly, owing to the Swiss capital controls and because of the difficulty of finding borrowers for Swiss franc funds outside Switzerland, the banks' net position in Swiss francs shifted from $0.4 milliard of assets to $1.0 milliard of liabilities. The Swiss franc's share of the market declined from 8 per cent. at the end of 1971 to 6 per cent. The market share of sterling, which after many years of decline had benefited in 1971 from the strengthening of sterling, tended downwards again. Gross sterling liabilities rose by $0.9 milliard to total $3.0 milliard in the first half of the year, but declined by $0.8 milliard in the second half, partly as a result of valuation changes. In percentage terms there were fairly large increases in the banks' liabilities in French francs and Dutch guilders, but the share of these currencies in the total positions of the Euro-banks has remained small.

Types of borrowers and lenders. A salient feature of the growth of the Euro-currency market in 1972 was again the predominance of interbank positions. In fact, on the uses side nearly the whole of the larger expansion of the market in comparison with 1971 was due to interbank claims. Credits to non-banks went up by $5.2 milliard, only $0.6 milliard more than in 1971; assets vis-à-vis banks rose by $26.5 milliard, compared with $17.3 milliard in 1971. Three-quarters of the increase in claims on non-banks was in dollars; as in 1971, there was, however, no evidence last year of significant Euro-dollar lending for the financing of leads and lags, hedging or outright speculation against the dollar. On the contrary, in the first quarter, when the dollar was still weak, credits to non-banks declined; in the third quarter they went up by $1.3 milliard, but this increase was smaller than in the second and fourth quarters when the dollar was relatively firm.

On the sources side, the part played by direct positions vis-à-vis non-banks was even more limited. Liabilities to non-banks expanded by $2.7 milliard; this was considerably more than in the two preceding years (though the decline shown in the statistics for 1971 was due to a change in the method of reporting figures for the

Swiss banks, without which there would have been a modest increase) but it was very little in comparison with the \$31.5 milliard growth in interbank liabilities. Dollar liabilities to non-banks, which had risen very sharply in 1969 but had edged up by only about \$1 milliard (after making approximate allowance for the aforementioned change in reporting methods) between the end of 1969 and 1971, went up by \$1.8 milliard to total \$11.8 milliard. Deutsche Mark liabilities to non-banks rose from \$1.7 milliard to \$2.1 milliard in the first nine months of the year but, despite a sharp recovery in Euro-Deutsche Mark deposit rates, they fell back to \$1.7 milliard in the fourth quarter.

The preponderance of interbank positions in the rapid growth of the banks' foreign currency assets and liabilities raises the question of the monetary significance of this expansion. One thing that first needs to be said is that the figures exaggerate the rôle of commercial banks as suppliers and users of Euro-currency funds. There are several reasons for this:

(a) The figures reported for assets and liabilities vis-à-vis banks include positions vis-à-vis official monetary institutions, although their significance is different from that of other interbank positions. It may be estimated that deposits received by the reporting banks from official monetary institutions amounted to about \$20 milliard at the end of 1972. The only direct information available on the increase in official deposits in the course of the year is a \$3 milliard rise, of which \$2.5 milliard was in dollars, in the funds received from official institutions by the foreign branches of US banks. If it is estimated that the US banks' share of that business amounts to between 35 and 50 per cent., the total increase for all banks would have lain between \$6 and 8.5 milliard in 1972.

(b) The figures reported by the Swiss banks exclude for the most part funds received from non-banks on trustee accounts. But to the extent that these funds are placed by the Swiss banks with other banks in the reporting area, they show up as interbank liabilities in the reported statistics; in the table on the net size of the market on page 167 below, these funds are included under liabilities to non-banks on the basis of rough estimates. The amounts involved are quite large, although there seems to have been a decrease in 1972.

(c) Positions reported vis-à-vis banks include foreign currency funds originally coming from non-banks but entering the market through banks outside the reporting European area, or foreign currency funds taken from the market by banks outside the European reporting area and then lent to non-banks.

(d) The reported statistics do not include foreign currency positions vis-à-vis domestic non-bank residents, for which complete figures are not available (although estimates for these positions are included in the table on page 167). The limited evidence which is available indicates that these positions are in some cases quite large.

However, even after allowance has been made for these shortcomings in the statistics, the fact remains that the largest single element in the Euro-currency market consists of transactions between commercial banks. In other words, the largest use of the Euro-currency market is as an interbank money market. This rôle of the market has various aspects.

Firstly, the banks of particular countries, taken as a group, have recourse to the market either as an outlet for surplus domestic liquidity or as a source of funds when domestic liquidity is short. In this respect the Euro-currency market acts as a channel for the movement of funds from countries with relatively low interest rates to countries with relatively high rates, with the banking systems of individual countries playing a part similar to that played in a national money market by individual banks. Of course these funds are also originally obtained from non-banks and are ultimately lent to non-banks. But since the corresponding liabilities and assets vis-à-vis non-banks are usually in domestic currency (and usually also vis-à-vis residents) they do not show up in the Euro-currency statistics and the banks themselves have to be regarded in a sense as the original suppliers and users of the foreign currency funds.

Secondly, the Euro-currency market acts as an interbank market enabling banks in particular countries to make fuller use than would otherwise be possible of a given overall level of domestic liquidity. Thus, banks in one and the same country have simultaneously both asset and liability positions in the market — and, indeed, the same tends to be true of individual banks which have recourse to the market to adjust the maturity structure of their assets and liabilities. In this respect the Euro-currency market is used by banks in much the same way as banks in the United States use the New York money market. It is this type of activity that accounts in large measure for the difference between the large gross position and the fairly small net positions which the commercial-banking systems of several continental European countries have in the Euro-currency market.

Finally, interbank positions in the Euro-currency market arise as a result of funds being passed through several banks in the market on their way from the original supplier to the ultimate user. Such interbank depositing occurs for a number of reasons. One is that banks customarily observe limits on their loans to particular borrowers and in particular markets. Another is that many banks specialise as regards the business they do, either on a geographical or a functional basis. This redepositing gives rise to double counting, since when the same funds pass through more than one bank in the reporting area the resultant credit chain will tend to show up more than once in reported assets and liabilities. It is mainly this kind of double counting which the table on the net size of the market (page 167) tries to eliminate. Some allowance is, however, made in the estimates for the market's rôle as an interbank money market referred to in the first and second points above.

Geographical break-down. The tables on pages 165 and 167 show the regional sources and destinations of funds intermediated by the Euro-banks. The differences in the conceptual basis and the coverage of these two tables have been discussed in previous Annual Reports.

An outstanding feature of 1972 was the rapid growth in positions vis-à-vis countries outside the reporting European area and other than the United States. Thus, the reporting banks' liabilities vis-à-vis these countries went up by $16.5 milliard and their assets by $14.2 milliard, or by about 50 per cent. each. On the liabilities side official deposits may have accounted for nearly half of the total increase, while lending to developing countries was an important element in the expansion of assets.

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

Positions vis-à-vis	December 1971			June 1972			December 1972		
	Dollars	All other currencies	Total	Dollars	All other currencies	Total	Dollars	All other currencies	Total
	in millions of US dollars								
	Liabilities								
Outside area									
Other western Europe	4,940	2,400	7,340	5,440	3,400	8,840	7,340	4,530	11,870
Eastern Europe	1,230	1,070	2,300	1,640	1,310	2,950	1,860	1,540	3,400
Canada	3,990	390	4,380	3,890	300	4,190	4,780	270	5,050
Japan	870	30	900	980	50	1,030	1,440	40	1,480
Latin America	4,050	760	4,810	4,460	700	5,160	6,860	880	7,740
Middle East	3,920	1,170	5,090	4,720	1,900	6,620	5,900	2,070	7,970
Other	5,260	1,380	6,640	6,370	2,350	8,720	7,360	3,070	10,430
Total	24,260	7,200	31,460	27,500	10,010	37,510	35,540	12,400	47,940
United States	6,470	340	6,810	6,830	450	7,280	7,050	550	7,600
Total outside area	30,730	7,540	38,270	34,330	10,460	44,790	42,590	12,950	55,540
Inside area									
Belgium	2,240	1,470	3,710	2,240	1,750	3,990	3,640	2,190	5,830
France	5,950	1,400	7,350	6,200	1,880	8,080	8,060	2,750	10,810
Germany	1,450	1,980	3,430	1,270	2,100	3,370	1,740	1,750	3,490
Italy	6,340	2,140	8,480	5,920	2,480	8,400	9,870	2,960	12,830
Netherlands	2,660	1,670	4,330	2,890	1,510	4,400	3,350	1,850	5,200
Sweden	400	150	550	560	160	720	580	160	740
Switzerland	11,570	7,810	19,380	11,860	7,370	19,230	13,560	6,810	20,370
United Kingdom	8,590	2,460	11,050	9,710	3,270	12,980	11,870	3,190	15,060
Total inside area	39,200	19,080	58,280	40,650	20,520	61,170	52,670	21,660	74,330
Unallocated	820	360	1,180	950	410	1,360	1,470	590	2,060
Grand total	70,750	26,980	97,730	75,930	31,390	107,320	96,730	35,200	131,930
	Assets								
Outside area									
Other western Europe	3,960	1,680	5,640	4,160	2,200	6,360	5,100	2,650	7,750
Eastern Europe	2,350	1,120	3,470	3,030	1,570	4,600	3,890	1,340	5,230
Canada	1,790	400	2,190	2,860	270	3,130	2,920	330	3,250
Japan	3,060	420	3,480	4,010	270	4,280	4,510	250	4,760
Latin America	4,000	650	4,650	4,300	580	4,880	6,260	680	6,940
Middle East	1,160	200	1,360	960	380	1,340	1,440	200	1,640
Other	6,830	1,290	8,120	8,850	1,480	10,330	11,730	1,820	13,550
Total	23,150	5,760	28,910	28,170	6,750	34,920	35,850	7,270	43,120
United States	9,200	350	9,550	9,640	390	10,030	10,440	480	10,920
Total outside area	32,350	6,110	38,460	37,810	7,140	44,950	46,290	7,750	54,040
Inside area									
Belgium	3,170	2,360	5,530	3,240	2,740	5,980	4,380	3,320	7,700
France	6,710	1,940	8,650	6,580	2,310	8,890	9,000	2,790	11,790
Germany	2,630	8,390	11,020	2,330	9,120	11,450	2,970	8,130	11,100
Italy	6,920	1,930	8,850	5,760	2,210	7,970	10,660	2,860	13,520
Netherlands	1,790	1,120	2,910	2,030	1,370	3,400	2,660	1,750	4,410
Sweden	570	430	1,000	580	490	1,070	470	550	1,020
Switzerland	3,720	2,190	5,910	3,520	1,920	5,440	4,190	1,700	5,890
United Kingdom	12,990	3,730	16,720	15,340	4,150	19,490	17,380	4,540	21,920
Total inside area	38,500	22,090	60,590	39,380	24,310	63,690	51,710	25,640	77,350
Unallocated	650	430	1,080	—	460	460	—	450	450
Grand total	71,500	28,630	100,130	77,190	31,910	109,100	98,000	33,840	131,840

In fact, the largest growth recorded in the banks' assets was in the residual category "Other" (+ $5.4 milliard), which includes, for example, the Far East (except Japan) and Africa, and in those vis-à-vis Latin America (+ $2.3 milliard). But lending to "Other western Europe" (+ $2.1 milliard), to eastern Europe (+$1.8 milliard) and to Japan (+$1.3 milliard) also rose quite strongly. On a net basis the Middle East ($2.6 milliard), "Other western Europe" ($2.4 milliard) and Latin America ($0.6 milliard) were suppliers of new funds to the Euro-banks, whereas the countries grouped under "Other" ($1.6 milliard), eastern Europe ($0.7 milliard) and Japan ($0.7 milliard) were net borrowers. From this, and from what was said on page 160, it can be seen that, contrary to the frequent assertion that in 1972 the Euro-currency market was flooded with funds from Japan, Japanese residents, and in particular the banks, were substantial net takers of Euro-currency funds.

The reporting European banks' claims on the United States rose by $1.4 milliard, after falling by $4.7 milliard in 1971. The increase was largely due to short-term borrowing by US banks in the Euro-currency market and to borrowing by the US branches of European banks from their head offices. Liabilities to US residents went up by $0.8 milliard, only half as much as in 1971. This increase occurred during the first and third quarters when the dollar was weak in the exchange markets and the premium of Euro-dollar rates over US money-market yields was consequently rather high.

The positions of the reporting banks within their own area are the most difficult to interpret. The figures in the table on page 165, although greatly inflated by double counting, imply an increase in assets of $16.8 milliard, about the same amount as in 1971, and an expansion in liabilities of $16.1 milliard.

As usual, the largest increases in the reporting banks' foreign currency positions vis-à-vis non-residents occurred vis-à-vis the United Kingdom, with assets and liabilities going up by $5.2 and 4.0 milliard respectively. The $1.2 milliard rise in net claims on the United Kingdom was mainly the result of a net flow from other reporting European banks to the UK banks, with the latter relending the funds to UK residents. The remaining $4.0 milliard increase in gross assets and liabilities vis-à-vis the United Kingdom reflected largely the UK banks' rôle as Euro-currency intermediaries.

One significant feature of the market in 1972 was that credits to Germany, which had been one of the main forces behind the market's growth in recent years, showed hardly any further increase. This was due to the Bardepot requirement on foreign borrowing by German non-bank firms and on those external liabilities of German banks that are not subject to reserve requirements, which was imposed in March 1972 but already had a certain effect between its announcement and its introduction. The rates applicable were originally set at 40 per cent., but they were raised to 50 per cent. in July 1972. At this level the Bardepot will of course deter borrowing abroad only as long as the rates charged for Euro-Deutsche Mark credits are more than half of the cost of domestic credit in Germany. Thus when in the third quarter of 1972 Euro-Deutsche Mark rates for some maturities dropped close to zero, Euro-currency credit became cheaper again than domestic borrowing in Germany and the Euro-banks recorded a $0.8 milliard increase in claims on Germany. With the sharp rise of Euro-Deutsche Mark rates in the fourth quarter, however, German firms began to make repayments, so that claims on Germany dropped by $1.2 milliard despite large-scale borrowing by German banks for year-end purposes.

Gross liabilities to Switzerland, which occupies an even more important position on the supply side of the market than Germany on the uses side, went up by only $1.0 milliard to $20.4 milliard, after increasing by $5.1 and 2.9 milliard in 1970 and 1971 respectively. The relatively limited growth last year reflects mainly a reduction in the volume of trustee funds channelled into the market by Swiss banks.

The increase of $0.9 milliard to a total of $2.1 milliard in unallocated liabilities was related to the expansion of the London banks' issues of dollar certificates of deposit.

The estimates in the following table which seek to eliminate the double counting due to redeposits between banks but take into account positions vis-à-vis residents, indicate that the supply of new Euro-currency funds from within the area went up by only $1.8 milliard and the absorption of Euro-currency funds from within the reporting European area by $5.1 milliard. This was considerably less than in 1971 when the increases were put at $4.7 and 8.8 milliard respectively. On the sources side the slow-down stemmed solely from the banks. One important element in this was the reversal in the swap policy of the Italian monetary authorities, as a result of which the Italian banks' aggregate net position in foreign currency towards both residents and non-residents turned round from $2.2 milliard of assets to $0.2 milliard of liabilities. The net position of the banks of most other countries also showed a decline in 1972. Moreover, there was a substantial drop in Swiss franc and Deutsche Mark funds supplied by the Swiss and German banks respectively to the other banks in the

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

End of period	Reporting European area: Total	of which: Banks[1]	of which: Non-banks	United States	Rest of the world	Un-allocated	Total
	In milliards of US dollars						
Uses							
1969	15.0	7.0	8.0	16.8	12.0	0.2	44.0
1970	24.0	9.0	15.0	13.1	19.0	0.9	57.0
1971	32.8	13.7	19.1	8.3	28.9	1.0	71.0
1972	37.9	17.1	20.8	9.6	43.1	0.4	91.0
Sources							
1969	21.7	9.5	12.2[2]	4.1	17.6	0.6	44.0
1970	27.7	13.5	14.2[2]	4.5	24.0	0.8	57.0
1971	32.4	16.4	16.0[2]	6.1	31.4	1.1	71.0
1972	34.2	16.4	17.8[2]	6.9	47.9	2.0	91.0
Net position[3]							
1969	− 6.7	− 2.5	− 4.2	+ 12.7	− 5.6	− 0.4	—
1970	− 3.7	− 4.5	+ 0.8	+ 8.6	− 5.0	+ 0.1	—
1971	+ 0.4	− 2.7	+ 3.1	+ 2.2	− 2.5	− 0.1	—
1972	+ 3.7	+ 0.7	+ 3.0	+ 2.7	− 4.8	− 1.6	—

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

reporting area. Had no allowance been made for the market's interbank money-market function, the figure for funds supplied by the banks themselves would have shown a decline.

On the uses side the slow-down was mainly in lending to non-banks, the two most important factors contributing to this being the tapering-off of new lending to German non-bank firms and a drop from \$2.3 to 0.6 milliard in the Italian banks' foreign currency claims on non-bank residents. On the other hand, there were substantial increases in the UK banks' and French banks' foreign currency lending to residents.

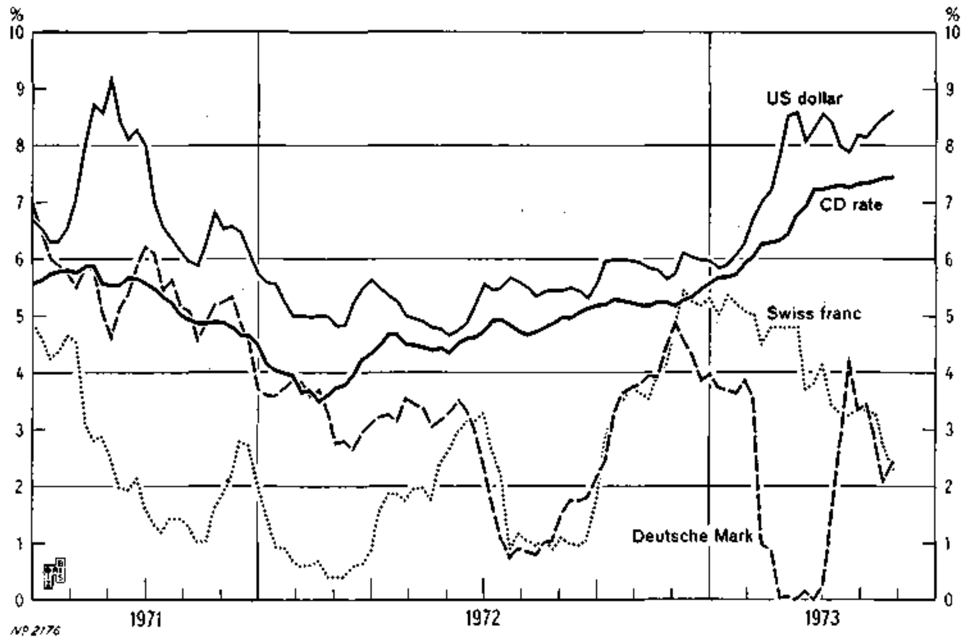
On a net basis the reporting European area and the United States were net borrowers of new funds to the tune of \$3.3 and 0.5 milliard respectively, while the rest of the world was a net supplier to the extent of \$2.3 milliard. In addition there was an increase in unallocated supplies of \$1.5 milliard.

Interest rate developments. In 1972, as in previous years, the basic trend of Euro-currency rates was determined largely by interest rate developments in the United States, with seasonal factors, the ups and downs of the dollar in the exchange markets and monetary developments outside the United States accounting for the fluctuations around this trend. The three-month Euro-dollar deposit rate, for example, tended to show a relatively high premium over market yields on US bank certificates of deposit when the dollar was weak in the exchange markets, while a strengthening of the dollar was usually accompanied by a prompt reduction of the premium. On the whole, however, Euro-dollar rates were relatively stable throughout 1972; even at the very short end of the market, interest rates, which in 1971 had at times climbed to rather extravagant heights, never came anywhere near 10 per cent.

The situation was quite different in the case of Euro-deposit rates for other currencies, such as the Deutsche Mark and the Swiss franc, which were subject to very strong fluctuations throughout 1972. The Euro-Swiss franc deposit rate, for instance, fell to below ½ per cent. in the second half of February, strengthened to a peak of 3¾ per cent. in the second half of June, dropped back to below 1 per cent. in July and ended the year at about 5 per cent. The reason for this difference between the behaviour of rates for Euro-dollar deposits and those for other Euro-currency deposits is that, particularly at times of dollar weakness and in view of the measures against capital inflows taken by the strong-currency countries, the markets for deposits in these currencies are much narrower than the market for Euro-dollar deposits. Unless the lending rates for the strong currencies fall so far as to offset the forward premium of these currencies vis-à-vis the dollar, it will consequently be very difficult for the Euro-banks to find borrowers for such non-dollar funds. In fact, at times of currency unrest deposit rates for non-dollar currencies will be largely governed by the movement in the forward premiums or discounts of these currencies vis-à-vis the dollar.

Although Euro-dollar rates fell from 7 per cent. in late November 1971 to 5 per cent. in late January, in the early months of 1972 they maintained a very substantial premium over comparable US money-market rates. The reason was the pronounced ease of the US short-term financial markets and, related to this, the continued uneasiness

Interbank rates on three-month Euro-currency deposits
and CD rate in the United States.
Weekly averages, in percentages per annum.



of the exchange markets, which was also reflected in the very low Euro-Swiss franc rate — ⅛ per cent. for one-month money. Throughout the first quarter the three-month Euro-dollar rate exceeded the corresponding US certificate of deposit rate by well over one percentage point, and thereby exerted a strong attraction both on US holders and on foreign private and official holders.

After the usual end-quarter tightening, which was accentuated by the upturn of interest rates in the United States, Euro-currency rates in April and May responded quite strongly to the temporary improvement in the exchange-market climate and to lower interest rates in several European centres. The premium of the three-month Euro-dollar rates over the US certificate of deposit rate contracted to below ½ per cent. and the Euro-dollar call rate went below the US Federal funds rate.

After reaching a low of 4½ per cent. at the end of May, the three-month rate jumped to a peak of just on 6 per cent. towards the end of June, when the difficulties besetting sterling had also begun to affect the dollar, and fluctuated around 5½ per cent. throughout the third quarter. This increase was not entirely due to the unrest in the exchange markets but was partly the result of the renewed upward trend in US interest rates. Nevertheless, the premium over the US certificate of deposit rate, which had declined to ¼ per cent. in early June, widened to about ¾ per cent. The uneasiness of the exchange markets was reflected mainly in the Euro-Deutsche Mark and Euro-Swiss franc rates, which under the impact of the widening forward discount of the dollar dropped from over 3 per cent. in June to about 1 per cent. in July and August for the three-month maturities while quotations for shorter-term maturities even reached zero on certain days.

The gradual return to calm led to a decline in the premium of Euro-dollar rates over US money-market rates in the second half of August and in September. Euro-dollar call-money rates went below Federal funds rates and stayed there until the end of the year. In early October the usual seasonal pressures and sharply higher interest rates in several European centres pushed the three-month rate up to 6 per cent. The improved climate in the exchange markets, and the resultant recovery of the forward exchange rate for the dollar, was again reflected mainly in the behaviour of Euro-deposit rates for non-dollar currencies. After climbing steeply during the preceding three months, rates for three-month Euro-Deutsche Mark and Euro-Swiss francs in December were four to five times higher than in August. The recovery of these rates was one of the factors that provided more scope for a tightening of monetary conditions in Germany and Switzerland, which, despite the controls on inflows, had remained under the influence of the very low Euro-currency market rates.

Owing to the firming of US short-term interest rates, the premium of Euro-dollar rates over US certificate of deposit rates had fallen to the abnormally low level of ⅛ per cent. at the beginning of 1973. However, the build-up of renewed unrest in the exchange markets soon led to a widening of this premium, and around the end of February, during the height of the crisis, it reached a peak of two percentage points, which naturally rendered the Euro-dollar market a very attractive outlet for holders of dollars. The three-month deposit rate soared from slightly below 6 per cent. at the beginning of January to a peak of 9¼ per cent. on 2nd March and then fluctuated around 8¼ per cent. up to the middle of May.

The rates for Euro-dollar call money were well above 10 per cent. on certain days during the crisis, but the most spectacular reaction to the currency upheavals was shown by the Euro-Deutsche Mark, with deposit rates for the whole maturity range up to three months down to zero on most days between the middle of February and 23rd March. The Euro-Swiss franc deposit rates also tended downwards during this period; however, their decline was dampened by the floating of the Swiss franc, which shifted the exchange-market adjustment away from the forward to the spot market and thus reduced the scope for covered interest arbitrage flows out of Euro-dollars into Euro-Swiss franc deposits. Similarly, the floating of the Deutsche Mark vis-à-vis currencies outside the EEC narrower-band arrangement and the consequent narrowing of its forward premium contributed to a recovery of the Euro-Deutsche Mark deposit rate to around 3½ per cent. by the middle of April.

Whereas the sharp rise in Euro-dollar rates during February was mainly due to the currency crisis, the fact that in the following three months they remained a long way above their early-January levels was attributable in large measure to the pronounced upward movement of interest rates in the United States. In addition, some other factors tended to keep Euro-dollar rates high. There was large-scale Euro-dollar borrowing by the public sector in the United Kingdom, and by Italian public agencies; there were reports of large loans being arranged for the Soviet Union; and in May the US authorities eased the banks' borrowing from the Euro-dollar market by reducing the reserve requirement on such liabilities from 20 to 8 per cent. — the same rate as that henceforth applying to increases in their domestic CD liabilities. Moreover, from the middle of May the market again came under the influence of the nervousness in the exchange markets and in early June the three-month Euro-dollar rate approached 9 per cent.

The Euro-bond market.

The features of the Euro-bond market last year were quite similar to those of the Euro-currency market. The volume of new funds channelled through the market — at $6.5 milliard — was 73 per cent. higher than in 1971 and by far the largest yet recorded. Despite the instability in exchange markets, issue activity was strong throughout 1972 — with flotations being particularly large during the last four months of the year. And as in the case of the Euro-currency market, the sharp growth in new business occurred at interest rates that were much lower and more stable than in 1971, indicating that ample supplies of new funds were forthcoming.

International and foreign bond issues:
Public offerings and private placements.[1]

Borrowing countries or areas	Years	International issues, by currencies: US dollars	Other currencies: Total	of which: Deutsche Mark[2]	of which: Guilders	of which: French francs	Total	of which: Convertible bonds[3]	Foreign issues in national markets[2]
		in millions of US dollars							
Western Europe . .	1970	911	629	415	194	—	1,540	68	215
	1971	853	866	392	173	29	1,719	35	596
	1972	1,203	1,307	506	245	308	2,510	131	535
Canada	1970	130	12	—	—	—	142	—	918
	1971	100	115	115	—	—	215	—	645
	1972	20	347	273	—	59	367	—	1,019
United States	1970	625	145	55	83	—	771	180	108
	1971	1,003	104	87	17	—	1,106	200	275
	1972	1,774	254	93	75	4	2,028	1,067	244
Other developed countries[4]	1970	130	158	126	—	—	288	70	49
	1971	165	344	236	47	—	509	45	51
	1972	218	383	264	68	15	600	—	59
Rest of the world[5] . .	1970	105	6	6	—	—	111	—	217
	1971	50	30	30	—	—	80	15	300
	1972	425	117	87	—	—	542	20	253
International institutions	1970	60	83	—	33	—	143	—	783
	1971	70	57	—	31	20	127	—	1,485
	1972	225	221	10	86	105	446	—	1,796
Total issues placed .	1970	1,961	1,032	601	310	—	2,994	317	2,290
	1971	2,241	1,515	860	268	49	3,756	295	3,352
	1972	3,864	2,628	1,232	473	490	6,491	1,218	3,906

[1] Includes bonds and notes with nominal maturities of five years or more, but not bank loans, stand-by and investment facilities. [2] Includes non-negotiable "Schuldscheindarlehen" (loans secured by certificates of indebtedness) placed privately. [3] Includes bonds with detachable warrants entitling holders to subscribe for shares. [4] Australia, Japan, New Zealand, South Africa. [5] Including small amounts placed by eastern European countries.

There are several factors that help to explain the buoyancy of supplies in 1972: the ease of the financial markets and/or the rapid growth of the monetary aggregates in western Europe and Japan; the restrictions on foreign investment in domestic securities in such countries as Germany; the large increase in official reserves even outside the Group of Ten countries, part of which seems to have been invested in the Euro-bond market; the liberalisation of capital exports in Japan, which was reflected in a sharp increase in Euro-bond purchases by Japanese residents; the favourable climate in the US share market which led to a brisk revival in the demand for convertible bonds; and, in the last four months of 1972, the improved confidence in the dollar.

On the demand side the lower cost of borrowing was the most important influence behind the \$2.7 milliard growth in the volume of new Euro-bond issues. For example, one significant feature of 1972 was a sharp increase, from \$0.05 to 0.5 milliard, in new issues by developing countries. Issues by international institutions jumped from \$0.1 to 0.4 milliard, \$0.1 milliard of this increase being accounted for by the IBRD and \$0.2 milliard by European entities such as the European Investment Bank. Flotations by other western European borrowers went up from \$1.7 to 2.5 milliard. The major part of this rise was in respect of UK and Scandinavian borrowers. UK takings rose from \$0.5 milliard in 1971 to \$0.8 milliard, reflecting principally the high cost of domestic credit and the combination of domestic controls on capital outflows and strong demand for foreign investment on the part of UK companies in anticipation of the entry of the United Kingdom into the EEC. Recourse to the market by Scandinavian borrowers, which was officially encouraged on balance-of-payments grounds, went up from \$0.4 to 0.8 milliard.

Euro-bond issues by US borrowers, which are a direct result of the US balance-of-payments restraint programme, expanded from \$1.1 to 2.0 milliard, despite a substantial drop in the total volume of US direct investment abroad as shown in the US balance-of-payments statistics. The recourse by US companies to the market was encouraged by the narrowing of the spread between corporate bond rates in the United States and those in the international dollar bond market and by a resurgence of demand for convertible bonds. In fact, total issues of convertible bonds soared from \$0.3 milliard in 1971 to \$1.2 milliard, virtually the whole of the increase being accounted for by US corporations.

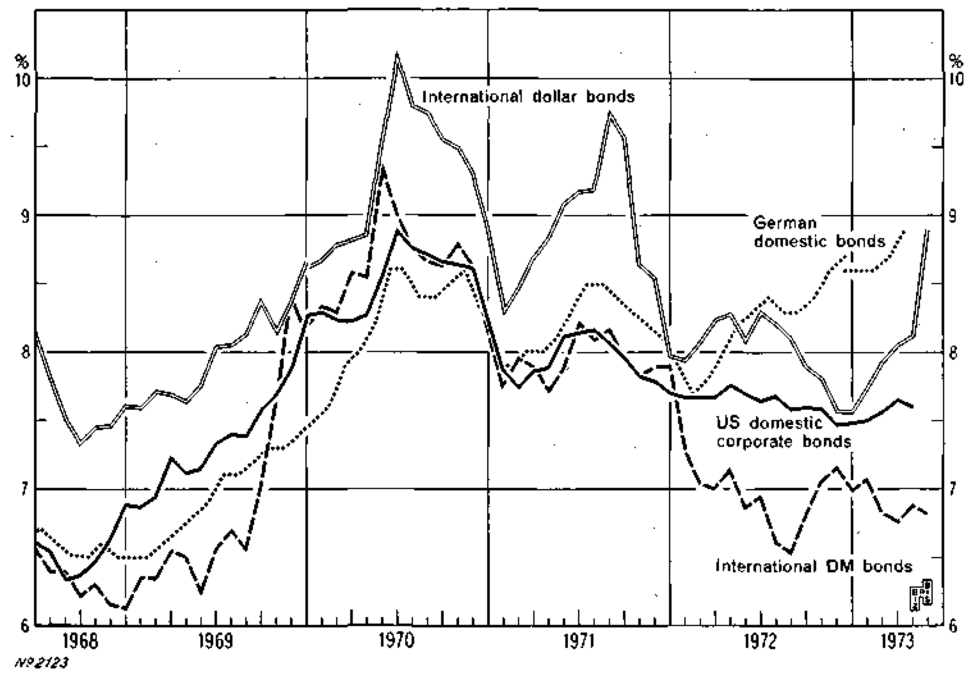
As to the currency denomination of new issues, dollar bonds continued to account for about 60 per cent., though over the year their share fluctuated quite sharply with the position of the dollar in the exchange markets. Thus it was as low as 36 per cent. in the July–August period, when most of the dollar issues in fact took the form of convertible bonds, while during the last four months of the year it amounted to 73 per cent. In absolute figures the monthly average of dollar issues rose from about \$0.15 to 0.45 milliard between these two periods.

The share accounted for by international DM issues dropped from 23 to 19 per cent., owing to the sharply widening gap in yields between German domestic bonds and foreign DM bonds, which caused German residents to shift \$1.3 milliard out of foreign DM bonds into domestic bonds. In fact, if foreign DM issues in Germany are included total purchases of international DM bonds by non-residents rose from \$1.4 milliard in 1971 to \$3.0 milliard, or by about the same amount as Euro-dollar bond issues. Moreover, there was a sharp increase in French franc issues from \$0.05 milliard in 1971 to \$0.5 milliard, or from 1 to 7 per cent. of total issues. The Dutch guilder maintained its market share of about 7 per cent. There was, moreover, a number of issues in such currencies as the Luxemburg franc, the Danish krone and the Australian dollar, most of which occurred in the third quarter when confidence in the US dollar was at a low ebb. The share of issues denominated in composite units of account dropped from 7 per cent. in 1971 to less than 0.5 per cent.

It may be noted that, at $3.9 milliard, conventional foreign issues in national markets also reached a record volume in 1972. The $0.6 milliard expansion as compared with 1971 was the result of increased borrowing by Canada (mostly by the provincial governments and their agencies) and by international institutions such as the IBRD, while other borrowers took up less than in 1971. The increase in foreign loan demand was mainly accommodated by Japan, Germany and Switzerland where foreign borrowing in the domestic market was welcome for balance-of-payments reasons. As already indicated in the preceding paragraph, the whole amount of new foreign bonds issued in Germany — $0.4 milliard — was, however, taken up by non-residents. Foreign issues in the US market showed very little change, a $0.2 milliard increase in Canadian issues being largely offset by a reduction in the amount taken up by international institutions.

As regards developments during the early part of 1973, the Euro-bond market began the year as strong as a lion but was soon reduced to a lamb by the renewed outbreak of the currency crisis and the weakness of the US share market. In January new issues amounted to $1.0 milliard, by far the largest monthly total yet recorded; 73 per cent. of it was in dollars. In February issues dropped back to $0.3 milliard, remained close to this level until April, and under the impact of further erosion of confidence in the dollar seem to have contracted to under $0.2 milliard in May. With borrowers unwilling to incur indebtedness in the strong currencies the share of dollar

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.

bonds in new issues at first remained fairly high; by May, however, it had fallen to about 30 per cent. Whereas in January issues of convertible bonds amounted to $0.25 milliard, there were no such issues during February, April or May.

Turning to interest rate developments, the yield on international dollar bonds showed, after the steep decline recorded in the last four months of 1971, some upward reaction between February and June 1972; during the rest of the year, however, it eased down from 8¼ to 7½ per cent., mainly under the effect of the come-back of the dollar in the exchange markets. The premium of Euro-dollar bond yields over US domestic corporate bond yields, which had averaged nearly 1 per cent. in 1971, amounted to about ½ per cent. from February to August but contracted to below ⅛ per cent. by the end of the year — the lowest premium yet recorded.

As was also the case in the Euro-currency market, the vicissitudes of the dollar had a particularly strong impact on non-dollar interest rates. Despite the upward trend of German domestic bond yields, the yield on Euro-DM bonds sagged from 7⅞ to 6½ per cent. in the first eight months of the year, at which level it was 1⅝ per cent. lower than the yield on dollar bonds and nearly 2 per cent. below the German domestic bond yield. With the temporary return of optimism concerning the dollar and the continued upward trend of bond yields in Germany, Euro-DM bond yields subsequently went up from 6½ to over 7 per cent. between the end of August and the end of January 1973 and the negative yield differential vis-à-vis Euro-dollar bonds narrowed to under three-quarters of a percentage point. The currency upheavals in February and March 1973 initiated a renewed rise in Euro-dollar bond yields and a decline in Euro-DM bond yields; the differentials therefore widened again but compared with the movements recorded during the August 1971 crisis the reaction was at first a fairly moderate one. In May, however, a further wave of pessimism carried the Euro-dollar bond yield to close on 9 per cent., i.e. over 1¼ percentage points above the level at which it had stood at the end of 1972.

VI. THE EUROPEAN MONETARY AGREEMENT.

Review and termination of the Agreement.

Pending a general assessment of its working and its future, the Agreement was renewed in 1971 for a further one-year period until 31st December 1972. In March 1972, following an interim report submitted by the Board of Management, the Council of the Organisation for Economic Co-operation and Development set up an Ad Hoc Committee concerning the European Monetary Agreement in which all members of the Organisation participated and which was presided over by the Chairman of the Board of Management. This Committee was entrusted with the task of examining the action required for the liquidation of the European Fund, and the possibility of maintaining some form of exchange guarantee between the central banks of those member countries of the Organisation which wished to participate. In July 1972, on the basis of the report of the Ad Hoc Committee, the Council accepted the proposed rules for the liquidation of the European Fund with effect from 31st December 1972 and the broad lines of a new exchange guarantee agreement of a type similar to that embodied in Part II of the EMA.

One feature of the agreed terms of the liquidation of the European Fund was that the Residual Capital was to be placed at the disposal of the Government of the United States. The Residual Capital was that part of the capital of the Fund which had originally formed the capital contributed by the Government of the United States to the European Payments Union, and which had been transferred from the Union to the European Fund when the Union was liquidated and the Fund established in January 1959. This capital, therefore, together with the income attributable to it, had to be returned to its original contributor. A further feature of the liquidation of the Fund was that the credits granted to Turkey were to be consolidated and taken over by the US Government as partial restitution of the Residual Capital. Representatives of the two countries had in the meantime agreed on the terms of the consolidated credit and the Council adopted their proposals at the same time as the recommendations of the Ad Hoc Committee.

The relevant legal texts for the implementation of these Decisions were subsequently worked out by the Board of Management of the EMA and by the Ad Hoc Committee and were adopted by the Council in December 1972.

Operations under the Agreement.

European Fund. At the end of March 1972 the total of credits outstanding was un/a 127.4 million,* all of which represented credits granted to Turkey.

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* In accordance with Article 24 of the Agreement, the accounts of the European Fund were kept in terms of a unit of account (un/a) of 0.888 670 88 grammes of fine gold. This was the gold value of one US dollar prior to the increase in the official price for gold, from US $35 to US $38 per fine ounce, as announced to the IMF with effect from 8th May 1972. Up to that date the US dollar had been taken to be equal to the unit of account in the books of the European Fund. Thereafter, dollar assets and liabilities were valued at the rate of 1 un/a per 38/35 US dollars. The resulting exchange loss on the Fund's dollar holdings incurred on that date is described on page 178, the exchange gain realised on capital account on liquidation on page 180 of this Report.

EMA: Utilisation of credits granted from the European Fund.

At value date for settlements for month	Greece		Iceland		Spain		Turkey		Totals		
	Available and undrawn	Drawings outstanding	Available and undrawn	Drawings outstanding	Available and undrawn	Drawings outstanding	Available and undrawn	Drawings outstanding	Available and undrawn	Drawings outstanding	Total credit granted
	in millions of units of account										
1959											
February	15.0	—	—	—	—	—	21.5	—	36.5	—	36.5
December. . . .	—	—	—	—	51.0	24.0	0.5	21.0	51.5	45.0	96.5
1960											
December. . . .	—	—	5.0	7.0	76.0	24.0	15.0	21.5	96.0	52.5	148.5
1961											
December. . . .	—	—	7.0	5.0	—	—	—	50.0	7.0	55.0	62.0
1962											
December. . . .	—	—	5.0	—	—	—	—	80.0	5.0	80.0	85.0
1963											
December. . . .	—	—	—	—	—	—	—	95.0	—	95.0	95.0
1964											
December. . . .	—	—	—	—	—	—	—	105.0	—	105.0	105.0
1965											
December. . . .	—	—	—	—	—	—	—	90.0	—	90.0	90.0
1966											
December. . . .	—	30.0	—	—	—	—	—	80.0	—	110.0	110.0
1967											
December. . . .	—	30.0	—	—	—	—	—	95.0	—	125.0	125.0
1968											
December. . . .	—	30.0	—	5.0	—	—	—	110.0	—	145.0	145.0
1969											
December. . . .	—	25.0	—	—	—	—	—	105.0	—	130.0	130.0
1970											
December. . . .	—	15.0	—	—	—	—	—	115.0	—	130.0	130.0
1971											
January.	—	—	—	—	—	—	—	115.0	—	115.0	115.0
February	—	—	—	—	—	—	—	130.0	—	130.0	130.0
October	—	—	—	—	—	—	—	125.0	—	125.0	125.0
December. . . .	—	—	—	—	—	—	—	127.4	—	127.4	127.4
1972											
May.	—	—	—	—	—	—	—	117.4	—	117.4	117.4
June	—	—	—	—	—	—	—	105.0	—	105.0	105.0

On 31st May 1972 Turkey drew un/a 25 million, being the whole of the sixteenth credit, and repaid un/a 35 million, of which un/a 15 million represented the third and last instalment of the seventh credit, un/a 5 million the second instalment of the eleventh credit, un/a 10 million the whole of the thirteenth credit and un/a 5 million the whole of the fourteenth credit. On 30th June 1972 Turkey repaid the third instalment of un/a 5 million of the eleventh credit and the whole — un/a 7.4 million — of the fifteenth credit. This brought the total amount of credits to Turkey outstanding at that date down to un/a 105 million, the amount at which the Council had agreed that credits to Turkey should be consolidated in connection with the forthcoming liquidation of the European Fund. In order to avoid prejudicing the agreed terms of the long-term consolidation of the credits granted to Turkey and following recommendations made by the Board of Management, the Council decided in September 1972 to suspend Turkey's obligations in respect of the two repayments, each of un/a 5 million, due on 30th September and 31st December 1972.

These transactions are all reflected in the table on page 176, which shows the position regarding the utilisation of credits granted from the European Fund on the value date for multilateral settlements (fifth working day of the following month) for February 1959, when the first credit was granted, for the end of each year from 1959 to 1970 and from the end of 1970 to June 1972 for each month in which transactions took place.

EMA: Payments made under the Multilateral System of Settlements.

Country	Payments made by the Fund (+) or to the Fund (—)						Net amount of settlement
	1959–64	1967	1968	1969	1972	Total 1959–72	
	in thousands of US dollars						
Austria	+ 25,083	+ 823	—	+ 30	—	+ 25,936	
	—	—	—	—	—	—	+ 25,936
Belgium	—	+ 633	—	+ 129	+ 124	+ 886	
	—	—	—	—	—	—	+ 886
Denmark	+ 240	+ 1,830	+ 9	+ 171	+ 1,783	+ 4,033	
	— 150	— 2,434	—	—	—	— 2,584	+ 1,449
France	—	+ 1,383	—	—	+ 2,471	+ 3,854	
	—	—	—	— 24,995	—	— 24,995	— 21,141
Germany	—	+ 3,444	—	+ 285	+ 4,470	+ 8,199	
	—	—	—	—	—	—	+ 8,199
Greece	+ 689	+ 1,210	—	+ 116	+ 1,121	+ 3,135	
	— 28,762	—	—	—	—	— 28,762	— 25,627
Iceland	—	+ 306	—	+ 5	—	+ 312	
	— 24	— 9	— 9	—	—	— 42	+ 270
Italy	+ 243	+ 1,047	—	+ 514	+ 1,936	+ 3,739	
	—	—	—	—	—	—	+ 3,739
Netherlands	+ 1,400	+ 1,604	—	+ 21	—	+ 3,025	
	— 1,378	—	—	—	—	— 1,378	+ 1,647
Norway	+ 889	+ 12	—	+ 4	—	+ 906	
	— 2,505	—	—	—	—	— 2,505	— 1,600
Portugal	—	+ 1,926	—	+ 20,813	—	+ 22,739	
	—	—	—	—	—	—	+ 22,739
Spain	—	+ 53	—	+ 1,237	+ 13	+ 1,303	
	—	—	—	—	—	—	+ 1,303
Sweden	—	+ 2,447	—	+ 28	—	+ 2,475	
	— 243	—	—	—	—	— 243	+ 2,232
Switzerland	—	+ 2,338	—	+ 212	—	+ 2,550	
	—	—	—	—	—	—	+ 2,550
Turkey	+ 9,212	+ 132	—	+ 734	—	+ 10,078	
	— 4,694	—	—	—	—	— 4,694	+ 5,384
United Kingdom	—	+ 624	—	+ 696	—	+ 1,320	
	—	— 17,368	—	—	— 11,918	— 29,286	— 27,966
Total	37,756	19,812	9	24,995	11,918	94,489	—

On the various credits granted between June 1959, when the first drawing was made, and the termination of the Agreement there were forty-three drawings totalling un/a 566.9 million. Repayments amounted to un/a 461.9 million.

Multilateral System of Settlements. As described in last year's Annual Report (page 169), at the end of December 1971 all member countries had notified margins beyond which they would not allow their currencies to fluctuate. With the exception of Greece, Iceland and Turkey, all member countries were applying margins of about 2.25 per cent. on either side of the central rate or parity.

With effect from 23rd June 1972 the United Kingdom suspended its buying and selling rates for the US dollar. Special settlements were therefore arranged under the exchange guarantee for balances held in pounds sterling immediately prior to the suspension of rates. Seven balances equivalent to US $11.9 million were settled on 6th July 1972.

The exchange guarantee under the Agreement became applicable for the last time when the Icelandic króna was devalued and new margins of 2.25 per cent. on either side of its new central rate were declared with effect from 20th December 1972. However, no balances in this currency were brought into the multilateral settlements.

The cumulative total of multilateral settlements during the whole lifetime of the Agreement amounted to US $94.5 million, as shown in the table on page 177.

Statement of Account.

The table on page 179 shows the situation of the Fund at the end of each financial year from 1959 to 1971 and thereafter monthly until the value date for November 1972, the last date for monthly settlements before liquidation.

On 8th May 1972, the value date for the April operations, the Fund incurred an exchange loss of un/a 5.2 million on its dollar holdings (included in the liquid resources), due to the new valuation of the dollar at the rate of 1 un/a per 38/35 US dollars. The loss was absorbed in the income and expenditure account but was fully covered by the undistributed and unallocated income. Moreover, the loss was more than compensated by a profit realised on liquidation, as mentioned below. As a result of the new valuation of the dollar, both the balance on the US Treasury account and the corresponding part of the Capital Fund were reduced in terms of units of account by un/a 9.8 million. The two operations offset each other in respect of their effect on the income and expenditure account but reduced the capital of the Fund from un/a 607.5 million to 597.7 million.

Credits and claims outstanding stood at un/a 133.7 million at end-March 1972. Of this sum, un/a 127.4 million represented credits to Turkey outstanding and un/a 6.3 million the balance of the long-term claims on Norway and Turkey. By the two repayments made in May and June 1972, described above, the total of credits and claims outstanding came down to un/a 111.3 million. In December 1972 the total fell by a further un/a 6.3 million as a result of the payment of the twelfth annuity by Norway and Turkey, and the repayment of the outstanding capital which these countries had agreed to undertake at

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

At value date for settlements for month	Assets				Total of Statement	Liabilities	
	Liquid resources	US Treasury account	Uncalled capital of member countries	Credits and claims out-standing		Capital Fund	Income and expendi-ture account
	in millions of units of account						
Opening	113.0	123.5	328.4	35.0	600.0	600.0	—
1959 December	104.4	123.5	302.9	80.0	610.9	607.5	3.4
1960 December	106.4	123.5	297.9	87.5	615.3	607.5	7.8
1961 December	109.2	123.5	297.9	87.8	618.4	607.5	10.9
1962 December	90.4	123.5	297.9	110.5	622.3	607.5	14.8
1963 December	82.1	123.5	297.9	123.1	626.6	607.5	19.1
1964 December	79.3	123.5	297.9	130.6	631.4	607.5	23.9
1965 December	101.3	123.5	297.9	113.1	635.8	607.5	28.3
1966 December	89.4	123.5	297.9	130.5	641.3	607.5	33.8
1967 December	82.6	123.5	297.9	142.8	646.9	607.5	39.4
1968 December	71.8	123.5	297.9	160.1	653.3	607.5	45.8
1969 December	96.6	123.5	297.9	142.2	660.3	607.5	52.8
1970 December	106.8	123.5	297.9	139.3	667.6	607.5	60.1
1971 December	119.5	123.5	297.9	133.7	674.7	607.5	67.2
1972 January	119.1	123.5	297.9	133.7	674.3	607.5	66.8
February	119.4	123.5	297.9	133.7	674.5	607.5	67.0
March	119.5	123.5	297.9	133.7	674.6	607.5	67.1
April.	114.5	113.8	297.9	133.7	659.9	597.7	62.2
May	125.2	113.8	297.9	123.7	660.6	597.7	62.8
June	139.6	113.8	297.9	111.3	662.6	597.7	64.9
July	139.3	113.8	297.9	111.3	662.3	597.7	64.6
August	139.6	113.8	297.9	111.3	662.6	597.7	64.9
September	140.0	113.8	297.9	111.3	663.0	597.7	65.2
October	140.2	113.8	297.9	111.3	663.2	597.7	65.4
November	140.5	113.8	297.9	111.3	663.5	597.7	65.8

the same time in connection with the liquidation of the European Fund. This brought the amount of credits outstanding at the end of December, immediately before the beginning of the liquidation operations, to un/a 105 million, representing the credits outstanding to Turkey.

Liquidation of the European Fund.

On 31st December 1972, as a consequence of the termination of the European Monetary Agreement, the following claims corresponding to uncalled capital of the Fund were cancelled:

(a) un/a 297.9 million representing the uncalled contributions from member countries;

(b) un/a 113.8 million, equivalent to the undrawn balance of US $123.5 million held on the account with the US Treasury. This balance had been transferred from the European Payments Union when the Union was liquidated. It formed, therefore, the first part of the Residual Capital which on liquidation had to be reconstituted and placed at the disposal of the Government of the United States, up to an amount of US $271.6 million.

On the same date the amounts outstanding on the credits granted to Turkey, totalling un/a 105 million, were transformed into a single consolidated credit of US $114.0 million which was transferred to the Government of the United States. The terms of this credit had been agreed as follows: repayable in US dollars in 50 equal semi-annual instalments in the twenty-five years 1978–2002; interest payable in US dollars at 2 per cent. per annum for the five years from 1973 to 1977 and at 3 per cent. per annum for the twenty-five years from 1978 to 2002.

All other liquidation operations, consisting mainly of the disposal of the liquid assets of the Fund, were carried out on 10th January 1973, the value date for the monthly settlements for December 1972, the last accounting period under the Agreement.

Immediately before the termination of the liquidation operations an exchange gain of un/a 11.7 million was realised on capital account. This gain was due to the fact that the second part of the Residual Capital transferred from the European Payments Union had amounted to un/a 148.0 million (of which un/a 113.0 million was transferred in liquid assets and un/a 35.0 million in the form of long-term claims on Norway and Turkey), whereas on liquidation an amount of US $148.0 million (now equivalent to un/a 136.3 million) had to be raised to obtain the full amount of the Residual Capital of US $271.6 million.

As a result of this gain the balance on the income and expenditure account distributable on liquidation went up to un/a 80.7 million. The following table shows in summarised form the claims cancelled in respect of uncalled capital and the way in which the other assets were used for the restitution of the capital called up and for the distribution of the accumulated net income of the Fund.

Payments to the Government of the United States were made in US dollars, those to member countries in gold. In addition to the un/a 3.3 million of the Fund's net

EMA: Summary of the liquidation operations of the European Fund.

Contributors	Unit	Uncalled capital cancelled	Called-up capital restituted: by transfer of credit	Called-up capital restituted: by payment in liquid assets	Total capital cancelled or restituted	Net income distributed in liquid assets	Total amount paid in liquid assets
		in millions of units indicated					
United States (Residual Capital)	US $	123.5	114.0	34.0	271.6	84.0	118.1
	un/a	113.8	105.0	31.3	250.1	77.4	108.7
Member countries. . . .	un/a	297.9	—	38.0	335.9	3.3	41.3
Total	un/a	411.7	105.0	69.3	586.1*	80.7*	150.0

* The capital of the Fund has been reduced and its net income increased by the exchange gain of un/a 11.7 million realised on capital account on liquidation.

income distributed on liquidation, member countries received during the lifetime of the Fund half-yearly interest payments on their contributions, totalling un/a 12.8 million. The last of such interest payments, amounting to un/a 0.5 million, was made in July 1972 in respect of the first half of the year. The following table shows for each member country the amount of uncalled contributions cancelled, the amount of called-up contributions repaid, the amount received as interest on their contributions in previous periods and the balance of each member country's share in the cumulative net income of the Fund paid out on liquidation.

EMA: Contributions repaid and net income distributed to member countries.

Member countries	Uncalled contributions cancelled	Called-up contributions repaid	Share in net income of the Fund: Paid as interest in previous periods	Share in net income of the Fund: Balance paid on liquidation	Share in net income of the Fund: Total share
	in thousands of units of account				
Austria	4,365	635	215	55	271
Belgium	26,188	3,812	1,293	331	1,624
Denmark*	15,000	—	—	—	—
France	43,647	6,353	2,142	549	2,691
Germany	43,647	6,353	2,142	549	2,691
Greece*	2,850	—	—	—	—
Iceland*	1,000	—	—	—	—
Italy	21,824	3,176	1,061	273	1,334
Netherlands	26,188	3,812	1,293	331	1,624
Norway*	15,000	—	—	—	—
Portugal	4,365	635	215	55	271
Spain	6,547	953	242	66	308
Sweden	13,094	1,906	646	166	812
Switzerland	18,332	2,668	905	232	1,136
Turkey*	3,000	—	—	—	—
United Kingdom	52,878	7,697	2,650	677	3,327
Total	297,925	38,000	12,804	3,283	16,087

* Member countries whose contributions were never called up because their payments were deferred.

Management of the European Monetary Agreement.

During the period under review the Board of Management continued its work of supervising the execution of the operations under the Agreement and advising the Council of the OECD on all related matters. The Board was particularly occupied with the preparations required for the termination of the European Monetary Agreement and the drafting of the relevant legal texts in accordance with the mandate received from the Council. A further task was the preparation of a new agreement concerning an exchange guarantee. In this work the Board was assisted by the Ad Hoc Committee concerning the European Monetary Agreement, in which all members of the OECD participated.

The Board met six times during 1972 and had a final session on 6th February 1973. The Ad Hoc Committee met five times. In December 1971 the Council had re-appointed M. Hay, Vice-President of the Directorate of the Swiss National Bank, as Chairman of the Board for a further year. M. Hay also presided over the meetings of the Ad Hoc Committee concerning the European Monetary Agreement.

As in previous years, the Bank for International Settlements, as Agent, presented monthly reports on the operations carried out under the Agreement. The report for December also covered the operations for the liquidation of the European Fund. To assist the Board in following international financial developments the Bank also provided statistical material on the international gold and foreign exchange markets and on the external monetary position of OECD countries, which the Representative of the Bank commented upon regularly at the Board's meetings.

With the termination of the European Monetary Agreement the transmission of confidential information to participating central banks relating to the conclusion and utilisation of concerted bilateral arrangements through which special support was given to the currency of a member country, with which the Bank had been entrusted since 1963, has also come to an end.

New Agreement concerning an Exchange Guarantee.

When the European Monetary Agreement came to an end on 31st December 1972 a new Agreement providing for an exchange guarantee came into force, which replaced the similar arrangements contained in Part II of the European Monetary Agreement. The central banks of the member countries of the former EMA (see table on page 181) and also Australia and Finland are participating in the new Agreement. The Bank of England is also a participant but has declared that it cannot apply the provisions concerning an exchange guarantee until it has been able to fix exchange rate margins for sterling.

The new Agreement, which has been established for an initial period of three years, is being operated within the Organisation for Economic Co-operation and Development. A new body, the Committee for Monetary and Foreign Exchange Matters, has been set up with responsibility for supervising the implementation of the Agreement concerning an Exchange Guarantee. The Agreement covers the amounts held by a central bank on an account with another participating central bank in the latter's national currency which are used as working balances.

The Bank for International Settlements has been asked to act as Agent for the purposes of the Agreement. At its meeting on 8th January 1973 the Board of Directors agreed that the Bank should perform this new task. Representatives of the Bank will attend the meetings of the Committee for Monetary and Foreign Exchange Matters, which will also provide a forum, open to all members of the Organisation, in which problems of monetary co-operation, and particularly those relating to the operations of the exchange markets, can be examined.

VII. ACTIVITIES OF THE BANK.

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

Last year the Bank continued to play an active rôle in facilitating co-operation among 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, it organised periodic meetings of central-bank officials to examine matters such as the development of the gold and foreign exchange markets and the Euro-currency market and meetings to study and exchange information on other economic and monetary, technical and legal questions of interest to central banks.

The Bank was invited to participate as an observer in the work of the Committee of the Board of Governors of the International Monetary Fund on Reform of the International Monetary System and Related Issues, usually known as the Committee of Twenty, which was established in September 1972. It has been represented at the meetings of this Committee at both Ministerial and Deputy level and has taken part in the work of a Technical Group on Disequilibrating Capital Flows which was set up by the Committee.

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 usually meet in Basle. During the past year both the number of meetings held and the variety of topics discussed increased substantially, especially in connection with the setting-up and operation of the scheme for the narrowing of the margins of fluctuation between the exchange rates of EEC currencies. The Secretariat of the Committee of Governors has also been asked by the Board of Governors of the newly-created European Monetary Co-operation Fund provisionally to undertake similar functions on its behalf.

Furthermore, the Bank continued last year to perform the functions entrusted to it in August 1964 by the Ministers of the Group of Ten of collecting and distributing to all the participants of the Group and to Working Party No. 3 of the Organisation for Economic Co-operation and Development statistical data concerning the financing of external surpluses and deficits of the Group of Ten countries. It also continued to assemble, survey and distribute statistical data on the Euro-currency market and to be associated with other work of the Group of Ten and of the OECD.

2. Operations of the Banking Department.

The Balance Sheet of the Bank and the Profit and Loss Account at 31st March 1973, certified by the auditors, are reproduced at the end of this Report; both are expressed in gold francs.*

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* In this chapter the term "francs" (abbreviated to F) signifies *gold* francs, except where otherwise indicated. The conversion into gold francs (units of 0.290 322 58... grammes of fine gold — Article 4 of the Statutes) of the various currencies included in the Balance Sheet has been made on the basis of the parity or central rate except in cases where there was a marked difference between this and the market rate; in these cases the basis adopted has been the middle market rate against the US dollar on 28th March 1973 and the gold price of US $42.22 per ounce.

The balance-sheet total at 31st March 1973 amounted to	F 25,249,615,031
against, on 31st March 1972,	F 29,362,151,157
It thus registered a fall of	F 4,112,536,126

or 14 per cent., compared with an increase of 23 per cent. during the previous financial year.

Two observations may be made in this connection:

(i) as was pointed out in last year's Annual Report, a considerable part of the increase in the balance-sheet total for the financial year 1971–72 was due to the receipt of a very short-term deposit running over the end of that financial year; this transaction came to maturity in the course of the financial year just ended;

(ii) the various currency adjustments which occurred during the financial year, in particular the devaluation of the US dollar by 10 per cent. in February 1973, which was only partly offset by the 3 per cent. revaluation of the Deutsche Mark in March 1973 and by the de facto appreciation of other currencies, were reflected in a net decrease in the assets and liabilities shown in the Balance Sheet.

But for these two exceptional factors, the effects of which can be seen in the data set out below, the balance-sheet total would have expanded by approximately 3.1 milliard francs.

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
1964	5,778	+ 828	+ 17
1965	7,850	+ 2,072	+ 36
1966	7,882	+ 32	—
1967	8,232	+ 350	+ 4
1968	12,041	+ 3,809	+ 46
1969	14,643	+ 2,602	+ 22
1970	20,699	+ 6,056	+ 41
1971	23,856	+ 3,157	+ 15
1972	29,362	+ 5,506	+ 23
1973	25,250	— 4,112	— 14

The following items are not included in the Balance Sheet:

(i) bills and other securities held in custody for the account of central banks and other depositors;

(ii) the assets (bank balances, bills and other securities) held by the Bank as Depositary under the Act of Pledge concluded with the European Coal and Steel Community and as Trustee for international government loans;

(iii) gold under earmark held by the BIS; this item amounted to 931 million francs on 31st March 1973, against 969 million francs on 31st March 1972.

LIABILITIES (COMPOSITION OF RESOURCES).

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			
1964	150	5,370	258	5,778
1965	151	7,417	282	7,850
1966	151	7,449	282	7,882
1967	151	7,764	317	8,232
1968	170	11,548	323	12,041
1969	200	14,133	310	14,643
1970	463	20,060	176	20,699
1971	539	23,086	231	23,856
1972*	754	28,401	207	29,362
1973*	849	24,179	222	25,250

*After allocation of the net profit for the year.

A. Capital, reserves, provisions and miscellaneous liabilities.

(a) Paid-up capital — F 300,703,125

The Bank's capital remained unchanged; it is made up of 481,125 shares paid up to the extent of 25 per cent.

(b) Reserves

(1) *Legal Reserve Fund* — F 30,070,313

This amount showed no change over the previous year, having reached the maximum laid down in the Statutes, namely 10 per cent. of the paid-up capital.

(2) *General Reserve Fund*

– before allocation of the net profit for 1972–73 — F 205,133,210

This compares with 144.1 million francs on 31st March 1972; the increase of 61 million francs was entirely due to a transfer from the net profit for 1971–72;

– after allocation of the net profit for 1972–73 — F 252,633,210

The amount that it is proposed to transfer to the Fund from this profit is thus 47.5 million francs.

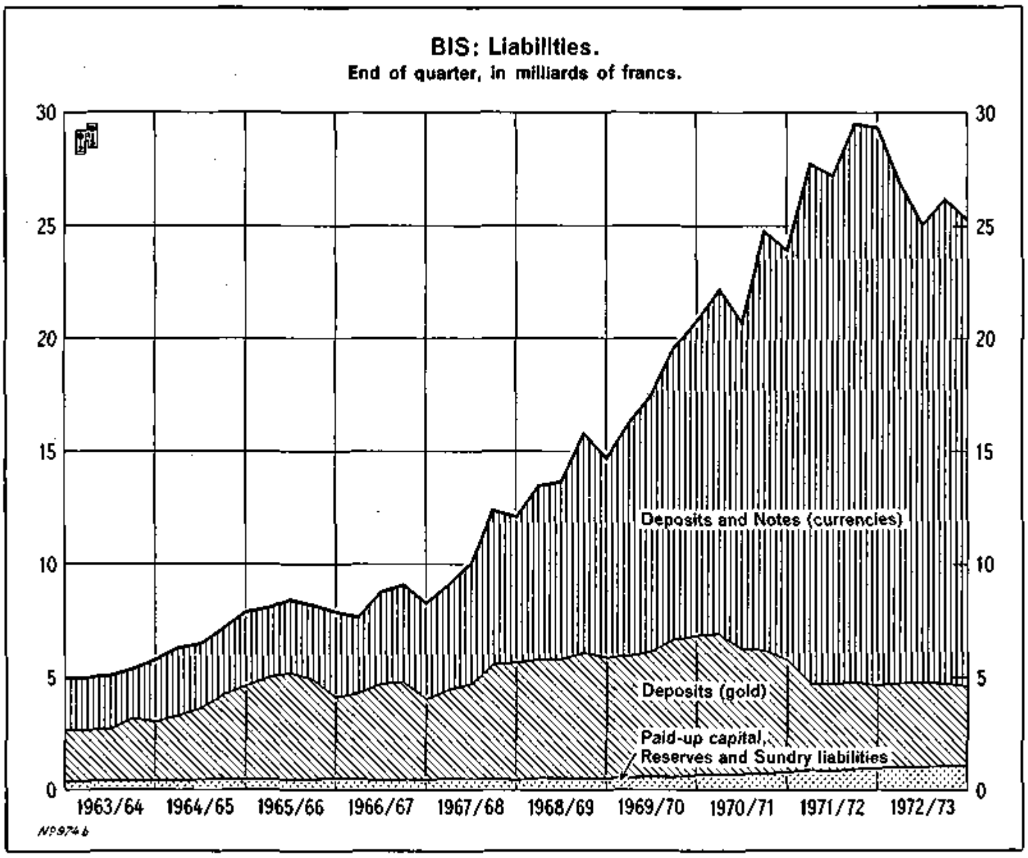
(3) *Special Dividend Reserve Fund*

– before allocation of the net profit for 1972–73 — F 61,207,964

This compares with 36.8 million francs on 31st March 1972; the difference of 24.4 million represents the amount transferred from the net profit for 1971–72;

– after allocation of the net profit for 1972–73 — F 75,175,781

This is on the basis of the recommendation that 14 million francs be transferred to the Special Fund from this profit in order to raise it to the maximum of one-quarter of the paid-up capital in accordance with Article 51 (5) of the Statutes.



(4) *Free Reserve Fund*

– before allocation of the net profit for 1972–73 F 156,800,000

This compares with 120.2 million francs on 31st March 1972; the difference of 36.6 million represents the amount transferred to the Fund from the net profit for 1971–72;

– after allocation of the net profit for 1972–73 F 190,332,183

The amount it is proposed to transfer to the Fund from this profit is 33.5 million francs.

The Bank's overall reserve position may thus be summarised as follows:

– before allocation of the net profit for 1972–73 F 453,211,487

This compares with 331.2 million francs on 31st March 1972, giving an increase of 122 million;

– after allocation of the net profit for 1972–73 F 548,211,487

This represents a further increase of 95 million francs.

(c) The item "Miscellaneous" rose to F 101,705,551

This compares with 98.4 million francs, giving an increase of 3.3 million.

(d) Provision for Building Purposes F 92,939,483

This compares with 82.1 million francs; the increase of 10.8 million francs is the net result of, on the one hand, the appropriation of an additional sum of 10 million francs decided on by the Board of Directors and an exchange gain of 5.4 million and, on the other hand, the settlement of incurred expenditure of 4.6 million francs.

(e) Profit and Loss Account F 122,063,281

This figure represents the net profit for the financial year 1972–73; it shows a decrease of 26.7 million francs compared with the net profit for the preceding financial year, which amounted to 148.8 million francs. Details of the proposed allocation of the profit for 1972–73 are given in Section 7 below; these proposals, which have already been referred to several times in connection with the development of the reserves, recommend in particular that a sum of 27,063,281 francs should be applied in payment of the dividend on 1st July 1973.

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 1972	1973	Movement
	in millions of francs		
Deposits of central banks	27,125	23,086	− 4,039
Deposits of other depositors	792	578	− 214
Notes	484	515	+ 31
Total	28,401	24,179	− 4,222

The decline of just over 4,000 million francs in "Deposits of central banks" (− 14.9 per cent.) was entirely due to the maturing of the short-term operation entered in the books of the Bank at the end of the preceding financial year, which the receipt of fresh deposits, though large, only partially offset. In relative terms "Deposits of other depositors" also recorded an appreciable decline (− 27 per cent.) owing principally to the liquidation of the European Fund set up under the European Monetary Agreement, while the item "Notes" increased by 6.4 per cent., chiefly as a result of the de facto appreciation of the Swiss franc.

The individual shares of these three items in the total of borrowed resources remained virtually unchanged over the financial year, the first still accounting for the bulk of the total.

BIS: Borrowed funds, by nature and term.

Term	Deposits in gold			Deposits in currencies			Notes		
	Financial years ended 31st March		Movement	Financial years ended 31st March		Movement	Financial years ended 31st March		Movement
	1972	1973		1972	1973		1972	1973	
	in millions of francs								
Sight	3,219	3,270	+ 51	69	384	+ 315	—	—	—
Not exceeding 3 months	112	239	+ 127	21,767	17,202	−4,565	—	—	—
Over 3 months	369	17	− 352	2,381	2,552	+ 171	484	515	+ 31
Total	3,700	3,526	− 174	24,217	20,139	−4,079	484	515	+ 31

(a) Deposits in gold F 3,526,438,223

This figure compares with that of 3,700 million at 31st March 1972. The decrease of 174 million, or 4.7 per cent., was the net outcome of two movements in opposite directions: a decline in deposits at over three months, partly offset by an increase in deposits at sight and at not exceeding three months. This development confirmed the trend referred to last year, which was attributable to the fact that the possibilities open to the Bank of utilising gold remuneratively were gradually decreasing. The net decrease in deposits was mainly due to withdrawals effected as a result of the liquidation of the European Fund set up under the European Monetary Agreement.

(b) Deposits in currencies F 20,138,027,139

This figure compares with 24,217 million francs at 31st March 1972, representing a decline of 4,079 million francs (– 16.8 per cent.). As already mentioned, this decrease was chiefly ascribable to the repayment of the short-term deposit held at the end of the previous financial year. New funds received by the BIS in the course of the last financial year offset part of the movement in deposits at not exceeding three months caused by the operation in question and gave rise to an increase of 7.2 per cent. in deposits in currencies at over three months.

(c) Notes F 514,526,742

This figure compares with the total of 484 million francs at 31st March 1972.

At the beginning of the financial year "Deposits in gold" represented 13 per cent. of all borrowed resources, "Deposits in currencies" 85 per cent. and "Notes" 2 per cent.; on 31st March 1973 the proportions were practically unchanged, standing at 15, 83 and 2 per cent. respectively.

ASSETS (EMPLOYMENT OF RESOURCES).

The following table gives a break-down of the main items of the assets according to their *nature*.

BIS: Distribution, by nature, of sight assets and other investments.

Nature	Financial years ended 31st March 1972		1973		Movement	
	in millions of francs					
Sight assets						
Gold	4,253		4,126		− 127	
Currencies	75	4,328	84	4,210	+ 9	− 118
Treasury bills						
Currencies	1,117	1,117	596	596	− 521	− 521
Time deposits and advances						
Gold	252		2		− 250	
Currencies	12,780	13,032	15,742	15,744	+ 2,962	+ 2,712
Securities at term						
Gold	279		—		− 279	
Currencies	10,605	10,884	4,638	4,638	− 5,967	− 6,246
Total						
Gold	4,784		4,128		− 656	
Currencies	24,577	29,361	21,060	25,188	− 3,517	− 4,173

(a) Gold F 4,125,844,150

This consisted entirely of gold in bars. The contraction in this item, which amounted to 127 million francs, corresponds to deposits which matured and were repaid.

(b) Cash on hand and on sight account with banks F 84,352,631

This item registered an increase of 9 million francs.

(c) Treasury bills F 595,538,145

There was a decline in this item of 521 million francs. The movement was due to the maturing of a substantial portion of these investments not renewable in this form.

Assets at sight or readily mobilisable, comprising the three items analysed above, totalled 5,445 million francs on 31st March 1972, corresponding to 18.5 per cent. of the balance-sheet total, and 4,806 million francs on 31st March 1973, representing 19 per cent. of the balance-sheet total. Parallel to this movement sight deposits on the liabilities side rose from 3,288 million francs, or 11.2 per cent. of the balance-sheet total, to 3,654 million, or 14.5 per cent.

(d) Time deposits and advances F 15,744,438,963

This figure compares with one of 13,032 million francs at 31st March 1972, representing an increase of 2,712 million. While time deposits and advances in gold declined, for the reasons mentioned above, from 252 million to 2 million francs, those in currencies registered a pronounced increase from 12,780 million to 15,742 million francs. This rise corresponded to an expansion of the Bank's investments in currencies on the markets, including that of the United States.

(e) Securities at term F 4,637,469,962

This figure represents an appreciable decrease — of 6,246 million — from the total of 10,884 million at 31st March 1972. This decline was accounted for by the following movements:

(i) liquidation of the sub-item "Securities at term in gold" as a result of the maturing of investments in the form of Treasury bills denominated in a weight of gold, to a total of 279 million francs;

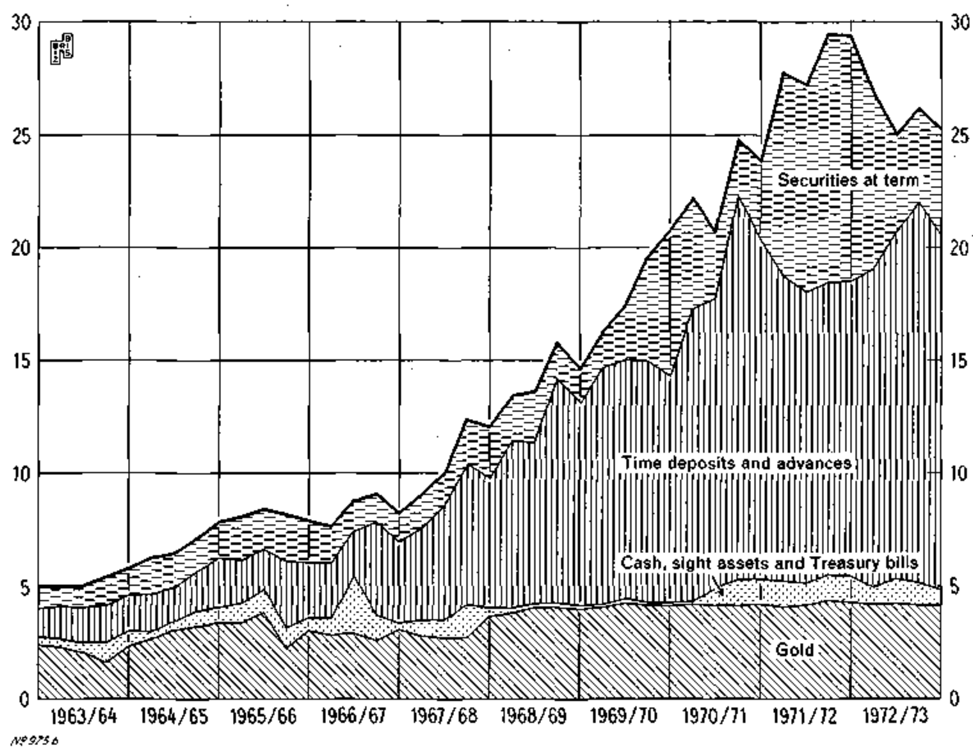
(ii) a decline of 5,967 million francs in the sub-item "Securities at term in currencies". This movement was due to the winding-up of the special operation mentioned above which on the assets side had taken the form of a receipt on a "pension" basis of paper denominated in US dollars; it was also due, to a much smaller extent, to a reduction in holdings of paper denominated in European currencies. These two movements were partially offset by a further increase in investments in the form of US bank certificates of deposit.

The table below shows the distribution of time deposits and advances and securities at term by *maturity*.

BIS: Time deposits and advances and securities at term, by maturity.

Periods	Financial years ended 31st March 1972	Financial years ended 31st March 1973	Movement
	in millions of francs		
Not exceeding 3 months	18,141	15,063	− 3,078
Over 3 months	5,775	5,319	− 456
Total	23,916	20,382	− 3,534

BIS: Assets.
End of quarter, in milliards of francs.



Forward gold operations.

These operations, which appear under note 2 to the Balance Sheet, resulted in a positive net balance (gold receivable) of F 95,424,432 compared with a negative net balance of 393 million francs at the end of March 1972, which represents a movement over the financial year amounting to 488 million. This movement was attributable to the maturing of swaps of gold (sold forward) against currencies, and to the conclusion of fresh swaps of gold (sold spot and repurchased forward) against currencies.

* * *

In the financial year 1972–73 the volume of the Bank's operations, at 265 milliard francs, returned approximately to the level recorded in the financial year 1970–71 (250 milliard); it was thus substantially lower than the record figure of 433 milliard francs reached in 1971–72.

This movement in the volume of operations is considerably larger than those in the Balance Sheet and the profits of the Bank; it is due chiefly to the large volume of special operations undertaken during the preceding financial year. In fact the Bank's normal business showed no real decline during the financial year 1972–73 and remained at a satisfactory level.

3. The Bank as Trustee for international government loans.

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

As regards the Dawes Loan, all the bonds which were issued in accordance with the London Agreement have now been redeemed: the outstanding conversion bonds were redeemed on 15th October 1969, and the rest of the outstanding bonds, namely those of the funding issues, fell due and were redeemed on 15th October 1972, as shown in the following table.

German External Loan 1924 (Dawes Loan).
Funding bonds.

Issue	Currency	Nominal value		
		Bonds issued	Bonds purchased for redemption in respect of the financial years 1958–59 to 1971–72	Bonds redeemed at maturity on 15th October 1972
American . . .	$	8,211,000	3,472,000	4,739,000
Belgian	£	157,800	70,400	87,400
British	£	2,232,700	989,300	1,243,400
Dutch.	£	291,700	120,900	170,800
French	£	499,100	224,200	274,900
Swiss	£	115,100	50,500	64,600
Swiss	Sw.fr.	418,000	164,000	254,000

For the Young Loan the financial year 1972–73 ended on 1st June 1973. The interest in respect of the financial year amounted to the equivalent of about 28.7 million francs and was duly paid to the Bank and distributed by the latter among the Paying Agents. Redemption of conversion bonds in respect of the financial year 1972–73 was effected solely by purchases of bonds on the market. All the outstanding funding bonds matured and were repaid on 1st December 1972, whereas the final maturity date for the conversion bonds is fixed at 1st June 1980.

The question whether the exchange guarantee attached to the Young Loan under the terms of the London Agreement was applicable in the case of the revaluations of the Deutsche Mark in 1961 and in 1969 was submitted in May 1971 to the court of arbitration provided for in the Agreement; the arbitral proceedings are in progress. The more recent questions regarding the application of the exchange guarantee which have been raised by the floating of the exchange rates for various currencies of issue and the introduction of central rates for certain of those currencies have been submitted by the Bank to the governments of the countries in which issues of the Loan were made.

German Government International Loan 1930 (Young Loan).

Conversion bonds.

Issue	Currency	Nominal value*			
		Bonds issued	Bonds purchased or drawn for redemption in respect of the financial years 1958–59 to 1971–72	1972–73	Balance after redemption
American . . .	$	60,292,000	11,973,000	1,217,000	47,102,000
Belgian	B.fr.	202,858,000	39,358,000	3,929,000	159,571,000
British	£	20,664,900	3,996,600	396,800	16,271,500
Dutch	Fl.	52,577,000	9,987,000	1,007,000	41,583,000
French	Fr.fr.	501,782,000	97,529,000	9,709,000	394,544,000
German	DM	14,505,000	2,757,000	270,000	11,478,000
Swedish . . .	S.kr.	92,780,000	17,969,000	1,777,000	73,034,000
Swiss	Sw.fr.	58,392,000	11,223,000	1,093,000	46,076,000

Funding bonds.

Issue	Currency	Nominal value*		
		Bonds issued	Bonds purchased for redemption in respect of the financial years 1958–59 to 1971–72	Bonds redeemed at maturity on 1st December 1972
American . . .	$	9,788,000	2,888,000	6,900,000
Belgian	B.fr.	45,683,000	12,970,000	32,713,000
British	£	4,930,600	1,515,700	3,414,900
Dutch	Fl.	8,500,000	2,284,000	6,216,000
French	Fr.fr.	110,508,000	21,279,000	89,229,000
German . . .	DM	416,000	263,000	153,000
Swedish . . .	S.kr.	6,014,000	1,608,000	4,406,000
Swiss	Sw.fr.	1,405,000	489,000	916,000

* Nominal value on 1st May 1973 established in accordance with the provisions of the London Agreement on German External Debts of 27th February 1953 but without taking into account the revaluations of the Deutsche Mark, the floating of the exchange rates for various currencies of issue, the introduction of central rates for certain of those currencies or the devaluation of the US dollar announced by the United States authorities on 12th February 1973.

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 1971	1972	
American . . .	$	1,667,000	1,002,000	93,000	572,000
Anglo-Dutch .	£	856,600	498,100	45,800	312,700
Swiss	Sw.fr.	7,102,000	3,580,000	363,000	3,159,000

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

The Bank's activities in its capacity as Agent for the execution of the financial operations of the EMA under the Organisation for Economic Co-operation and Development came to an end on 31st December 1972; they have been described in Chapter VI of this Report. The Bank has received in this connection a contribution of Sw.fr. 375,000 towards its administrative expenses for the period 1st April to 31st December 1972, 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 table on the next page shows the amounts outstanding on the secured loans issued by the European Coal and Steel Community between 1954 and 1961 for which the Bank performs the functions of Depositary in accordance with the provisions of the Act of Pledge concluded between itself and the Community on 28th November 1954.

During the financial year 1972–73 the amounts received by the Bank for the service of the secured loans came to the equivalent of about 14 million francs in respect of interest and about 37 million francs in respect of redemption. By the end of the financial year the total amount outstanding had been reduced to the equivalent of approximately 253 million francs.

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 1973	Rates of interest %	Year of final maturity or redemption
1st	1954	United States	US Government	$	100,000,000	41,300,000	3⅞	1979
2nd	1955	Belgium	Caisse Générale d'Epargne et de Retraite, Brussels	B.fr.	200,000,000	102,200,000	3½	1982
3rd	1955	Germany	Westdeutsche Landesbank Girozentrale, Düsseldorf and Münster[1]	DM	50,000,000	19,894,800	3¾	1981
4th	1955	Luxemburg	Caisse d'Epargne de l'Etat, Luxemburg	B.fr.	20,000,000	10,220,000	3½	1982
				L.fr.	5,000,000	—	3½	1961
5th	1956	Saar	Landesbank und Girozentrale Saar, Saarbrücken	DM	2,977,450[2]	967,671	4¼	1977
6th	1956	Switzerland	Public issue	Sw.fr.	50,000,000	8,750,000	4¼	1974
7th	1957	United States	Public issue	$	25,000,000	4,100,000	5½	1975
8th	1957	United States	Public issue	$	7,000,000	—	5	1962
9th	1957	United States	Bank loans	$	3,000,000	—	5	1962
10th	1957	Luxemburg	Etablissement d'Assurance contre la Vieillesse et l'Invalidité, Luxemburg	L.fr.	100,000,000	61,112,259	5⅝	1982
11th	1958	United States	Public issue	$	35,000,000	14,300,000	5	1978
12th	1958	United States	Public issue	$	15,000,000	—	4½	1963
13th	1960	United States	Public issue	$	25,000,000	13,450,000	5⅜	1980
14th	1960	United States	Public issue	$	3,300,000	—	4¾	1963
				$	3,300,000	—	4⅞	1964
				$	3,400,000	—	5	1965
15th	1961	Luxemburg	Etablissement d'Assurance contre la Vieillesse et l'Invalidité, Luxemburg	L.fr.	100,000,000	73,772,396	5¼	1986
16th	1961	Netherlands	Public issue	Fl.	50,000,000	29,900,000	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.

6. The Bank as Agent for the European Monetary Co-operation Fund.

With a view to promoting the progressive establishment of economic and monetary union, the member countries of the European Economic Community set up a European Monetary Co-operation Fund on 6th April 1973. In the first stage of its operation this new organ is to be responsible for the following matters:

(1) the concertation necessary for the proper functioning of the Community exchange system, viz. the narrowing of the margins of fluctuation between the currencies of EEC member countries;

(2) the multilateralisation of positions resulting from intervention carried out by the central banks in Community currencies and the multilateralisation of intra-Community settlements;

(3) the administration of the two short-term credit arrangements instituted by the EEC central banks under agreements concluded on 9th February 1970 (the BIS has been acting as agent for the arrangements set up under this agreement) and on 10th April 1972.

The Board of Governors of the Fund, which is composed of the Governors of the Community central banks, a representative of Luxemburg and a delegate of the Commission of the European Communities, held its first meeting in Basle on 14th May 1973. It decided at this meeting to entrust to the BIS, from 1st June 1973, the function of Agent responsible for the execution of technical aspects of the Fund's operations. The responsibilities involved are essentially of an accounting nature. They consist of keeping the Fund's accounts, which will record the various operations undertaken within the context of the functions described under (2) and (3) above, and have the aim of ensuring the proper operation of the Fund's activities.

7. Net profits and their distribution.

The accounts for the forty-third financial year ended 31st March 1973 show a surplus of 136,048,276 francs. The surplus for the preceding financial year was 156,364,072 francs and that for the financial year 1970–71 amounted to 133,049,026 francs. The main reason for the reduction during the year 1972–73 has been the appreciable narrowing of the Bank's margin of profit on its operations as a whole.

The Board of Directors has decided to transfer to the Provision for Exceptional Costs of Administration an amount of 3,984,995 francs and to the Provision for Building Purposes a sum of 10,000,000 francs. As a result of these decisions the net profit amounts to 122,063,281 francs, against 148,832,656 francs for the previous financial year and 99,448,906 francs for the financial year 1970–71. The allocation of this amount is fixed by Article 51 of the Statutes.

On the basis of this provision, the Board of Directors recommends that the net profit of 122,063,281 francs be applied by the General Meeting in the following manner:

(i) an amount of 18,042,187 francs in payment of the preferential dividend of 6 per cent. per annum, this dividend being fixed at 37.50 francs per share;

(ii) an amount of 9,021,094 francs — a sum falling within the statutory limit of 20 per cent. of the remainder of the net profit — to be appropriated in payment of the maximum further dividend of 3 per cent. per annum, this dividend being fixed at 18.75 francs per share;

(iii) an amount of 47,500,000 francs to be transferred to the General Reserve Fund;

(iv) an amount of 13,967,817 francs to be transferred to the Special Dividend Reserve Fund; after this allocation the Fund would reach its statutory maximum, viz. one-quarter of the paid-up capital, or 75,175,781 francs, corresponding approximately to the preferential dividend for four years; and finally

(v) an amount of 33,532,183 francs, representing the remainder of the available net profit, to be transferred to the Free Reserve Fund. This Fund can be used by the Board of Directors for any purpose which is in conformity with the Statutes.

If these proposals are accepted, the total dividend will amount to 56.25 francs per share and will be paid in Swiss francs on 1st July 1973 to the shareholders whose names are entered in the Bank's share register on 20th June 1973.

The Balance Sheet, the Profit and Loss Account and the movement during the financial year on the Provision for Building Purposes 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 1973 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.

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

Baron Ansiaux, whose mandate as a member of the Board was due to expire on 7th August 1972, was re-appointed under Article 27(2) of the Statutes by M. Robert Vandeputte, Governor of the National Bank of Belgium, in July 1972.

In September 1972 Dr. Donato Menichella, whose mandate as a member of the Board was due to expire on 7th November 1972, was re-appointed under Article 27(2) of the Statutes by Dr. Guido Carli, Governor of the Bank of Italy.

The mandate of Dr. Leonhard Gleske as a member of the Board was due to expire on 31st December 1972. He was re-appointed under Article 27(2) of the Statutes by Dr. Karl Klasen, President of the Deutsche Bundesbank, in December 1972.

The mandate of Dr. Jelle Zijlstra, who had been elected to the Board under Article 27(3) of the Statutes, was due to expire on 31st March 1973. He was re-elected at the meeting of the Board held on 12th March 1973.

The Chairman informed the Board at its meeting on 13th November 1972 that the Rt. Hon. Lord O'Brien of Lothbury, Governor of the Bank of England, had appointed Mr. C. W. McMahon to act as his Alternate in place of Mr. C. J. Morse, who had assumed the appointment of Chairman of the Deputies of the IMF's Committee of Twenty. He expressed the Bank's gratitude to Mr. Morse for his valuable services during a period of more than six years.

At the meeting of the Board held on 9th April 1973 the Chairman announced that M. Olivier Wormser, Governor of the Bank of France, had appointed M. André de Lattre as his Alternate in place of M. Bernard Clappier, who had assumed the appointment of President and General Manager of the Crédit National. The Chairman thanked M. Clappier for the valuable services he had rendered the Bank during more than nine years.

Dr. Hans Mandel, who had joined the Bank from the Bank deutscher Länder in 1954 and had been Head of the Banking Department since 1962, retired at the end of September 1972. At the meeting of the Board held on 11th September 1972 the Chairman expressed to Dr. Mandel the sincere gratitude of all members of the Board for the able manner in which he had carried out his important functions during a period of remarkable growth in the Bank's activities.

At its meeting held on 12th June 1972 the Board appointed Mr. D. H. Macdonald Head of the Banking Department and Mr. R. T. P. Hall as a Manager of the Bank. Mr. Macdonald's appointment took effect on 1st October 1972 and Mr. Hall's on 16th October 1972.

CONCLUSION.

In every post-war economic recession or pause it has been demonstrated that the use of stimulative fiscal and monetary policy initiated a cyclical upswing. This Keynesian mechanism was again evident in the present cycle. From 1969 to 1971 one industrial country after another had applied the brakes to the expansion of output in an effort to stem inflationary forces. Then, as slackness in employment and capacity utilisation became the centre of concern from 1970 to the end of 1971, policies were reversed so as to put activity on a recovery course. Over the past year the renewed expansion has been confirmed in all countries.

In this cyclical pattern the United States has had a lead of about a year to eighteen months. After unusual resistance, recovery started in the second half of 1971 and gathered momentum and strength very quickly. The gain in total output in 1972 was exceptionally large and a high rate of expansion has continued in the first half of this year. Indeed, by late 1972 it became evident that the pace of the upswing was unsustainable without soon running up against excess demand pressures. A shift to restrictive budget and monetary policies was therefore initiated with the aim of limiting the expansion rate to the longer-term potential of the economy. Whenever these policies may begin to bite, it seems sure that 1973 will be another year of exceptional advance.

In western Europe and Japan generalised expansion has been confirmed since the middle of 1972. Besides, it has been an upturn of exceptional speed. In both Germany and Japan in particular the climate of the economy changed in the space of about six months from one of semi-stagnation to expansion of boom proportions. The authorities in both countries were led to shift policies to restraint. In Japan the change has so far been rather mild, but in Germany severe monetary and fiscal measures have been taken. The United Kingdom also has experienced a rapid upswing since the highly stimulative budget of 1972. Up to the present the economy still has a margin of slack in productive resources although unemployment has come down over the past year at a rapid rate. Recently, however, a marked rise has been shown in the number of vacancies and the availability of labour in certain regions has largely evaporated. It appears that the authorities may be confronted in the coming year with a choice between allowing the strong upswing to continue and the need to temper emerging demand pressures.

In France the growth of output has proceeded on a more even course than elsewhere. While the inflation problem intensified in the latter months of last year, the authorities have been trying to contend with it by measures which would not bring on a setback in activity. Italy has been an exception in the general cyclical picture. Output was weak in both 1971 and 1972, though recently there has been an upturn in several industries. With labour relations still an obstacle and with no signs of revival in the building industry, a sustained cyclical upswing is not yet assured.

Against the policy success on the production front, however, there must be chalked up another year of failure on the inflation front. The period of slack demand did little to temper the rate of price and wage increases and since about the end of last summer the upward movements have been accelerating. The typical increase in the cost of living has been 6–10 per cent., while wage increases of about 10 per cent. have been the norm — with a few cases much higher. A new factor during the past year has been the exceptionally sharp rise of world commodity prices, which has had a strong impact on wholesale price indexes.

A variety of forces has been involved in this accelerated inflation. At the core there is the persistency of excessive wage increases following one after another and exerting their cost-push against prices. Rising farm incomes have likewise been achieved with the help of higher farm prices. For about the past nine months the rapid expansion of demand has also been a factor. No doubt there has been bad luck on the supply side of several commodities which have risen sharply in price, but it has seemed in recent years that bad luck in prices never gets offset by good luck.

A feature of recent inflation has been the rapidity of its international transmission. This comes from the reciprocal effects of rises in export and import prices, from the fact that labour markets extend beyond national boundaries, and from the general integration of the international economy. A special effect in a number of countries has come from the effort of the central banks to hold the exchange rate by buying large offerings of dollars at the cost of new creation of domestic money. In any case, the expansion of money and credit has everywhere been at a high rate, and while this has often been a consequence of inflationary forces, it has no doubt played its part as a cause of inflation also.

The limitations of demand management as an anti-inflation weapon have led to much greater use of direct controls. In both the United States and the United Kingdom the authorities felt obliged to invoke a wage and price freeze, and then statutory controls, in an effort to break the grip of the inflationary spiral — though in both cases it involved a change of view about the instruments appropriate to the management of the economy. Their efforts certainly had positive results, as wage inflation in both countries was reduced. In the United States, however, the government initiated a new phase of the anti-inflation policy early this year which introduced a voluntary element into the programme and prices have again been rising sharply. Whether the change to this Phase III was from reasons of ideology or from reluctance to overstrain the power of government, it is clear that this experience with controls was not a lasting breakthrough on the inflation problem. In the United Kingdom the high guide-lines set for wages are as much an indication of the difficulty of the problem as a promise of its cure.

The fact is that the authorities in almost all countries have in practice reconciled themselves to lower standards of performance in containing inflation. The degree of stability in the value of money that there was, say, in the United States in the first half of the 1960s, or in Germany and Switzerland, is no longer an operating objective — not because its broad social and political benefits are not recognised but because they are beyond the reach of government authority in the strained and fluid world of today. Attention to public opinion has obliged governments to give top priority to full employment and economic expansion, and the pursuit of other objectives can only be partial and intermittent.

Although severe controls on international movements of money had progressively been imposed, the selling of dollars in February was so large that the defence of the Smithsonian central rates had to be given up. The United States then attempted to make a return to fixed exchange rates feasible by declaring a new devaluation of the dollar of 10 per cent. But by this time the scepticism of the market had reached such a point that even the new central rates could not long be held. The continued lack of confidence was not based on a calculation that the eventual benefits to the US payments position of the new devaluation, added to that of a year earlier, would not be adequate in the longer run. It was influenced rather by the US intention to refrain from market support of the dollar, to phase out controls on capital exports, and to impose only moderate demand restraint. The only feasible decision at that point was general renouncement of obligatory defence of the new central rates. Six countries of the Common Market joined together to maintain cross rates among themselves within the margins of 2¼ per cent., however, and several other countries are adhering to this island of fixed exchange rates.

The march of events has confronted the negotiators of the Committee of Twenty on reform of the international monetary system with a rather different situation from that which existed at the time they received their mandate. The fact is that market forces have already brought their own reforms; the dollar, sterling, the yen, the Swiss franc, the lira and the rest of the Common Market currencies as a block are all floating against each other and there is no near-term prospect of these floats ending. Many observers consider this a real reform, compared with the earlier clinging to disequilibrium. Because the psychological effect of general floating on the private business and banking world has been profound, and because some countries apparently feel that a fixed parity is a burden they are reluctant to reassume, the way ahead is obscure.

Ostensibly, the objective of the reform is still to reinstate a system of parities, with the obligation to defend the parity unless a change is required in the interests of basic equilibrium. But the new lingo is "a system based on stable but adjustable exchange rates". These words themselves do not make it clear whether the stress in official objectives is to be on the "stability" or on the "adjustability". And if the stability commitment remains shadowy, one may doubt whether market forces could be contained in the face of inevitable jolts. Experience by now certainly shows that frequent changes in rates make the defence of new rates much harder.

The difficulties of creating a new system which aims at international management to assure stable rates, an effective adjustment process, and symmetry between the dollar and other currencies may be easily seen. To improve the adjustment process it is proposed that there be an objective indicator of disequilibrium that would be a signal to initiate consultations which would in good time oblige the undertaking of adjustment measures. If the indicators are all that objective, however, it may be supposed that the market would recognise the situation as soon as the officials and precipitate an upset before the bureaucratic machine could carry its consultations to the point of taking corrective decisions.

At the same time, it is evident that stability of rates, particularly for the dollar itself, is bound up with convertibility. But the maintenance of convertibility depends upon the limited reserves of the monetary authority not being drained away while optimistic forecasts and half-measures allow a disequilibrium to drag on. Although the United States has indicated its readiness to participate fully in any required adjustment, it has not clarified just how it would interpret its own objective indicator or just how it would be prepared to manage its balance of payments. Many other countries feel that the onus of adjustment would in practice be on them and they are against the use of changes in exchange rates as the first line of defence, either by themselves or by the United States. To them the prospect of appreciating to make room for larger US capital exports is particularly unattractive. Wherever the fault of too slow adjustment might tend to lie, however, the United States could not be expected to commit itself to convertibility without there being a limit on the freedom of surplus countries to buy dollars.

What are to be the chips in the new monetary game? All the principal reserve assets have their backers, but the most favoured formula seems to award first place to SDRs, a declining rôle to gold, and more or less severe limitations on further accumulations of dollar reserves. It remains to be seen, however, whether a stable rate system can be erected on this theoretical configuration, particularly now that Gresham's law has worked its wont. Meanwhile, down in the vaults, gold remains unused — but not unloved.

René Larre

General Manager

BALANCE SHEET AND PROFIT AND LOSS ACCOUNT

AT 31st MARCH 1973

BALANCE SHEET

ASSETS

(Before and after

		Gold francs
Gold		4,125,844,150
Cash on hand and on sight account with banks		84,352,631
Treasury bills		595,536,145
Time deposits and advances		
Not exceeding 3 months	11,587,662,185	
Over 3 months...	4,155,053,699	
» » » (gold)	1,723,079	
		15,744,438,963
Securities at term		
Not exceeding 3 months	3,475,089,689	
Over 3 months	1,162,380,273	
		4,637,469,962
Miscellaneous		61,971,179
Land, buildings and equipment		1
		25,249,615,031

Note 1: The gold franc is the equivalent of 0.290 322 58... grammes fine gold — Art. 4 of the Statutes.

Note 2: At 31st March 1973, gold receivable against currencies on forward contracts amounted to 95,424,432 gold francs.

AT 31st MARCH 1973

allocation of the year's Net Profit)

LIABILITIES

		Before allocation Gold francs	After allocation Gold francs
Capital			
Authorised: 600,000 shares, each of 2,500 gold francs ...	1,500,000,000		
Issued: *481,125 shares* ...	1,202,812,500		
of which 25% paid up ...		300,703,125	*300,703,125*
Reserves			
Legal Reserve Fund ...	30,070,313		*30,070,313*
General Reserve Fund ...	205,133,210		*252,633,210*
Special Dividend Reserve Fund ...	61,207,964		*75,175,781*
Free Reserve Fund ...	156,800,000		*190,332,183*
		453,211,487	*548,211,487*
Deposits (gold)			
Central banks			
Sight ...	3,236,803,943		
Not exceeding 3 months ...	239,291,786		
Over 3 months ...	17,259,809		
Other depositors			
Sight ...	33,082,685		
		3,526,438,223	*3,526,438,223*
Deposits (currencies)			
Central banks			
Sight ...	372,351,963		
Not exceeding 3 months ...	16,763,640,170		
Over 3 months ...	2,456,915,569		
Other depositors			
Sight ...	11,832,628		
Not exceeding 3 months ...	438,175,065		
Over 3 months ...	95,111,744		
		20,138,027,139	*20,138,027,139*
Notes			
Over 3 months ...		514,526,742	*514,526,742*
Miscellaneous ...		101,705,551	*101,705,551*
Provision for Building Purposes ...		92,939,483	*92,939,483*
Profit and Loss Account ...		122,063,281	—
Dividend payable on 1st July 1973 ...		—	*27,063,281*
		25,249,615,031	*25,249,615,031*

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 1973 and of its profit for the year ended on that date. We have obtained all the information and explanations which we have required. The Bank has kept proper books, and the Balance Sheet and the Profit and Loss Account are in agreement with them and with the information and explanations given us.

Zurich, 26th April 1973.

PRICE WATERHOUSE & CO.

PROFIT AND LOSS ACCOUNT

for the financial year ended 31st March 1973

		Gold francs
Net interest and other income ...		154,388,073
Less: Costs of administration:		
Board of Directors ...	262,358	
Management and Staff ...	13,623,098	
Office and other expenses ...	4,454,341	18,339,797
Net operating surplus ...		136,048,276
Less: Amounts transferred to:		
Provision for Exceptional Costs of Administration ...	3,984,995	
Provision for Building Purposes ...	10,000,000	13,984,995
Net Profit for the financial year ended 31st March 1973 ...		122,063,281
The Board of Directors recommends to the Annual General Meeting that the Net Profit should be allocated in accordance with Article 51 of the Statutes as follows:		
Dividend of 6% p.a. on paid-up capital		
37.50 gold francs per share ...		18,042,187
		104,021,094
Additional dividend (statutory maximum) of 3% p.a. on paid-up capital		
18.75 gold francs per share ...		9,021,094
		95,000,000
Transfer to General Reserve Fund ...		47,500,000
		47,500,000
Transfer to Special Dividend Reserve Fund (statutory maximum thereby attained)		13,967,817
		33,532,183
Transfer to Free Reserve Fund ...		33,532,183
		—

Movement on the Provision for Building Purposes during the financial year ended 31st March 1973

	Gold francs
Balance at 1st April 1972 ...	82,065,109
Add: Exchange difference ...	5,465,630
Transfer from Profit and Loss Account ...	10,000,000
	97,530,739
Less: Amortisation of expenditure incurred ...	4,591,256
Balance at 31st March 1973 per Balance Sheet ...	92,939,483

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. Lord O'Brien of Lothbury, London
Dr. Edwin Stopper, Zurich
Robert Vandeputte, Brussels
Olivier Wormser, Paris
Per Åsbrink, Stockholm

Alternates

Dr. Paolo Baffi, Rome, or
Prof. Francesco Masera, Rome
Dr. Otmar Emminger, Frankfurt a/M., or
Johannes Tüngeler, Frankfurt a/M.
Georges Janson, Brussels
André de Lattre, Paris, or
Marcel Théron, Paris
Christopher W. McMahon, London, or
M. J. Balfour, London

MANAGEMENT

René Larre	General Manager
Dr. Milton Gilbert	Economic Adviser, Head of the Monetary and Economic Department
Dr. Antonio d'Aroma	Secretary General, Head of Department
D. H. Macdonald	Head of the Banking Department
Henri Guisan	Legal Adviser
Dr. Antonio Rainoni	Manager
Maurice Toussaint	Manager
R. T. P. Hall	Manager

D. H. Stapleton	Deputy Secretary General
Prof. Dr. F. E. Klein	Deputy Legal Adviser
A. N. Barltrop	Assistant Manager
Dr. Warren D. McClam	Assistant Manager
M. G. Dealtry	Assistant Manager
Robert Chaptinel	Assistant Manager