BANK FOR
INTERNATIONAL SETTLEMENTS

FORTY-EIGHTH ANNUAL REPORT

1st APRIL 1977 – 31st MARCH 1978

BASLE

12th June 1978

TABLE OF CONTENTS

LIST OF TABLES AND GRAPHS

(Graphs are indicated by an asterisk)

Page

The State of the World Economy

Recent Economic and Financial Developments in the Western Industrial World

Domestic Policies for Growth, Price Stability and External Adjustment

Page

Activities of the Bank

FORTY-EIGHTH ANNUAL REPORT

submitted to the

ANNUAL GENERAL MEETING

of the

BANK FOR INTERNATIONAL SETTLEMENTS

held in

Basle on 12th June 1978

Ladies and Gentlemen,

I have the honour to submit herewith the forty-eighth Annual Report of the Bank for International Settlements for the financial year which began on 1st April 1977 and ended on 31st March 1978.

The net profit for the year amounted to 191,050,134 gold francs, after transfer of 427,372 gold francs to the Provision for Exceptional Costs of Administration and 13,000,000 gold francs to the Provision for Building Purposes. This compares with a net profit of 167,920,050 gold francs for the preceding year and one of 178,876,749 gold francs for the financial year 1975–76.

The Board of Directors recommends that, in application of Article 51 of the Bank's Statutes, the present General Meeting should apply the sum of 71,050,134 gold francs in payment of a dividend of 110 Swiss francs per share.

The Board further recommends that 48,000,000 gold francs be transferred to the General Reserve Fund, and the remainder of 72,000,000 gold francs to the Free Reserve Fund.

If these proposals are approved, the Bank's dividend for the financial year 1977–78 will be payable to shareholders on 1st July 1978.

Chapter I introduces the Report with a brief review of the state of the world economy which focuses on the diverse forces currently exerting a depressive influence on demand and output. Among them, inflation and balance-of-payments constraints figure prominently. In the domestic context, Chapter II presents a factual account of developments in the western industrial countries over the past twelve to eighteen months, first reviewing output and demand trends, passing on to price and cost movements and labour-market indicators, and ending with a detailed coverage of monetary and financial developments. The following chapter discusses macro-economic policy in the present unusual environment of recession combined with continuing inflation and external disequilibrium. In particular, it looks at the extent to which these new circumstances have given impetus to the search for new techniques in the fields of incomes policy and money-supply targeting. In the international context, Chapter IV examines in detail recent developments in world trade and balances of payments and Chapter V does the same for the international credit and capital markets. Chapter V also comments upon the gradual shift of emphasis in the course of 1977 from prudential aspects of international bank lending to concern over the macro-economic implications of the large deterioration in the US balance of payments. In Chapter VI the international monetary scene is reviewed, beginning with an account of exchange-market developments and a discussion of their effects on international competitiveness. The chapter notes that in many cases very large movements in nominal exchange rates have not resulted in any significant change in real effective rates, while even where changes in the latter have occurred the balance-of-payments effects seem to have been small. The lesson appears to be that adjustment via exchange rate changes must be backed up by appropriate domestic policies. After documenting gold-market developments, the chapter concludes with an assessment of the level and composition of international liquidity. Chapter VII deals with the Bank's own activities during the financial year, the Balance Sheet and the financial results. The Conclusion of the Report sums up the main policy recommendations.

I. THE STATE OF THE WORLD ECONOMY.

The main thread running through this Report is that the world economy operated last year under the converging influence of three depressive factors: the global oil imbalance, the external payments disequilibrium among the oil-consuming industrial countries and the persisting inflationary disturbances inherited from the late 1960s and early 1970s. All three of these factors have exerted a restraining influence on government policies, while the climate of uncertainty generated by them has affected business decisions and perhaps even consumer behaviour. The result has been a renewed slowdown in the growth of world trade and output. It seems quite possible, moreover, that in some of the major industrial countries the current growth recession also reflects the working of other factors of a more structural nature, but the slack in the world economy makes it difficult to identify them and therefore to devise appropriate remedies.

Considering that the global oil surplus has actually declined and that many countries have achieved a better balance in their external payments and have managed to reduce inflation, this evaluation of the present state of the world economy might seem rather paradoxical. But not so if one looks beneath the surface. For there is a close interrelation between the shrinking oil surplus, the improved balance-of-payments situation in a number of countries, the slowdown of inflation and the unsatisfactory growth performance of all the major economies except the United States. On the one hand, while actual and potential external deficits have put a constraint on expansion in a number of countries, continued cost inflation and the memory of recent inflationary excesses have exerted a strong inhibiting influence on the growth of domestic demand in *all* countries — including those which have been running current-account surpluses. On the other hand, the resulting slower growth has helped to compress the global oil surplus, led in many countries to successful balance-of-payments adjustment and contributed to a decline in inflation rates. But what would happen if the world economy were to return to faster growth and a higher level of employment?

Balance-of-payments constraints on domestic expansion.

With respect, first, to balance-of-payments considerations, the number of countries whose policies have recently been dominated by their desire to adjust is impressive — and so are the results. These countries fall into four groups. From a combined current-account shortfall of $11 billion in 1976, the three large European deficit countries of the Group of Ten moved almost into balance for 1977 as a whole, and were actually in surplus in the second half of the year. Four other developed countries managed to reduce their combined current-account deficit from $8½ billion in 1976 to $2 billion in 1977. During the same period the aggregate deficit of nine high-growth developing countries declined from $11 to 6½ billion; and this improvement would look even more impressive if calculated from the much larger

Major current-account adjustments in 1977.

Countries	Balance on current account 1976	1977	Change 1976 to 1977
	In billions of US dollars		
Group 1: Group of Ten countries			
France	— 6.0	— 3.2	+ 2.8
Italy	— 2.8	+ 2.3	+ 5.1
United Kingdom	— 2.0	0.0	+ 2.0
Total	— 10.8	— 0.9	+ 9.9
Group 2: Other developed countries			
Finland	— 1.2	— 0.2	+ 1.0
Israel	— 1.0	— 0.5	+ 0.5
South Africa	— 2.0	+ 1.0	+ 3.0
Spain	— 4.3	— 2.5	+ 1.8
Total	— 8.5	— 2.2	+ 6.3
Group 3: Developing countries			
Brazil	— 6.6	— 4.5	+ 2.1
Mexico	— 3.0	— 1.8	+ 1.2
Seven other leading LDCs[1]	— 1.2	0.0	+ 1.2
Total	— 10.8	— 6.3	+ 4.5
Group 4: Eastern European countries[2]	— 6.8	— 2.9	+ 3.9

[1] Argentina, Chile, Colombia, Peru, the Philippines, South Korea and Taiwan. (The nine countries in this group account for about 70 per cent. of outstanding bank lending to oil-importing LDCs.) [2] Merchandise trade f. o. b.

deficits incurred in 1974 and 1975. Finally, the trade deficit of eastern European socialist countries declined from $7 to 3 billion. The positive swing in the external positions of these four groups of countries comes to the sizable aggregate figure of more than $24 billion.

Except in the case of a few countries which benefited from higher export prices, these successful adjustments were achieved through restrictive demand management. The mix and thrust of policies varied from country to country, but generally monetary and fiscal policies, and in some cases incomes policies, were applied.

Significantly, not all governments — perhaps not even the majority of them — felt constrained to make these adjustments because of lack of finance for balance-of-payments purposes. The supply of funds available through international banking channels remained abundant, and quite a number of the countries in these groups could have delayed external adjustment or spread it over a longer period. That they did not do so suggests that their primary concern was to combat domestic inflation and to avoid taking on a heavy burden of external indebtedness that might create longer-term financing problems. They responded directly to the constraints of internal and external imbalance rather than waiting for the emergence of financing difficulties.

Another striking fact was that the external accounts proved highly sensitive to changes in domestic demand. Income elasticities of demand for imports turned out to be quite high even in countries whose real exchange rate did not depreciate. The practical result has been a strong deflationary impulse transmitted to the rest of the world by a tapering-off, or even an absolute decline, in the volume of imports. In some cases there was also a better-than-average performance in exports.

These demonstrations of responsibility by many deficit countries have been a welcome development. They would have been even more welcome had their contractionary influence on world trade been offset by adequate expansionary forces from other sources. But this was not the case. The global oil surplus declined, but not enough; the aggregate current-account surplus of the strong-currency industrial countries actually increased; and the major offsetting influence came either from smaller developed or developing countries, which were scarcely in a position to play a "locomotive" rôle, or from the United States, whose soaring current-account deficit raised as many new problems as it helped to solve old ones.

No net stimulus from surplus countries.

The "traditional" surplus countries as a group — oil exporters, Germany, Switzerland and Japan — provided no net stimulus to the rest of the world. In fact, their aggregate current-account surplus increased marginally from $51 billion in 1976 to $52.5 billion in 1977.

To take, first, the oil-exporting countries, their global current-account surplus narrowed, it is true, from $40 billion in 1976 to $34 billion in 1977, and the quarterly figures show a declining trend throughout last year. As a result, the 1978 figure may well prove to be no more than one-third of the peak reached in 1974. There can be no doubt that this decline reflects a substantial genuine adjustment to the increase in the price of oil which took place at the end of 1973. This adjustment occurred in three ways: a reduction in the consumption of oil per unit of gross national product in many large industrial countries, more through the substitution of other energy sources than through conservation; a decline in the "real" price of oil since 1974; and sizable absorption of imports of goods and services by the oil producers.

Changes in real gross national product and in oil consumption.

Countries	Real gross national product	Inland deliveries of petroleum products*
	percentage changes, 1973 to 1977	
United States	+ 8.3	+ 1.4
Japan	+ 12.8	− 10.3
France	+ 11.8	− 11.5
Germany	+ 5.9	− 11.5
Italy	+ 8.2	− 6.9
United Kingdom	+ 0.1	− 16.3

* Based on OECD/IEA oil statistics, expressed in metric tons; excludes marine bunkers and refinery stocks.

But behind this reassuring development there were two disturbing facts. One was the continuous deceleration in the rate of growth of the volume of imports by oil exporters: from a very high rate of more than 40 per cent. in 1975 to less than 25 per cent. in 1976 and probably around 15 per cent. in 1977. This trend reflects the social, organisational and technical difficulties encountered by the "low absorbers" in sustaining a high rate of import growth, the desire of the "high absorbers" to keep the pace of their economic growth within manageable and less inflationary limits and the concern of some of them regarding the deterioration in their external accounts. The second fact was that despite a slack world economy the value of oil exports increased by about 10 per cent. — almost exclusively, admittedly, as a result of higher oil prices rather than of any noticeable expansion in the volume of oil sales.

Taken together, these two facts suggest that in the event of more satisfactory growth in the world economy the oil surplus could well increase again — a prospect that itself makes the event unlikely. Only further economies in the use of oil could provide an escape from this dilemma. Will those industrial countries which have already proved successful in saving oil be able to keep up this trend? And will the United States — which has been the least successful among the major industrial countries in achieving a substantial reduction in the use of oil per unit of gross national product — be able to follow the example set by other countries?

Equally worrying has been the stubborn persistence of current-account surpluses in the Federal Republic of Germany and Switzerland and, even more so, the increase in Japan's current-account surplus from $3.7 billion in 1976 to $11 billion in 1977. In real terms, Germany's imports of goods and services rose by 4.2 per cent. between the two years, i.e. at the same rate as that recorded by exports. Thus the impact of Germany's development on the rest of the world was neutral: it did not add to the depressive forces emanating from other sources, but nor did it offset them. The volume of Japanese imports of goods and services, on the other hand, increased by only 2 per cent., to be set against a 10.4 per cent. rise in exports. The net influence of Japan's development on the world was therefore contractionary; and this was true not only of last year, but also of the 1974–77 period as a whole, while in this longer perspective the net effect of Germany's development was expansionary.

The persistence of current-account surpluses in Germany and Switzerland and the sharp rise in the Japanese surplus are the more remarkable since all three countries saw a substantial appreciation in their currencies' trade-weighted exchange rates. While in all three cases much of the appreciation occurred quite recently — between September 1977 and late March 1978 — the effective exchange rates of the Deutsche Mark and the Swiss franc had been strengthening quite substantially over a much longer period. There are several reasons why exchange rate appreciation apparently had little impact on these countries' current accounts. With regard to the recent sharp rises, their J-curve effect may have been strong; in addition, transactions were probably brought forward as a result of expectations. In a longer perspective, the better-than-average performance of Germany and Switzerland in their fight against inflation meant that their real exchange rates increased much less than the nominal rates — or not at all during some periods. Finally, domestic demand was stubbornly weak last year in Germany and Japan. The surplus-creating effect of this factor proved as powerful in the strong-currency countries as that of deliberately restrictive demand management elsewhere.

The depressive influence of inflation and structural problems.

The reasons for the inadequate development of domestic demand in those countries which did not have to undertake restrictive policies for the sake of external adjustment — the striking cases are Japan and Germany, but they are not the only ones — are quite complex. The most plausible single explanation is the restraining effect on expenditure of past inflationary experiences and the fear that they might repeat themselves in the future. This can be seen clearly from the behaviour of both business and governments.

One of the main reasons why the business recovery failed to sustain its initial momentum was the inadequate response of private investment to the cyclical upswing. It is highly probable that the cautious attitude of industry was motivated not only by the existence of excess capacity but also by the memory of the inflationary boom of the early 1970s which ended in profits being squeezed between rising costs of labour, raw materials, energy and finance, and collapsing markets. This caution seems to have been justified by more recent events, when profits have again been squeezed between rising unit labour costs and appreciating currencies.

As for the government sector, its stimulatory contribution to global demand diminished in many cases: partly under the impact of the fiscal drag produced by inflation; partly because of the reluctance to further expand public expenditure, whose share in the economy was already considered excessive; partly because governments maintained their commitment to limit or reduce the size of the public-sector deficit, which, on the basis of past experience, the public has come to link with the risk of rekindling inflation. Or to put it more simply: the very high level of both public expenditure and public-sector deficits left little scope for an intensification of expansionary fiscal policies while the memory of double-digit inflation was still vivid in people's minds.

At first sight, the reasons for this persistent preoccupation with inflation may seem difficult to understand. Have not inflation rates declined in a large number of countries, both developed and developing? This is, of course, true. But it is also true that the circumstances which seem to have contributed to the decline in inflation rates may be transitory or cannot work to the benefit of all countries at the same time. Indeed, upon closer examination it is clear that rates of inflation have receded only in two sets of circumstances — or in a happy combination of the two. They have declined in those countries which, through deliberately restrictive policies, have maintained substantial slack in their economies. And they have declined in particular where the effective exchange rate has appreciated — as a result either of more recently successful domestic adjustment, or of a longer tradition of anti-inflationary policies.

It is remarkable — and at the same time disquieting — that the one country, Switzerland, which has re-established near-stability of the domestic retail price level has managed to do so only with the help of an effective appreciation of more than a third over the past three years and a current level of real output well below its pre-recession peak. Had retail prices not been excessively rigid downwards, the joint impact of these two developments would have been an actual fall in the price level. Germany is another case in point: retail price inflation is still running at a rate of around 3 per cent., although the Deutsche Mark's effective exchange rate appreciated by 25 per cent. between the end of 1975 and end-March 1978 and growth decelerated in 1977, leaving unemployment at a high level by post-war standards. From the opposite angle, the experience of the United States illustrates well the public's preoccupation with inflation. Alone among the major industrial countries, the US economy grew at a satisfactory pace during the last year; but coinciding with this the dollar's effective exchange rate has depreciated and the domestic inflation rate has slightly accelerated. The conclusion seems to be that behind the veil of the current growth recession, or of appreciating exchange rates, inflation and inflationary expectations are still very much alive in the western industrial world — and even more, one might add, in many of the developing countries. That this inflation is generally not being caused by any excess demand, but bears instead the signs of a continuing spiral of costs and prices, does not diminish its inhibiting impact on public and private spending decisions.

There are, however, signs that inflation, or the fear of accentuating it, may well not be the only reason for the slowdown in the growth of some of the major industrial economies. It is possible to argue that, independently of a worldwide slack in demand, a break has occurred in their growth trend. There are a number of reasons that make such an assumption plausible. The share of profits in national income has declined, and in several countries this decline started before the recession. The volume of fixed capital expenditure stopped growing several years ago. Large excess capacity has emerged in specific industries — such as steel, shipbuilding, textiles, artificial fibres, some basic petrochemicals, and so on — either because of earlier synchronised investment booms or because of the successful industrialisation of a number of developing countries. Even the nature of technological innovations, which now tend towards automation and labour saving, appears to be basically different from the kind of innovation which in the past gave birth to investment booms in the electricity, motor-vehicle or petrochemical industries. Such maladjustments suggest the possibility of a slowdown of the "Kondratieff" type after several decades of virtually uninterrupted fast growth. However, the worldwide slack in economic activity makes it exceedingly difficult to assess the genuinely structural nature of these developments. Clearly, some of them can simply be attributed to the fact that the world economy, and especially that of the western industrial world, is working well below the optimal use of capacities. Problems that are basically cyclical can easily appear to be structural in these circumstances. But there are so many signs pointing in the direction of genuine structural imbalances that it would be foolish for policy-makers to ignore them by aiming at growth rates comparable to those of the 1960s.

One set of structural problems of a special kind seems to affect Germany and Japan, whose growth has been persistently export-led since the early 1950s. This means that in both countries industrial investment has been closely geared to export prospects. Decelerating growth in world trade, restrictive demand management in a number of traditional import markets and the emergence of protectionism, together with appreciating currencies, have created an environment which discourages the revival of domestic industrial investment. A shift to a pattern of growth dominated by the expansion of domestic demand inevitably takes a long time.

Forces of expansion.

A number of countries, it is true, did exert an expansionary influence on the world economy last year. Among the developed countries outside the Group of Ten, five together recorded an increase in their current-account deficit from \$8.5 billion in 1976 to \$15.8 billion in 1977; similarly, non-oil developing countries not listed in the table on page 4 also saw their current deficit widen very slightly.

The major expansionary stimulus last year came, however, from the United States, which alone among the large developed countries expanded at a fairly rapid pace, closely along the lines of a traditional cyclical recovery. In the process, employment rose substantially and unemployment was appreciably reduced, while profits recorded a buoyant recovery and contributed to a reasonable expansion of investment. As a result, US imports of goods and services increased in real terms from 1976 to 1977 by 10.3 per cent., while exports rose by less than 2 per cent. The deterioration in the current account was therefore considerable: from a deficit of \$1.4 billion in 1976 to one of \$20.2 billion in 1977. And the negative swing in the US current account between 1975 and 1977 was even larger, amounting to \$31.8 billion.

There are, however, two reasons why the positive impact of the United States on the world economy may have been weaker than is suggested by these very large overall figures.

The first, already alluded to in the comments on oil consumption per unit of gross national product, is that a substantial part of the rise in US demand for foreign goods and services consisted of a sharp increase in purchases of oil. This could hardly stimulate world activity, since the import capacity of most oil producers was already limited for reasons other than their current export receipts. On the contrary, the strong US demand for oil may have contributed to last year's higher oil price, thus indirectly aggravating the oil deficits of other oil-importing countries.

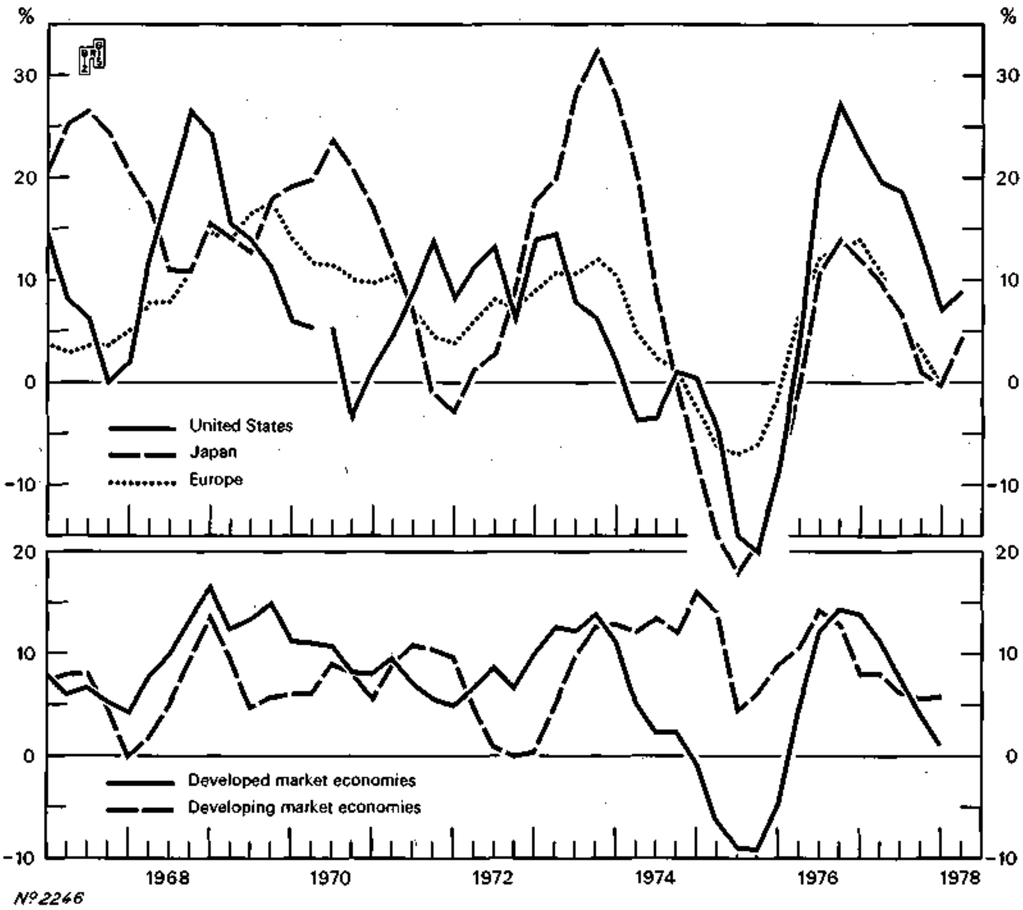
The second qualification is derived from the disturbing impact of the sizable US current-account deficit on exchange rates. It must, of course, be recognised that the depreciation of the dollar and the appreciation of the strong currencies have been the joint result of the US deficit and the surpluses in the strong-currency countries, and cannot therefore be attributed in any meaningful sense to any individual imbalance. But there is one way in which the US deficit might be thought to have accentuated the effective appreciation of the strong currencies — and that is through the autonomous capital outflow from the United States in 1977 and the early months of 1978, which amplified the impact of the current account on exchange rates. The corresponding speculative capital inflow into Germany, Switzerland and Japan is likely to have raised the value of these currencies above the rate to which they would have risen in any case under the impact of their own surpluses had the counterpart deficits been spread more evenly over the rest of the world. Given the export-oriented structure of German and Japanese industries referred to above, these additional appreciations of the Deutsche Mark and the yen have further discouraged domestic industrial investment in both countries and may have postponed for even longer the hoped-for recovery in their domestic economies.

Moreover, the climate of uncertainty generated by the sharp currency fluctuations has certainly had a restraining effect on growth, not only in the appreciating countries but also worldwide.

Asymmetry in the adjustment process.

To sum up this brief survey, adjustment policies last year had, on balance, a net depressive effect on world economic activity. There were two obvious reasons for this. Firstly, the oil imbalance, although shrinking, was still there: the sum of current-account deficits was therefore bigger than that of the adjustable surpluses. Secondly, domestic demand did not expand sufficiently in the surplus countries, because the growth of public and private expenditure was inhibited by past inflationary experiences, current cost/price inflation or structural imbalances. Thus, while restrictive demand management undertaken by deficit countries proved to be highly effective, its expansionary counterpart in the surplus countries did not. As a result, the burden of adjustment fell on the first group of countries, much as would have been the case under a régime of fixed exchange rates.

Volume of imports.
Percentage changes over year.*



* Calculated on the basis of two-quarter moving averages of unadjusted quarterly data.

Although nominal exchange rates have moved substantially since the beginning of floating, this outcome is not so surprising. As a matter of fact, exchange rate changes may be thought to have enhanced, rather than offset, the asymmetrical impact of these disequilibrating forces. With regard to countries experiencing depreciation, restrictive policies appeared inevitable in order to break the depreciation/inflation spiral. On the other hand, appreciation in the surplus countries put an additional brake on domestic expansion, by hindering the revival of investment, and thus bears a partial responsibility for the limited success of expansionary policies.

The global impact of this asymmetrical adjustment process on world activity can be seen from the graph, which shows twelve-month rates of change in import volumes for the period 1967–77. The striking fact to emerge from the upper section of the graph is that until 1972 there was little synchronisation in movements of imports into the United States, Japan and Europe. The synchronisation started during the 1972–73 boom and has since continued, despite flexible exchange rates, with the United States showing the only significant rise in real imports at the most recent date.

A second striking fact, shown in the lower section of the graph, is that the developing countries (including the oil producers) continued throughout the 1974–75 recession to provide positive support to world trade — indeed quite powerful support until the end of 1974. The novelty of the more recent development lies in the simultaneous downturn in the rate of growth of import volumes for both the large industrial areas and the developing countries.

Having said this, the question arises whether the world is caught in a cumulative process which could possibly lead not only to a further slowdown in growth but even to an outright recession. This is unlikely to happen. True, there are a number of smaller developed and developing countries — those whose current accounts deteriorated last year — which cannot, and should not, postpone adjustment and some of which, in fact, have already embarked upon policies of domestic restriction. More important, it would be hard to imagine the United States continuing its solitary "locomotive" rôle: many economists forecast a normal cyclical deceleration in the growth of the American economy during the next twelve months.

On the other hand, there are several reasons for hoping that the world economy might receive support from other sources. Japan and Germany have taken measures to stimulate domestic demand which, it is to be hoped, will have a positive effect on their imports. Many larger countries, both industrial and developing, which have succeeded in restoring their external balance are now in a position to relax the restrictive stance of their policies. They will be helped by the fact that most of them have managed to rebuild their external reserves, and that international capital and credit markets are liquid. The figures on changes in oil consumption per unit of gross national product clearly show that some real adjustment to the oil price increase has already taken place, and therefore suggest that more may follow. Most of these hopes, of course, are based on the assumption that policy-makers will face up to the major challenge of successfully co-ordinating their efforts to reverse the contractionary forces at work in the world economy. Some of these policy problems are discussed in the concluding section of this Report.

II. RECENT ECONOMIC AND FINANCIAL DEVELOPMENTS IN THE WESTERN INDUSTRIAL WORLD.

Over the past year there has been a marked difference between economic developments in the United States and those in other industrial countries. In the United States the economy has continued to expand at a fairly vigorous pace, sustained by appreciable increases in consumer spending and housing and a revival in private equipment investment. In Japan, on the other hand, industrial production stagnated from the spring of 1977 onwards, a steep rise in exports and government outlays having failed to give impetus to private domestic expenditure; and in western Europe industrial output actually declined during the spring and summer. The long-awaited upturn in fixed investment failed to materialise, expenditure on personal consumption and stock accumulation tapered off and, owing to the weakness of economies in both Europe and the non-industrial world, export growth fell short of individual countries' expectations. Since the late autumn industrial production has again been rising in Japan and western Europe, but in relation to its pre-recession trends further ground has been lost.

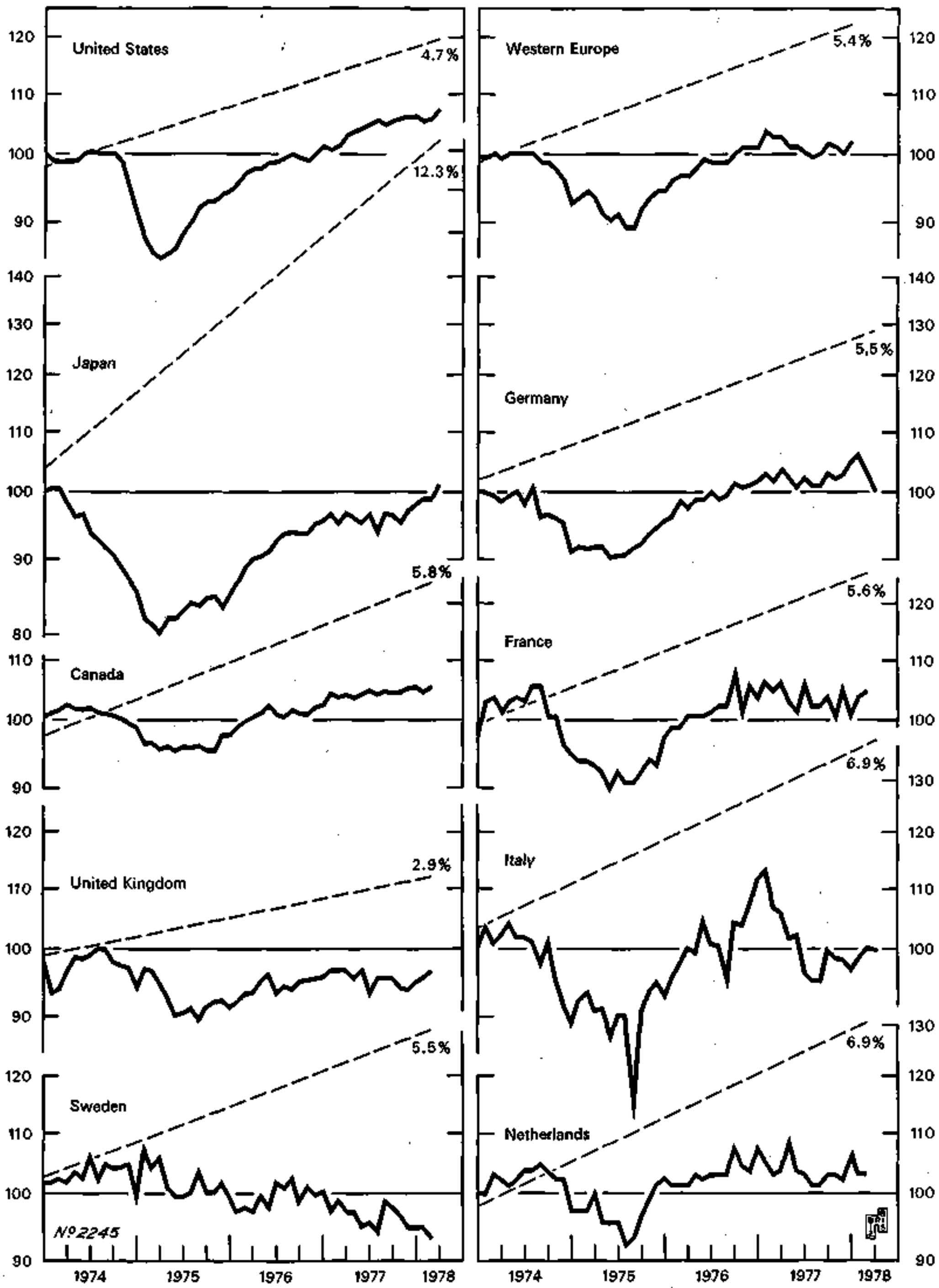
The difference in the pace of economic growth between the United States and the rest of the industrial world was also reflected in unemployment and price behaviour. In the United States employment expanded strongly, unemployment declined appreciably and the underlying rate of increase in consumer prices began to edge up. There was no significant decline in unemployment elsewhere; on the other hand, in a large number of countries inflation decelerated.

Rates of monetary expansion were generally moderate by the standards of some recent years but periods of fast growth were recorded in the United States, Germany, Switzerland and the United Kingdom, where the development of the aggregates had previously been relatively stable. Owing to the continued cyclical upswing, business, consumer and mortgage credit all rose strongly in the US economy, but elsewhere credit flows were still mainly under the influence of public-sector borrowing. In all but a few cases, however, most of the government's financing requirement could easily be met by non-monetary means. Short-term interest rates rose in the United States but fell on balance in many other countries. Reflecting the slowdown in inflation rates, long-term interest rates recorded appreciable declines in Japan and Germany. Elsewhere, however, yields dropped very little or, as in the United States, rose slightly.

The course of the economic recovery.

Given the steepness of the decline in output during the 1974–75 world recession, the subsequent recovery in the industrial countries proved weak and hesitant despite a strong beginning. Its slow and uneven course may be seen in the graph,

Industrial production in relation to pre-recession trends.*



* Monthly indices (fourth quarter 1973 = 100) and log-linear trends based on quarterly data for the period 1955–74. The inset figures represent the average annual growth rates implicit in these trends.

which shows movements in industrial production — a sensitive and fairly up-to-date indicator of cyclical developments. Included in the graph are the trends in industrial production established over the period 1955–74. With the rise in energy prices and the associated changes in factor costs and patterns of demand, a portion of the capital stock must have become obsolete. Moreover, the growth of potential output has been reduced by low rates of investment in recent years and, in some countries, a slower rate of growth in the labour force, the closing of a technological gap vis-à-vis the most advanced countries and the need to take more account of environmental considerations. But the pre-recession trends in production and the expectations of steadily improving real incomes to which they gave rise established the criteria against which developments in recent years have so often been judged. The frequent use of the word "crisis" to describe the recent situation must be seen largely in relation to this strong past performance.

As recorded in last year's Annual Report, an initial strong rebound in activity in late 1975 gave way in most countries the following spring to a longish pause during which output recorded little further expansion. A renewed upsurge in production occurred in a number of countries in late 1976 and early 1977 and seemed to offer some hope of a continuation of self-sustained recovery. A new setback was soon to follow, however.

In the United States the growth of output slackened in the course of last year as the recovery advanced but on balance moved up closer to the pre-recession trend. Elsewhere, there were renewed signs of fundamental weakness. In Japan and Canada production began to stagnate in the spring, while in western Europe actual declines in industrial output were recorded in the summer and autumn. With little progress made in reabsorbing idle resources, the expansion was clearly running out of steam.

Most disappointing of all was the wilting of the recovery in Germany and Japan, two countries which had made early advances in bringing inflation under control and which, in view of the strength of their external current-account positions, had been expected to play the part of locomotives in the world economy. In neither country was there any significant increase in industrial output from the beginning until close to the end of 1977. The other industrial countries, many of which had recently adopted or reinforced restrictive policies designed to cope with high rates of inflation and weak external positions, generally fared even worse. Between January and October 1977 industrial production fell by 5.4 per cent. in France, 2.3 per cent. in the Netherlands and 3.4 per cent. in Belgium. In Italy, where the economy had expanded strongly in 1976 and where a restraint programme agreed on with the IMF had been adopted, the decline in the January–October 1977 period came to 13 per cent. In the United Kingdom a very modest increase in 1976 was reversed, and by October 1977 the index stood only 5 per cent. above its 1975 recession trough. In Sweden, where the economy had earlier been deliberately shielded from the world recession, industrial production had fallen back by the third quarter to a level last recorded at the beginning of 1973.

A trough in production seems to have been passed by the late autumn and a modest advance has since been discernible in many European countries and also in Japan. Poor results recorded in the United States in early 1978 were attributable to strikes and a severe winter; labour disputes also influenced developments in Germany in the spring.

The chequered pattern of industrial production is fairly closely mirrored in the broader measures of gross national product. Quarterly growth rates for real gross national product in the major countries show a general weakening after the first quarter of 1977, with a slowdown in the United States and periods of stagnation or decline elsewhere. Except in Italy, however, declines did not continue for more than one quarter. In nearly all industrial countries the expansion of real gross national product slowed down on an annual basis between 1976 and 1977. In many the increase in 1977 fell appreciably short of national authorities' published forecasts or targets — a notable case being that of Germany where the year-on-year increase came to only 2½ per cent., compared with the authorities' declared objective of 5 per cent.

Why did this apparently so unexpected setback occur? Some insight can be gained by comparing developments in the components of overall expenditure. The accompanying tables show changes in recent years on a fourth quarter to fourth quarter basis for the larger countries. However, for the smaller countries comparisons are based on annual averages.

Elements of weakness in aggregate expenditure.

Until the spring of last year the recovery, such as it was, had been based largely on the turn-round in stocks and on consumer durable outlays postponed during the recession. Hopes that a self-sustaining expansion would develop were pinned largely on the expectation that, with the abatement of inflation, the usual upswing in fixed investment and, in some cases, exports would eventually get under way. In the event, the increase in personal consumption slackened, stockbuilding provided little further support and private fixed investment remained weak in most countries except the United States. At the same time, wishing to improve external positions or to avoid rekindling inflationary expectations, many governments contributed to the renewed slowdown by permitting taxation to erode the growth of private incomes. Many countries were counting on a strengthening of demand abroad to tide them over an essential phase of budgetary and financial adjustment. Not surprisingly, however, given the widespread tendency towards fiscal restraint, domestic demand slackened simultaneously throughout much of the industrial world and in the developing countries. The resulting deceleration of import growth was reflected in unexpected export shortfalls in individual countries.

From the point of view of international adjustment, it is interesting to compare developments in total domestic expenditure with those in gross national product. Such a comparison can help to indicate the extent to which individual countries imparted stimulus to the world economy or, on balance, gained strength from abroad. In the United States the expansion of domestic expenditure far outpaced the rise in gross national product but the effect on other industrial economies of the increase in the US external deficit was to a considerable extent concentrated on Canada and Japan. In the United Kingdom, Italy and Spain, where stringent stabilisation programmes were in force, domestic expenditure weakened sharply and

Larger industrial countries:
Changes in real gross national product and its components.

Countries	Years	Real gross national product	Final demand[1]	Domestic demand: Total[2]	Consumption: private	Consumption: public	Fixed investment: non-residential	Fixed investment: residential	Exports	Imports
		average annual rates of change 1960–74 and rates of change in years ending in the 4th quarter of 1975, 1976 and 1977, in percentages								
United States . . .	1960–74	3.6	3.6	3.6	3.8	2.9	5.0	1.8	7.1	6.9
	1975	2.5	3.5	2.2	5.3	2.7	−10.4	7.3	− 1.4	− 7.3
	1976	4.7	4.4	5.5	5.9	− 0.3	7.0	22.1	4.4	17.7
	1977	5.7	4.8	6.3	4.8	4.7	8.3	15.0	− 2.2	7.0
Japan	1960–74	9.4	9.3	9.3	8.3	6.2	12.0	12.1	14.5	13.9
	1975	3.5	4.2	2.6	6.2	6.8	− 5.3	9.4	0.4	− 7.4
	1976	5.1	4.7	4.0	3.9	2.7	5.1	− 2.8	18.4	14.0
	1977	5.3	6.0	4.2	2.9	4.8	8.8	6.5	4.1	− 5.2
Germany . . .	1960–74	4.2	4.3	4.1	4.4	4.7	4.7[3]	2.6[4]	8.1	8.2
	1975	1.6	1.7	3.7	3.8	5.1	8.2[3]	− 0.8[4]	− 1.7	6.1
	1976	4.8	3.0	5.1	3.3	0.3	5.3[3]	5.6[4]	10.3	12.4
	1977	2.1	3.2	1.2	3.2	1.7	3.9[3]	− 1.1[4]	4.6	1.8
France	1960–74	5.4	5.4	5.4	5.3	3.7	7.2		9.4	10.4
	1975	2.9	4.1	4.2	6.7	7.8	2.5		− 0.5	5.5
	1976	4.2	2.7	3.0	3.5	1.5	3.3		13.1	8.0
	1977	2.4	3.4	0.5	2.0	3.3	− 0.1		6.0	− 2.1
United Kingdom . .	1960–74	2.8	2.9	2.7	2.6	2.4	4.4	3.2	5.5	5.0
	1975	− 2.1	− 0.9	− 3.4	− 3.4	5.1	− 8.2	6.1	1.0	− 4.3
	1976	3.9	2.3	3.2	2.9	1.5	− 2.4	− 8.1	8.8	6.1
	1977	− 0.3	− 0.4	− 0.8	− 0.3	− 0.3	− 3.5	− 5.3	0.6	− 1.3
Italy	1960–74	5.1	5.0	5.0	5.4	3.7	4.3	3.8	10.8	9.8
	1975	0.6	.	− 0.3	2.3[2]		− 11.0		10.3	6.2
	1976	6.0	.	4.6	3.8[2]		8.5		9.3	3.1
	1977	− 1.4	.	− 3.0	− 2.5[2]		− 5.1		3.1	− 3.6
Canada . . .	1960–74	5.4	5.3	5.5	5.2	5.9	5.7	6.0	7.9	8.3
	1975	2.6	6.7	3.5	8.4	2.5	6.1	19.2	− 4.2	− 2.1
	1976	3.5	2.0	4.1	5.7	− 0.5	− 5.6	5.3	8.1	7.6
	1977	4.0	4.4	0.6	0.9	2.9	2.3	−10.1	9.8	− 2.0

[1] Equals change in real gross national product minus net investment in inventories. [2] Includes change in inventories. [3] Machinery and equipment. [4] Total construction.

external trade helped to sustain output. But domestic expenditure grew more slowly than total demand in many other countries, including Japan and Switzerland. Real imports of goods and services by most of the industrial countries other than the United States rose only slowly or declined last year. While this was in many cases consistent with national authorities' policy assumptions, the slow growth in exports implied by action elsewhere to achieve similar objectives was not.

Private expenditure.

Personal consumption expenditure, previously a mainstay of the economic recovery, lost momentum last year — even for a time in the United States, where a sharp upsurge at the beginning of 1977 was followed by a long consolidation phase which lasted until the final quarter of the year. In most other countries real consumption expenditure recorded only small rates of increase far below the long-run averages; in the United Kingdom there was actually a decline.

Other industrial countries: Changes in real gross national product and its components.

Countries	Years	Real gross national product	Final demand[1]	Domestic demand					Exports	Imports
				Total[2]	Consumption		Fixed investment			
					private	public	non-residential	residential		
		average annual rates of change 1960–74, annual changes 1975, 1976 and 1977, in percentages								
Austria . . .	1960–74	4.9	4.9	5.0	4.8	3.3	5.1[3]	8.3[4]	9.0	9.1
	1975	– 2.0	0.8	– 2.7	2.5	3.0	– 8.0[3]	– 4.4[4]	– 7.2	– 9.0
	1976	5.2	1.9	7.6	4.0	2.5	10.9[3]	2.0[4]	11.3	17.9
	1977	3.5	5.3	4.9	6.9	2.0	12.4[3]	5.1[4]	5.0	8.5
Belgium . . .	1960–74	5.0	4.8	4.8	4.2	5.3	5.7	4.4	9.1	8.7
	1975	– 2.0	1.0	– 0.4	0.9	7.2	– 2.4	– 5.9	8.8	11.1
	1976	5.5	4.3	5.9	6.1	4.6	– 4.1	15.4	9.3	10.4
	1977	1.7	2.2	2.1	2.6	5.3	0.6	0.0	5.3	6.2
Denmark . . .	1960–74	4.2	4.3	4.2	3.6	5.4	5.2	7.1	7.0	7.1
	1975	– 1.7	2.7	– 2.8	4.9	5.8	– 8.4	–16.8	– 2.4	– 4.2
	1976	5.0	1.5	12.4	6.5	6.3	15.8	25.4	3.4	16.8
	1977	1.5	3.2	– 2.6	0.0	2.6	– 4.3	–15.0	4.5	– 3.0
Finland. . . .	1960–74	5.2	4.8	5.3	5.1	5.7	3.6	6.7	6.7	7.2
	1975	0.9	1.0	4.6	3.7	6.4	10.8	– 3.6	–13.9	0.4
	1976	0.4	1.5	– 3.4	0.0	3.3	–12.1	–11.5	13.7	– 3.3
	1977	– 0.9	1.7	– 4.3	– 2.0	4.7	– 9.0	2.7	7.7	– 5.7
Netherlands .	1960–74	5.1	5.2	4.8	5.5	3.0	4.7	6.5	8.6	8.4
	1975	– 1.2	2.4	– 1.7	3.9	4.9	– 3.5	– 6.8	– 2.9	– 4.0
	1976	4.6	2.2	4.5	2.7	4.4	– 3.0	1.9	10.3	10.9
	1977	2.2	2.3	5.1	3.9	2.5	10.0	14.9	– 2.2	2.5
Norway . . .	1960–74	4.8	4.7	4.9	4.1	5.7	5.9	6.6	7.2	7.4
	1975	4.2	5.7	5.9	5.2	6.2	12.7	7.9	3.1	7.0
	1976	5.8	6.2	7.0	6.3	7.0	11.7	– 1.6	9.4	12.0
	1977	4.1	6.8	1.8	4.6	10.2	1.8	– 1.2	7.2	2.2
Spain	1960–74	7.3	7.1	7.6	6.9	6.0	9.6		11.1	15.2
	1975	0.6	1.4	0.4	1.8	6.0	– 2.4		– 1.3	– 2.6
	1976	2.0	2.5	1.6	2.8	5.5	– 1.5		9.4	5.7
	1977	2.4	2.6	0.1	0.1	4.5	– 1.4		11.0	– 4.5
Sweden . . .	1960–74	4.1	4.1	3.8	3.3	4.7	4.3	3.8	8.5	7.3
	1975	1.0	0.4	3.3	3.1	5.1	0.6	– 3.5	– 8.8	– 1.8
	1976	1.7	2.1	2.3	4.3	3.7	– 0.1	– 9.0	4.5	6.7
	1977	– 2.4	1.5	– 3.1	1.3	3.2	– 1.9	– 9.0	– 1.0	– 3.3
Switzerland .	1960–74	4.2	4.2	4.5	4.2	5.0	6.4	– 0.5	6.5	7.4
	1975	– 7.4	– 2.6	–10.6	– 2.9	0.7	– 8.1	–30.6	– 6.6	–15.4
	1976	– 2.1	– 1.8	– 1.4	0.5	4.0	–10.1	–13.5	10.2	12.7
	1977	4.1	3.1	3.6	2.5	1.0	3.2	2.1	10.5	9.4

[1] Equals change in real gross national product minus net investment in inventories. [2] Includes change in inventories. [3] Machinery and equipment. [4] Total construction.

The differences were largely attributable to divergent trends in personal disposable incomes: an acceleration in the United States, accompanying rapid rises in employment, contrasted with a slowdown in Japan and western Europe where, in most cases, the rise in nominal wages slowed down, fiscal drag was severe and unemployment grew. In Italy tax increases designed to reduce the budget deficit were a significant influence, while in the United Kingdom the continuation of the pay restraint policy involved a further cut in real wages. The personal savings ratio in the United States reached a 25-year low in the first quarter of 1977 and then rose moderately. In most other countries savings ratios seem to have come down last year but, measured in relation to their recession highs, their decline was generally smaller than that in the US ratio.

Towards the end of last year there were signs of a revival of personal consumption in a number of European countries. This reflected primarily the expansionary influence on disposable incomes of budget measures decided on in the autumn and of the slow-down in inflation which increased the purchasing power of wage incomes in particular.

Movements in *stocks* provided little support for output in 1977 and were in fact for the most part a distinct source of weakness. Even in the United States companies exercised caution in adding to inventories. In most other countries stock accumulation came to a standstill because of the poor prospects for the expansion of final expenditure or holdings of stocks came to be regarded as excessive and were cut back.

The strong revival of *residential construction* which is a normal characteristic of the early upswing was discernible last year only in the United States, where single-unit dwellings were a major source of strength and multi-unit building activity remained slack. In many European countries the housing market was still dominated by a large overhang of unsold units. In Germany and the Netherlands dwelling construction finally showed some signs of revival but elsewhere housing investment generally declined last year.

In the case of *non-residential fixed investment,* the contrasts between countries were particularly sharp last year. In the United States it was largely because of a recovery in business fixed investment that the economic recovery proved self-sustaining. Expenditure on transport equipment rose sharply in early 1977 and outlays for machinery strengthened as the year progressed. Non-residential construction was much less dynamic but by the fourth quarter total business fixed investment was 8½ per cent. higher in real terms than a year earlier. In western Europe and Japan, however, business fixed investment was still a very weak element in total expenditure. Far from strong in 1976, it grew only slowly last year in Germany, stagnated in France and Belgium and declined in Sweden. Increases recorded in the United Kingdom, Switzerland and the Netherlands must be seen against a background of declines in the previous two or three years. Total non-residential fixed investment (including public investment) was still below its 1972–73 peak level last year in all of the large industrial countries except Canada, where energy development projects have been a major element, and France.

Fiscal stimulus to the economy.

In view of the weakness of private spending, it may seem surprising that the stance of fiscal policy was so restrictive in many countries during most of 1977. In relation to gross national product, general-government financial deficits, which had by and large contracted quite sharply in 1976, were kept to modest proportions or reduced further last year in all of the major countries except Japan and Italy (see table on page 56). Public consumption expenditure grew quite slowly in most continental European countries and fell slightly in the United Kingdom. Even more striking is the fact that public investment declined not only in the United

Kingdom but also in Germany and the Netherlands. At the same time, inflows of tax revenue continued at fairly high rates despite the slower growth of private incomes and expenditure.

Budgetary restraint measures had, of course, been introduced in late 1976 as a component of stabilisation programmes in Italy, the United Kingdom, France and many smaller countries. However, continuing inflation resulted in substantial fiscal drag and a new atmosphere of frugality in public spending became fairly widespread. It seems to have reflected concern with the potential monetary implications of large budget deficits and also, in some cases, preoccupation with the sheer size of the deficit and a strong desire to make progress towards reducing trend rates of growth in government expenditure. Indeed, attempts to economise on expenditure often proved more effective than intended, while in some cases legal or administrative delays hindered the execution of large investment projects and central authorities were unable to deter some local administrations from effecting retrenchments.

In the course of last year, however, tax cuts and expenditure measures designed to support employment and to increase private incomes were adopted by an increasing number of governments. In the United States income-tax reductions and measures to boost public investment were approved in early 1977. In Japan, where from late 1976 onwards the Government progressively added to its public-works programmes, public expenditure rose quite rapidly. In some countries, including Belgium, Denmark, Sweden and Canada, public expenditure on selective job-creation programmes was increased, more reliance being placed on monetary policies for purposes of safeguarding external positions.

From the summer onwards expansionary budget programmes were introduced in Germany, France, the United Kingdom, the Netherlands and Japan. The wide variety of measures included increases in public investment, steps to encourage private investment (Germany and France), concessions in respect of personal income tax (Germany and the United Kingdom) or social security contributions (the Netherlands), increases in transfer payments and selective measures designed to boost employment in the public or private sector (France, the Netherlands and the United Kingdom). These programmes were not strongly stimulative. But they did give some support to investment activity, and the tax measures were designed to offset the main impact of fiscal drag on private incomes. Much the same may be said of the $24 billion package of income-tax concessions for companies and individuals as proposed in the United States by the President last January, except that it was intended to offset also the effect of higher social security taxes.

As a result of these various measures, public expenditure began to advance more rapidly in late 1977 and early 1978 in some of the countries where its growth had previously been weak. In Germany, in particular, public investment at last took an upward turn, giving some welcome support to the capital goods sector.

Prices and costs.

Rates of inflation came down further in most countries last year. A slight acceleration in the rate of consumer price increase was fairly general in the first half of 1977, mainly reflecting rises in food prices. Since then, however, a slowdown has occurred in all countries except Canada, Denmark, Norway, Sweden and Spain, as well as the United States, where a renewed acceleration is clearly evident in monthly data. All these latter countries, it may be noted, experienced significant currency depreciation last year. In Italy and the United Kingdom rates of inflation, previously as high as 25 per cent., showed a sharp decline but, particularly in the case of Italy, still remained fairly steep. In Japan, Germany, Belgium and the Netherlands rates of consumer price increase have finally been reduced (with the help of currency appreciations and after nearly three years of weak economic activity and high unemployment) to levels not markedly higher than those recorded in the 1960s. In Switzerland consumer prices remained virtually stable.

Changes in consumer prices.

Countries	Annual averages		Twelve months ending					
	1965–69	1969–73	1974 Dec.	1975 Dec.	1976 Dec.	1977 June	1977 Dec.	1978 April
	in percentages							
United States	3.8	4.9	12.2	7.0	4.8	6.9	6.8	6.5[2]
Canada	4.0	4.6	12.5	9.5	5.8	7.8	9.5	8.4
Japan	4.9	7.5	22.0	7.7	10.4	8.5	4.8	4.5[2]
Germany	2.2	5.3	5.9	5.4	3.9	4.0	3.5	2.9
France	4.0	6.1	15.2	9.6	9.9	10.2	9.0	9.2[2]
United Kingdom	4.1	8.0	19.2	24.9	15.1	17.7	12.1	7.9
Italy	2.1	3.6	25.3	11.1	21.8	20.0	14.9	12.6[2]
Austria	3.6	5.7	9.7	6.8	7.2	5.9	4.6	3.9
Belgium	3.4	5.2	15.7	11.0	7.6	7.8	6.3	5.3
Denmark	6.4	6.4	15.5	9.6	13.1	10.8	12.2	12.2[2]
Finland	5.0	6.9	16.9	18.1	12.3	14.6	11.9	10.5[1]
Netherlands	5.1	6.7	10.9	9.1	8.5	6.7	5.2	4.6[2]
Norway	3.6	7.9	10.5	11.0	8.0	8.7	9.1	8.2
Spain	4.9	8.4	17.9	14.1	19.8	22.3	26.4	22.0[2]
Sweden	3.8	6.8	11.6	8.9	9.6	11.9	12.7	12.5
Switzerland	3.4	6.4	7.6	3.4	1.3	1.8	1.1	1.4

[1] February. [2] March.

Several cost developments in particular contributed to the widespread slowdown in inflation. On average, commodity prices stabilised in dollar terms, while a considerable number of countries enjoyed the additional advantage of an appreciation of their currencies in effective terms in relation to the dollar. Wage claims moderated further, while remaining high in absolute terms. Moreover, business firms often had to accept renewed pressure on profit margins.

Spot prices of *commodities* in world markets, which had already climbed back to their previous peak levels, recorded a further upsurge in the first half of last year. By April 1977 the "Economist" dollar-based index stood at a level nearly twice as high as its June 1975 trough and 40 per cent. above that of the previous peak recorded in May 1974. Against a background of hesitant and far from complete recovery in the industrial countries, the steep ascent of the index seemed ominous. In retrospect, the concern it caused seems to have been excessive: a sharp decline in commodity prices followed and by mid-February 1978 the "Economist" index stood slightly below its level of a year earlier. A subsequent rise in the index mainly reflected the depreciation of the US dollar in the exchange markets. Moreover, examination of the components shows that movements in food prices — reflecting shortages of coffee, a severe winter in the United States and an earlier drought in Europe — accounted for most of the rise in the total index in 1977. Food prices also figured prominently in its subsequent decline as the temperate-zone food supply situation, in particular, showed a marked improvement. Prices of industrial raw materials increased by about 8 per cent. in early 1977, then moved back down and in early 1978 stood no higher than their end-1976 level. In the case of most key base metals, consumer stocks have grown and spot prices may now be close to, or below, average costs of production.

World-market commodity prices: The "Economist" indicator.

Items	1971 Dec.	1974 May	1975 June	1976 Dec.	1977 April	1977 Dec.	1978 mid-May
	dollar-based indices, 1970 = 100						
Food and beverages	95	269	236	336	445	374	395
Industrial raw materials	87	235	146	180	195	178	181
Metals	76	224	111	123	138	127	123
Fibres	107	266	208	276	274	242	258
Total index	91	254	201	277	347	296	310
Total index adjusted for effective depreciation of the US dollar*	91	230	179	264	337	273	280

* Depreciation since the Smithsonian Agreement of 21st December 1971.

Last year also saw some easing of energy prices (which are not included in the commodity price index). In two stages in January and July 1977 the OPEC countries had increased official crude-oil prices by 10 per cent. on average, but in December it was decided to leave these prices unchanged for the time being in dollar terms. Indeed, as supplies of oil were plentiful, free-market prices of most crudes had fallen below their posted levels.

Partly for these reasons and partly because of exchange rate effects, wholesale prices of raw or base materials fell appreciably in the course of 1977 and early 1978 in Belgium, France, Germany and Japan, and rose at a much slower rate in Italy and the United Kingdom. Clearly, in these countries imported cost pressures were no longer contributing to domestic inflation. In the United States wholesale prices of thirteen sensitive industrial raw materials declined by about 6 per cent. between February and September, but rose by about 8½ per cent. between September and March.

The momentum of *wages* has proved a more intractable element in the inflationary process. Following their explosive advance in 1974, rates of increase in nominal wages have come down progressively and the rise in 1977 was again less than in the preceding year in most countries, with the notable exception of the United States and, more surprisingly, Germany. However, in most countries other than Switzerland the increase remained within a range of 7½–12 per cent., while in Italy and Spain it was still over 20 per cent.

Nominal and real earnings in industry.

Countries	Nominal earnings[1]						Real earnings					
	1969–73 average	1973–77 average	1974	1975	1976	1977	1969–73 average	1973–77 average	1974	1975	1976	1977
	changes from December to December, in percentages											
United States	6.7	7.6	8.7	6.8	7.0	7.8	1.4	−0.1	−3.1	−0.2	2.1	0.9
Canada	8.5	13.3	16.6	13.4	12.4	10.0	3.4	3.7	3.6	3.6	6.5	0.5
Japan	18.7	15.0	25.6	14.5	11.2	9.3	8.9	3.6	3.0	6.3	0.7	4.3
Germany	12.5	9.6	16.4	6.5	7.2	9.3	6.2	4.8	9.9	1.0	3.2	5.6
France	*12.3*	*15.5*	*20.3*	*14.8*	*15.1*	*12.1*	*5.3*	*4.1*	*4.4*	*4.7*	*4.7*	*2.8*
Italy	*18.9*	*23.8*	*24.0*	*20.2*	*28.7*	*22.9*	*9.3*	*4.9*	*−1.0*	*8.2*	*5.8*	*7.0*
United Kingdom	13.0	17.5	27.6	20.7	12.3	11.1	3.9	−0.2	7.1	−3.4	−2.4	−0.9
Austria	9.7	10.1	15.3	10.4	7.2	4.4	3.3	3.0	5.1	3.4	0.0	−0.2
Belgium	14.1	14.9	24.4	16.2	9.5	9.1	8.0	4.3	7.5	4.7	1.8	2.6
Denmark	15.9	14.3	22.0	13.9	11.4	10.2	7.3	3.7	5.6	3.9	−1.5	−1.8
Finland	15.4	15.9	24.6	17.2	14.0	8.8[2]	6.8	0.9	6.6	−0.8	1.5	−3.9[2]
Netherlands[3]	14.8	12.5	16.6	13.9	8.0	9.5	6.9	3.8	5.3	3.5	−0.6	3.9
Spain	18.4	26.1	31.3	26.5	31.1	21.6[3]	8.2	7.2	11.4	10.9	9.4	−5.0[3]
Sweden	10.3	13.0	13.7	18.7	11.0	8.9	2.8	2.1	1.9	9.0	1.3	−3.4
Switzerland	*8.8*	*5.6*	*13.0*	*7.7*	*1.6*	*2.1*	*1.0*	*2.2*	*5.0*	*4.2*	*0.3*	*1.0*

[1] Monthly, weekly or hourly earnings, except for figures in italics, which refer to wage rates. [2] September.
[3] October.

Rises of this order were high in relation to the increase in consumer prices observed last year in most countries. Indeed, in Japan, Germany, Italy, Belgium and the Netherlands the rise in real wages seems to have recorded a renewed acceleration. The explanation lies partly in a more rapid deceleration in consumer prices than was anticipated in wage settlements. But progress towards bringing down underlying rates of inflation was nevertheless impeded. Moreover, in most of the countries in question real wages had risen very steeply during the recession and early phases of the recovery. Average rates of increase of 3–5 per cent. over the last four years, at a time when output growth was very weak, must bear some responsibility for the rise in unemployment. It was only in the United States that a fall in real wages occurred during the recession in response to market forces alone. In the United Kingdom real wages fell in each of the last three years but this was mainly due to the Government's incomes policy aimed at bringing down inflation and halting the slide of sterling. Falls in real wages recorded last year in Austria, Denmark, Finland and Sweden were also partly attributable to deliberate efforts on the part of the authorities to bring about some moderation in settlements.

In conditions of weak economic activity, profit margins in many countries were squeezed last year between substantial rises in unit labour costs and much smaller increases in prices for industrial products. Unit labour costs began to rise again in Japan and Germany and moved up faster than before in most of the other large industrial countries. Wholesale or producer prices of manufactured output, on the other hand, slowed down markedly almost everywhere. In Japan, Germany, France, Belgium and the Netherlands their rise in 1977 as a whole fell within a range of 0–3½ per cent. and was well below the increase in consumer prices. Exceptions to this general pattern were Canada and the United Kingdom, where the rise in unit labour costs decelerated and, with prices of industrial goods still rising fairly rapidly, profit shares increased. In the United States the rise in the prices of industrial products kept pace with that in unit labour costs, so that profits per unit of output remained at the improved level reached in 1976.

Employment and unemployment.

By the spring of 1977 unemployment rates had slipped just below their recession peaks in Germany and the United States but remained very high everywhere by previous post-war standards. In the United States the unemployment rate declined further in the course of last year but in Germany and Japan it changed little, while in many other countries unemployment had risen by the autumn to levels even higher than those recorded in 1975 and 1976. In some cases the rate has since fallen slightly, but on the basis of projected output trends unemployment in Europe is likely to remain very high for some time to come.

Unemployment rates.[1]

Countries	1957–73 highest annual rate	1957–73 average annual rate	1975 December	1976 December	1977 June	1977 December	1978 April
	in percentages						
United States	6.8	5.0	8.3	7.8	7.1	6.4	6.0
Canada	7.1	5.5	7.0	7.5	8.0	8.5	8.6[2]
Japan	1.5	1.1	2.0	1.8	2.1	2.1	2.1[2]
Germany	3.5	1.4	4.9	4.4	4.6	4.5	4.4
France	2.2	1.6	4.2	4.3	5.3	4.8	4.9
United Kingdom	3.8	2.2	5.0	5.6	5.7	6.0	5.8
Italy[3]	8.2	4.0	3.5	6.8	7.7	7.1	.
Belgium	6.3	3.7	8.7	9.8	9.2	11.0	10.8[2]
Netherlands	2.7	1.5	5.5	5.2	5.4	5.1	5.1
Sweden	2.5	1.7	1.6	1.5	1.5	1.8	2.1
Switzerland	0.0	0.0	0.9	0.6	0.3	0.4	0.3

[1] As a percentage of the civilian labour force (in Belgium the insured labour force). Seasonally adjusted series except for Belgium, Italy, Sweden and Switzerland. [2] March. [3] New series as from December 1976.

The difference in developments in unemployment last year is all the more striking when set against the background of a 2½ per cent. annual average rate of growth in the civilian labour force in the United States and stable or declining trends in the working population in many northern European countries. In the United States employment expanded by a record 4½ per cent. in the course of last year, while in Germany, France, the United Kingdom and Sweden it remained stable or declined.

Unemployment in the industrial countries undoubtedly includes structural as well as cyclical elements. In recent years there have been changes in the composition of labour forces (in particular, a rise in the proportion of women and young people) and compensation for unemployment has risen. At the same time, wage bargaining and incomes policies have led to lower wage differentials and employment opportunities in some traditional industries or regions have declined.

It seems more than likely that the rise in unemployment in Europe partly reflects employers' attempts at rationalisation in response to sharp rises in real wages. Actual declines in employment in the industrial sector were a novel feature of the recovery period in a number of European countries and there is scattered evidence of efforts to economise on labour even in tertiary sectors such as banking and the public service.

Employment and labour productivity.

Countries	Civilian employment					Labour productivity[1]				
	1969–73[2]	1973–77[2]	1975[3]	1976[3]	1977[3]	1969–73[2]	1973–77[2]	1975[3]	1976[3]	1977[3]
	changes, in percentages									
United States	2.0	1.8	−0.4	3.3	4.4	1.5	0.2	2.9	1.4	1.2
Japan	1.0	0.4	0.4	1.0	1.3	8.1	2.6	3.1	4.1	3.9
Germany	0.3	−1.7	−2.8	0.0	−0.8	4.1	3.2	4.5	4.8	2.9
France	1.1	−0.1	−1.7	0.8	0.0	4.5	2.9	4.7	3.4	2.4
United Kingdom	0.2	−0.1	−1.0	−0.2	0.1	3.4	0.0	−1.1	4.1	−0.7
Italy	−0.1	1.5	0.3	1.0	0.7	4.3	0.5	0.3	5.0	−2.1
Canada	3.0	2.6	2.4	1.2	2.6	2.6	0.4	0.2	2.3	1.4
Sweden	0.7	1.4	2.1	0.3	0.1	2.2	−0.4	−0.6	2.2	−2.9

[1] Change in real gross national product per employed civilian worker. [2] Annual averages. [3] Fourth quarter to fourth quarter.

The working of these forces is reflected in the unusual relationships between movements in gross national product and in total employment. The ratio between the two can be regarded as a rough measure of labour productivity in the economy as a whole. Cyclical developments in productivity in the United States have conformed to the usual pattern, falling in the recession and rising at a gradually diminishing pace in the upswing, though over the 1973–77 period as a whole the rise in output only just kept pace with the growth of the labour force. In Japan and Canada slower growth over that period has involved a reduced rate of increase in both employment and labour productivity. In Germany, France and the United Kingdom, however, overall labour productivity rose faster than gross national product during the recovery and over the 1973–77 period as a whole, with total employment falling. Much the same seems to have occurred in Belgium and the Netherlands. In Germany, and to a lesser extent in France, the rise in labour productivity in the last few years was fairly pronounced by historical standards considering that there was so little rise in output. In the United Kingdom, Italy, Sweden and Canada productivity grew very slowly or fell over the 1973–77 period. To some extent this reflects cyclical divergences between countries, but it is also due, at least in part, to the impact of labour-market measures designed to encourage the hoarding of labour and to moderate the sharp rise in recorded unemployment which might have resulted from attempts to restore profitability in industry.

Monetary policies and money markets.

Last year monetary policy was conducted within a framework of constraints which, according to the situation and viewpoint of individual authorities, reflected the need to moderate inflation or was dictated by external circumstances. In all the larger countries other than Japan — and in some smaller ones — constraints had been formalised in a commitment on the part of the monetary authorities to keep rates of expansion of the monetary aggregates broadly in line with some form of published norm or limit. Monetary policies of this sort generally had a distinct medium-term orientation: the idea was to keep monetary expansion on a moderate, even course with a view to stabilising and gradually reducing inflationary expectations.

In these circumstances there was only limited scope for adapting monetary policy in ways which might stimulate economic activity. When output weakened or inflation abated more than expected, monetary norms were adjusted down only marginally, if at all. But, as time went on, the authorities in many countries accepted — at least for certain periods — rates of monetary expansion considerably in excess of the limits suggested by their targets. The compromise which each country had chosen had to be reconsidered in the light of unexpected developments in the exchange markets. These posed a dilemma first for the United Kingdom and then, with the general weakening of the dollar, for Japan, Germany and Switzerland. France, Belgium and the Netherlands had to adjust monetary policy to support their currencies, though only for short periods.

In the *United States* monetary expansion accelerated in the spring and summer and short-term interest rates began to go up, raising the question whether the cause was failure to meet the targets or the attempt to adhere to them too strictly. In the event, the Federal Reserve tried to compromise by resisting the rise in the Federal funds rate to some extent while permitting rates of monetary expansion to go beyond the upper end of the target ranges. Federal Reserve discount rates, which had already been raised from 5¼ to 6 per cent. in August–October, were increased to 6½ per cent. in January 1978 in an effort to check the plunge of the dollar in the exchange markets. Subsequently, the growth of the narrowly defined money stock slowed down markedly, but by April a renewed acceleration was evident. In May discount rates were raised to 7 per cent. The medium-range targets for monetary expansion were changed little during the year, the lower limit being eased down and the upper limit of the ranges for M_2 and M_3 being reduced by 1 and 1½ percentage points respectively.

Monetary and credit aggregates: Objectives and rates of expansion.

Country	Monetary or credit aggregate	Objective for 1977[1]	Monetary or credit expansion in 1977[1]	Objective for 1978[1]	Monetary or credit expansion, quarterly averages at annual rates: 1977 Q1	1977 Q2	1977 Q3	1977 Q4	1978 Q1
		in percentages							
United States	M_1	4½–6½	7.8	4 – 6½	7.1	8.3	8.3	7.4	5.1
	M_2	7 –10	9.8	6½– 9	11.3	9.3	10.3	8.2	6.6
	M_3	8½–11½	11.7	7½–10	12.8	10.6	12.5	11.0	
Germany	Central-bank money	8	9.0	8	7.9	6.5	12.8	11.5	14.5
	M_1				11.4	7.3	12.8	10.0	25.0
	M_3				7.1	6.8	14.6	12.8	7.6
France	M_1				10.5	5.2	14.2	7.5	
	M_2	12½	13.9	12	14.4	8.9	15.8	12.7	
United Kingdom	M_1				9.2	21.1	25.0	27.8	23.6
	Sterling M_3	9–13	16.3	8–12	– 4.3	12.4	11.9	15.2	24.8
	DCE[2]	19½	11.3	13	– 0.8	7.7	– 0.1	7.4	29.1
Canada	M_1	8–12	9.2	7–11	8.5	11.1	11.0	13.6	5.8
	M_2				13.0	14.1	9.4	10.8	8.9
Switzerland	M_1	5	5.4	5	9.0	0.1	2.9	9.0	36.8
	M_2				2.0	10.4	5.6	6.9	5.4
Italy	M_1				24.2	19.1	20.3	19.9	
	M_2				24.4	17.4	18.8	22.6	
	Total credit	15	17.8		17.0	20.0	16.5	17.3	

[1] For the United States, fourth quarter to fourth quarter; for Germany and Switzerland, annual averages; for France and Italy, December to December; for the United Kingdom, 12-month periods ending April 1978 and April 1979; for Canada, February–April 1976 to June 1977 and period beginning June 1977. For France, Italy and, in respect of domestic credit expansion, the United Kingdom, the objectives shown represent upper limits. [2] The limit and actual domestic credit expansion during the period are expressed as percentages of sterling M_3 at the beginning of the period.

In *Germany* monetary expansion began to quicken from June onwards, but the weakness of the domestic economy and the strength of the Deutsche Mark dissuaded the authorities from taking restrictive action. Indeed, in July–September the lombard rate was lowered, cheaper refinancing facilities were provided on a flexible basis and ample bank liquidity was ensured by a lowering of reserve requirements and increases in rediscount quotas. In December the discount and lombard rates were reduced; and, in raising reserve requirements on banks' liabilities to non-residents and in offering sterilisation paper, the authorities offset only part of the increase in bank liquidity stemming from official exchange-market interventions. Because of the slow rate of expansion recorded early in the year, the increase in central-bank money calculated on an annual average basis exceeded the official target by only a small margin. However, the increase in 1977 (fourth quarter to fourth quarter) came to 9.6 per cent., compared with a range of 6–7 per cent. envisaged at the beginning of the year. For 1978 the target, which is related more to the growth of productive potential than to expected developments in actual output, was set at 8 per cent. (annual average basis), as in 1977. This, it was stated, would be broadly consistent with an expansion of 5–7 per cent. between the fourth quarter of 1977 and the fourth quarter of 1978. Early in the year the actual rise was quite rapid but it slowed down again in the spring.

In *Japan*, against the background of a weak domestic economic recovery and upward pressure on the yen, the official discount rate was brought down from 6½ to 3½ per cent. in three stages between March 1977 and March 1978 and declines in a wide range of administered rates followed. From June onwards the Bank of Japan's "window guidance" ceilings on commercial-bank lending were administered with flexibility in a way which amounted to authorisation of most of the banks' own lending programmes. Commercial banks' reserve requirements were lowered in October. (In March 1978 the requirement applying to increases in non-resident yen deposits was raised from 50 to 100 per cent.)

In the *United Kingdom* a marked revival of confidence in sterling and a notable decline in monetary financing of the public sector brought about a sharp change in the monetary climate last year. In a context of large inflows of funds from abroad and heavy net purchasing of foreign currency by the authorities, interest rates declined sharply. At the same time, the rate of domestic credit expansion was slow, remaining well within the ceiling agreed with the IMF and, following a fall in the first quarter, the broadly defined sterling money supply entered a phase of rapid expansion. Confronted with difficulties in simultaneously pursuing their monetary and exchange rate objectives, the authorities gave priority to the former and in October set the pound free to float. The minimum lending rate had come down from 14¼ to 5 per cent. between January and October. By mid-May 1978, however, with monetary expansion running above target and the external situation less favourable, the rate had moved back up to 9 per cent.

In seeking to meet the limits on total credit expansion agreed with the IMF and the EEC, the authorities in *Italy* relied largely on ceilings on the expansion of bank credit to the economy and on measures to limit the public-sector financing requirement. An effort was also made to keep domestic interest rates attractive in relation to those abroad, allowing for differences in inflationary expectations; nevertheless, the official discount rate was brought down from 15 to 11½ per cent. in June–August. In the event the economy weakened more than expected and the external situation improved considerably. But the rise in public expenditure was still not effectively restrained. As a result the increase in total credit from bank and non-bank sources came to Lit. 35,700 billion in 1977, compared with an original target level of Lit. 30,600 billion.

In *France*, where the fragile external position and a fairly high rate of inflation were still key considerations, the authorities kept bank credit expansion subject to norms which were designed to be consistent with the official target limit for the expansion of M_2. Indeed, for 1978 the scope for increases in certain types of credit which had been exempt from the norms was narrowed slightly. Between January and September 1977 the authorities permitted a gradual fall in short-term interest rates and the Bank of France's discount rate was reduced from 10½ to 9½ per cent. in August. For a time, in late 1977 and early 1978, money-market management was directed towards defending the franc. A steep rise in short-term interest rates was encouraged and the Bank of France suspended certain of its money-market interventions. Subsequently, however, the pressures slackened and the monetary defences were lowered.

In *Belgium* and the *Netherlands* money-market conditions eased during much of 1977 and discount rates were lowered in the spring and summer. Later in the year both countries had to cope with pressures on their currencies within the European joint float, as the Deutsche Mark rose against the dollar. Measures taken included increases in discount rates and steps to encourage a tightening of bank liquidity. However, the need for severe restraint was short-lived. In Belgium, for instance, the discount rate, which had been raised from 6 to 9 per cent. in December 1977, was brought down to 5½ per cent. by late March 1978. In *Sweden* and *Denmark* monetary policies last year were geared largely to protecting external positions (though both countries devalued their currencies). High interest rates and credit ceilings were the main instruments used to encourage inflows of private funds from abroad.

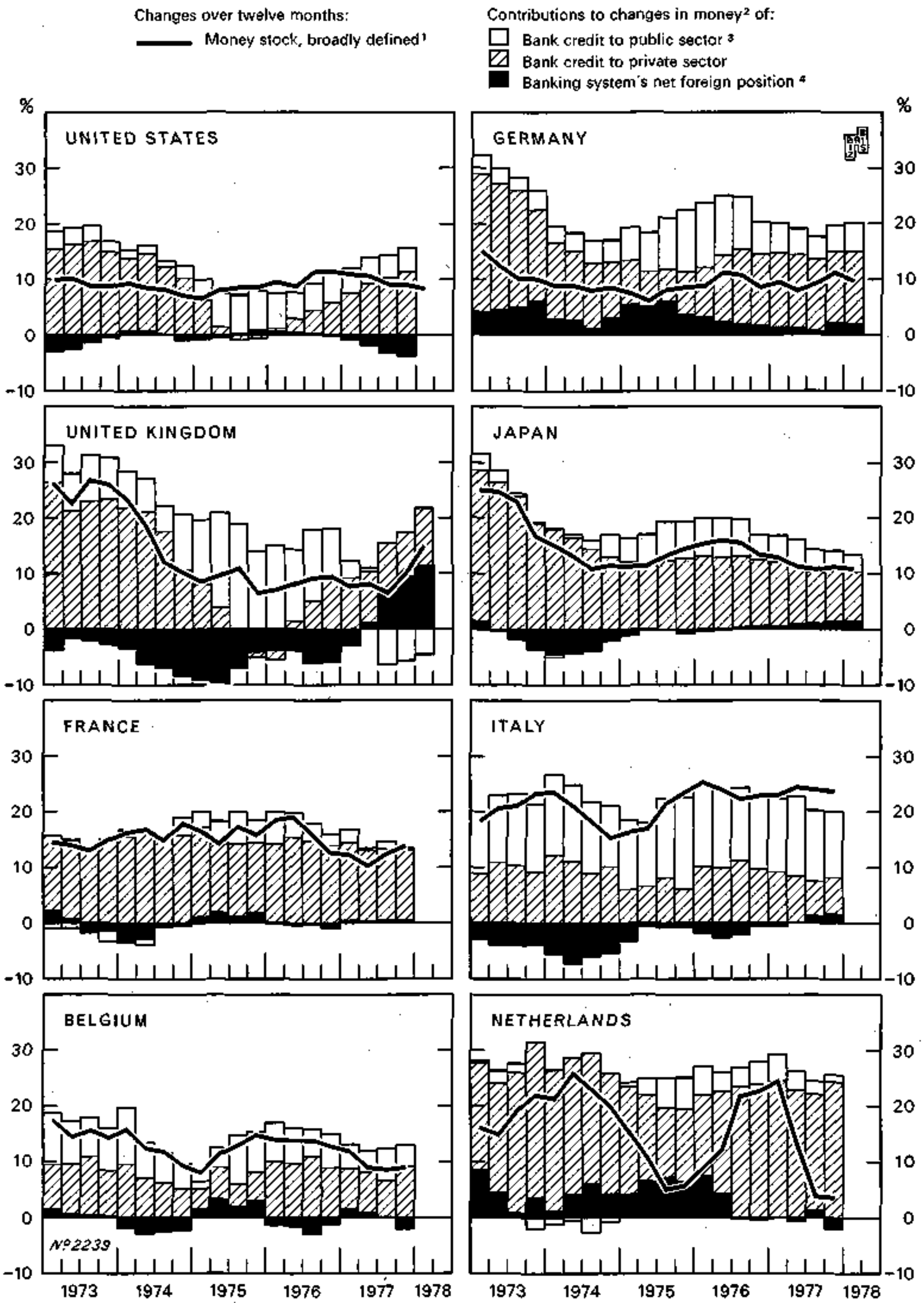
Developments in the monetary aggregates.

Considered over a wide spectrum of countries, rates of expansion of the monetary aggregates seem last year to have been fairly moderate — at least by the standards of the early 1970s. At the same time, differences between rates of monetary expansion in the industrial countries by and large narrowed. To a considerable extent this reflects a deceleration in rates of monetary growth in countries where previously very high rates of inflation have been reduced. In Italy rates of monetary expansion remained fairly high last year, though the rise was less than that in nominal incomes. In the United Kingdom M_1 expanded very rapidly but, paradoxically, this was largely a result of the slowdown in inflation and the associated sharp decline in interest rates, which reduced the incentive to switch into interest-bearing assets. A similar, usually temporary, acceleration has been seen in a number of other countries in recent years. A particularly marked slowdown in the expansion of M_2 occurred in the Netherlands last year, following an explosive rise in 1976, under the influence of ceilings on the growth of bank credit financed by money creation. In Japan a deceleration brought rates of expansion of M_2 down to figures which were strikingly low in relation to those experienced in earlier years.

Yet certain of the countries which attempted explicitly to stabilise rates of growth in the aggregates — typically against a background of comparatively moderate rates of monetary expansion over several years — had some difficulty in doing so. In most cases monetary expansion, measured over the whole of the target period and on the basis laid down in the target announcement, came reasonably close to meeting the objective. Over shorter periods, however, rates of monetary growth continued to fluctuate over a fairly wide range, moving for months at a time beyond the limits which could be inferred from the norms.

One of the reasons, of course, was that at times national authorities explicitly gave priority to attempting to stabilise interest rates or exchange rates. Another seems to have been changing substitution relationships between monetary claims and assets not included in the chosen aggregates. In the United States the acceleration in M_1 growth seems partly to have reflected a reduction in the rate at which negotiable instruments of new types were being accumulated instead of demand deposits. On the other hand, late in 1977 a slowdown in the growth of corporate time deposits and savings deposits, as the interest rates paid on them

Changes in the money stock and the contributions of its counterparts.



[1] Based on national sources; first quarter of 1978 partly estimated. For Germany M_3; for the United Kingdom sterling M_3; for other countries M_2. [2] The percentage contributions of the counterparts add up to the percentage change in money, except for differences due to balance-sheet items not shown – the principal one being domestic non-monetary liabilities of banks. [3] For the United Kingdom includes public-sector borrowing abroad; for the United States includes Treasury bills held by foreign official institutions. [4] For France the Bank of France only; for the United Kingdom includes public-sector borrowing abroad (–); for the United States includes official assets, liabilities to foreign official institutions (–) and other bank-reported claims vis-à-vis non-residents (net).

became uncompetitive, helped to moderate the expansion of the broader aggregates, though at the same time banks began to issue substantial amounts of large CDs which are not included in M_2 or M_3. In Germany the release of large amounts of personal-sector deposits (DM 7 billion in January and DM 15 billion in July) previously blocked in non-monetary savings instruments seems to have contributed to the acceleration in the expansion of M_3 and the unusually small rise in the non-monetary liabilities of banks recorded last year. In the United Kingdom variations during the year in rates of expansion of sterling M_3 seem to have been influenced to a significant extent by the changing relative attractiveness of National Savings certificates and building society deposits, which are not included in the aggregate. Factors such as these help to explain why it has been so difficult for monetary authorities to regulate closely the growth of particular monetary aggregates in the very short run and why it may not always be appropriate to attempt to do so.

Bank borrowing by the public sector was not a major stimulus to monetary expansion last year. Having already in 1976 fallen below the peak rates recorded in 1975, the year of recession, it declined further last year in the United States, Germany, Japan and France. This reflected in varying degrees small or contracting public-sector deficits (except in Japan), receptive conditions for sales of government paper outside the banking system and, in some cases, determined efforts to limit monetary financing. In France, in particular, the avoidance of a net increase in monetary financing of the Treasury over the year as a whole was an explicit objective of policy. In both the Netherlands and the United Kingdom the public sector actually reduced its indebtedness to the banking system last year. In Belgium and Italy, however, the public sector continued to borrow from the banking system on a fairly large scale.

Contrasting developments in bank credit to the private sector largely reflected differences in countries' cyclical positions and in rates of inflation. In the United States a strong recovery in business loans, together with sharp rises in real estate and consumer credits, was reflected in a very rapid increase in total bank lending. In Japan, by contrast, the rate of expansion of bank loans, at 9.5 per cent. last year, was the lowest recorded for over twenty years. Considering the weakness of economic activity, bank credit to the private sector expanded fairly rapidly last year in Germany, France, Belgium and the Netherlands. However, in Germany in particular, the increase was mainly in the form of medium and long-term credits, with a considerable portion serving to finance housing and consumption. In some of the other countries, too, there are indications of a faster rise in lending to the personal sector than in credits to business enterprises. In Italy and the United Kingdom bank credit to the private sector only more or less kept pace with the rise in consumer prices: improvements in the balance of payments, including the unwinding of leads and lags, helped to moderate credit demand.

Quantitative ceilings on bank credit expansion were in force in 1977 and early 1978 in Italy, France, the Netherlands, Austria, Denmark and Japan. In each of these countries except Japan there are indications of a restrictive impact. For instance, in Italy interest rates on bank loans remained rather high in relation to those on money-market instruments, while in France the expansion of unrestricted credits, at

35 per cent. in 1977, far exceeded the rise (8 per cent.) in credit subject to the norm. In the Netherlands banks were free to expand their lending to the private sector outside the ceiling by using funds raised on the capital market and did so on a substantial scale.

Inflows of funds from abroad can, of course, influence money and/or domestic credit expansion directly and also indirectly via their influence on banks' reserve positions. The external counterpart of monetary expansion shown in the graph, which for most countries reflects changes in the external position of the entire banking system, indicates only the direct influences. Only to a limited extent does it reflect the large rôle played by official purchases of foreign exchange in monetary expansion last year in Italy, the United Kingdom and Germany, because in each case there was a deterioration in the banks' external positions. Moreover, it is not always possible to adjust these figures for changes made in the valuation of net foreign assets. In Germany the net increase in the external assets of the banking system contributed one-sixth of the increase in the broad money supply in the final quarter of 1977. In Belgium, on the other hand, external factors exerted a restrictive influence on monetary expansion — owing to the efforts made to stabilise the exchange rate of the franc within the "snake". For the United States the external item reflects the rise last year in US liabilities to foreign official holders — most of the counterpart being shown as credit to the public sector.

Government financing.

Public-sector and central-government financing requirements, including funds borrowed for lending purposes, have declined quite steeply over the last two years in France, Germany, the United Kingdom and the United States. Last year there was a reduction also in the Netherlands. In Belgium, Italy and Japan, however, the requirements showed further increases last year in absolute terms, even though in some cases there were modest declines in relation to gross national product.

A reduction in public-sector financing requirements, usually with a view to limiting the need for monetary financing, was an explicit objective of policy in a number of countries last year. In both Italy and the United Kingdom, in particular, the authorities had committed themselves to quantitative limits in respect of public-sector financing under programmes designed to improve their external payments positions. In relation to the objectives, developments in the two countries were rather different. In the United Kingdom the borrowing requirement of the entire public sector (including that of the public corporations) came to an estimated £5.7 billion in the fiscal year ending in March 1978, equivalent to 4.6 per cent. of gross national product, well within the limit of £8.7 billion earlier established in agreement with the IMF. In Italy, on the other hand, the government deficit in 1977 came to Lit. 17,000 billion, compared with a limit of Lit. 13,100 billion envisaged in international undertakings, while the borrowing requirement of the total public sector, for which a ceiling of Lit. 16,450 billion had been set, actually reached Lit. 21,000 billion. In other countries borrowing requirements in 1977 often proved to be smaller than originally expected but are likely to increase this year following a shift towards a more expansionary fiscal policy stance.

Government financing.[1]

Items	Years	Belgium	France	Germany	Italy	Japan	Netherlands	United Kingdom	United States
		as a percentage of gross national product							
Public-sector financing requirement[2] . . .	1975	6.2	3.4	6.6	15.5[3]	7.1[4]	4.8	10.1[5]	6.6
	1976	6.6	2.0	4.5	13.0[3]	10.2[4]	4.7	7.6[5]	3.9
	1977	7.0	2.4	3.2	12.1[3]	9.4[4]	3.7	4.1[5]	3.2
Central-government financing requirement . . .	1975	5.7	3.0	6.3[6]	11.6[7]	2.8	3.1	8.0[8]	5.9
	1976	5.9	1.1	4.4[6]	9.5[7]	4.8	3.6	5.5[8]	4.0
	1977	6.5	1.2	2.7[6]	9.9[7]	4.7	3.0	3.2[8]	3.7
met by:									
Central bank	1975	0.0	1.4	0.6	7.7	.	0.0		0.6
	1976	0.8	0.7	0.3	6.9	.	0.4		0.7
	1977	0.6	−1.0	0.0	−2.0	.	0.1	2.3	0.4
								0.0	
Banks	1975	1.3	0.9	4.3	0.5	2.1	1.0	1.4	1.7
	1976	1.4	−0.3	2.8	−0.5	3.7	0.6		0.8
	1977	0.6	0.6	2.0	8.0	3.0	0.4		−0.1
Other domestic sources.	1975	4.4		1.1	3.4		2.1	5.5	3.1
	1976	3.7		0.7	3.1		2.7	4.5	2.0
	1977	5.4	0.8	0.7	3.9	0.7	2.6	6.8	1.7
			0.7			1.1			
Foreign sources. . .	1975	0.0	1.6	0.3	0.0	1.7	0.0	0.2[9]	0.5[9]
	1976	0.0		0.6	0.0		−0.1	1.0[9]	0.5[9]
	1977	−0.1		0.0	0.0		−0.1	−5.0[9]	1.7[9]

[1] Net changes in borrowing and cash balances, including borrowing for lending purposes. Partly based on BIS estimates. [2] Central government, local authorities and the social security system, on a cash basis. [3] As defined in the Letter of Intent to the IMF; includes borrowing requirement of some public enterprises. [4] Net issues of medium and long-term government bonds and local-government bonds; also includes issues of government-guaranteed bonds and private placements of bonds by government agencies (together equivalent to 1.5 per cent. of GNP in 1977). [5] Includes borrowing requirement of public corporations, equivalent to approximately 1.1 per cent. of GNP in 1977. [6] All public authorities other than social security. [7] General government. [8] Includes central-government lending to public corporations (equivalent to approximately 0.3 per cent. of GNP in 1977). [9] Includes increases (–) in official foreign exchange assets.

A fairly large proportion of the central government's financing requirement could be covered last year by non-monetary means in most countries — Italy being a major exception. Generally, with the business sector making only limited call on the bond markets, large amounts of government paper could be placed with the non-bank public at stable or declining interest rates. In the United Kingdom steep declines in bond yields as inflation was brought under better control provided particularly favourable conditions for the sale of government stocks. To help reduce fluctuations in net official sales of gilts, a traditional problem exacerbated by increased sensitivity of the market to monetary developments, the authorities issued a new type of stock with the principal payable in instalments. In France a large government loan was issued with success and the public took up large amounts of Treasury bills. Sales of government securities to non-banks were also very large in Belgium, the Netherlands, Japan and the United States. In Japan and the United Kingdom non-bank financial institutions took up the bulk of the paper sold outside the banking system, but in some countries substantial purchases were made by individuals or non-financial enterprises accumulating liquidity in a context of very weak private investment. In the United States state and local governments, which had brought their own financial positions into large surplus, last year took up some 30 per cent. of all market securities issued by the Federal Treasury. In Germany non-bank investors purchased relatively small amounts of government securities; the narrow margin between interest rates on short-term instruments and capital-market yields discouraged expectations of further falls in coupons and provided investors with little incentive to acquire assets with uncertain capital values. Moreover, the social security system, classified as a non-bank investor in the table, was in large deficit and ran down its claims on the rest of the public sector.

As for external financing, one of the most interesting developments last year took place in the United States, where nearly half of the central government's financing requirement was covered by purchases of US Government securities by non-residents. The bulk of these reflected the investment by foreign monetary authorities of dollar balances acquired in official intervention operations in the exchange markets. In the United Kingdom non-residents' acquisitions of British Government securities were fairly substantial: far less, however, than the rise in official reserve assets which is recorded in the table as (negative) financing from external sources.

At all events central-government recourse to financing from the banking system was fairly limited last year except in Italy, Japan and Germany (for which the breakdown in the table also covers borrowing by local authorities). In Japan the weakness of business demand for credit was a substantial offsetting factor as far as money creation was concerned, while in Germany the banks continued to refinance a considerable part of their loans to the public authorities in the capital market.

Private borrowing and lending.

Largely owing to differences in cyclical developments, a rapid expansion of business, mortgage and consumer credit in the United States last year contrasted sharply with generally weak levels of private borrowing in other countries — though housing loans showed signs of recovery in some of them.

This pattern can be clearly seen in the table below, which gives a rough indication in relation to gross national product of movements in borrowing by domestic non-financial sectors in national credit markets, mainly in the form of issues of securities and direct loans from financial institutions.

Business borrowing expanded very strongly in the United States last year, mainly because corporate investment expenditure rose by more than companies' available internal resources. But, in addition, corporations continued to add to their financial assets: instead of deteriorating rapidly as it had done in previous phases of cyclical upswing, corporate-sector liquidity last year remained close to the improved level established by the restructuring of balance sheets in 1975–76. The weakness of the share market was a deterrent to equity issues, and public issues of bonds fell below the 1976 level. Corporations raised a large volume of funds through private placements and mortgage borrowing but the emphasis fell more and more on short-term credits from banks and issues of commercial paper. Rising interest rates increasingly put a check on short-term borrowing for liquidity purposes but banks became more

Funds raised in credit markets by domestic non-financial borrowers.[1]

Countries	Years	Public-sector borrowing[2]	Enterprise borrowing[2] Equities	Bonds	Loans[3]	Total	Housing credit	Consumer and other personal credit[2]	Total
		In percentages of gross national product							
United States . .	1974	2.0	0.3	1.5	5.0	6.8	2.5	1.0	12.3
	1975	6.3	0.6	2.0	0.5	3.1	2.5	0.7	12.6
	1976	4.9	0.6	1.5	2.3	4.4	3.6	1.7	14.6
	1977	4.3	0.4	1.2	4.3	5.9	4.6	2.3	17.1
Germany	1974	2.3	0.3	0.2	3.3	3.8	2.4	0.0	8.5
	1975	5.9	0.5	−0.1	1.9	2.3	2.2	0.4	10.8
	1976	3.6	0.4	0.0	3.2	3.6	2.4	1.3	11.1
	1977	3.2	0.2	−0.1	2.9	3.0	3.0	1.2	10.4
Japan.	1974	6.4	0.6	0.5	9.9	11.0	4.9		22.3
	1975	8.6	0.8	0.9	10.3	12.0	4.7		25.3
	1976	9.4	0.6	0.4	9.1	10.1	5.0		24.5
	1977	9.6	0.6	0.3	6.6	7.5	4.5		21.6
United Kingdom .	1974	5.5	0.1	0.0	5.4	5.5	2.8	0.0	13.8
	1975	8.2	0.9	0.1	0.6	1.6	3.5	−0.4	12.9
	1976	4.7	0.6	0.0	2.5	3.1	3.1	0.7	11.6
	1977	7.1	0.5	−0.1	2.3	2.7	2.9	0.9	13.6
Canada	1974	4.8	0.3	0.7	5.3	6.3	4.2	2.0	17.3
	1975	5.4	0.6	0.9	2.5	4.0	4.3	2.0	15.7
	1976	4.4	0.5	−0.5	3.5	3.5	4.7	2.1	14.7
	1977	5.9	1.0	0.7	2.7	4.4	5.7	1.6	17.6
France	1974	1.2	0.6	0.5	7.1	8.2	2.4	−0.1	11.7
	1975	3.9	0.5	1.2	5.5	7.2	2.9	0.4	14.4
	1976	2.1	0.4	0.7	5.3	6.4	3.7	0.4	12.6
	1977	2.8	0.4	0.6	5.7	6.7	3.1	−0.1	12.5

[1] BIS estimates, based on national data which differ conceptually from country to country. For the United States, funds raised in credit markets other than by the foreign sector; for Germany, borrowing through money-market paper, bonds, shares and loans from banks, building societies and insurance companies; for Japan, issues of securities and loans from financial institutions and the Government; for the United Kingdom, issues of securities, national savings, local-authority borrowing, bank lending, public-sector loans, loans for house purchase, other loans and mortgages and retail credit; for Canada, funds raised by major non-financial borrowers except securities purchased by non-residents; for France, government borrowing, credits to the economy and security issues by non-financial enterprises. [2] For Japan and the United Kingdom, borrowing by public enterprises is included in public-sector borrowing and that by unincorporated business is included in personal-sector credit. [3] Includes money-market paper.

aggressive in their lending policies, making selected loans at interest rates below prime rates and offering fixed-rate term loans at up to five years.

In other countries the pace of enterprise borrowing remained quite moderate or declined last year. Business fixed investment was very weak and the process of balance-sheet restructuring which had involved long-term borrowing to finance liquid asset accumulation came to an end — somewhat later in Canada than elsewhere. In the United Kingdom industrial and commercial companies moved into financial surplus in the second half of last year, while in Japan the financial deficit of the corporate sector was remarkably low in relation to gross national product. In Germany the deficit of the enterprise sector rose slightly above the modest level recorded in 1976 but the ratio of internally generated funds to gross investment remained high. The rate of corporate borrowing from banks recorded a marked fall in Germany, Japan and Canada and remained very modest in the United Kingdom. Except in Canada bond and share issuing activity also tapered off.

Housing credit expanded fairly rapidly last year in a number of countries. In general, the recovery was centred on mortgage loans to individual house buyers.

In the United States, where home mortgages registered a record increase which far exceeded requirements for the financing of new construction and turnover of existing houses, individuals clearly reduced their equity in housing in order to finance other expenditure. Long-term first-mortgage loans at fixed interest rates of around 9 per cent. were cheaper than consumer credit and attractive also, it would seem, in the light of the outlook for consumer prices generally. In a number of European countries interest rates on mortgages came down and although current rates of increase in consumer prices declined too, individuals apparently continued to think of home ownership as a long-term hedge against inflation. Borrowing to finance the purchase or repair of existing dwellings was encouraged by tax measures in a few countries. In several of them relatively cheap finance from specialised housing credit institutions was readily available or became more plentiful. In the United States the flow of funds to deposit institutions, previously strong, slowed down when interest rates on short-term deposits rose to Regulation Q ceilings late in 1977. But the impact was much less sharp than on similar occasions in the past because the fixed-term deposits which these institutions had been permitted to accept in recent years remained competitive considering the severe interest rate penalties entailed in early withdrawals. In the United Kingdom the building societies were slow to follow the decline of interest rates available on market instruments and benefited from large inflows throughout much of the year. In Germany the decline in capital-market yields encouraged a large increase in home loans, which are granted by specialised credit institutions and refinanced by the issue of mortgage bonds.

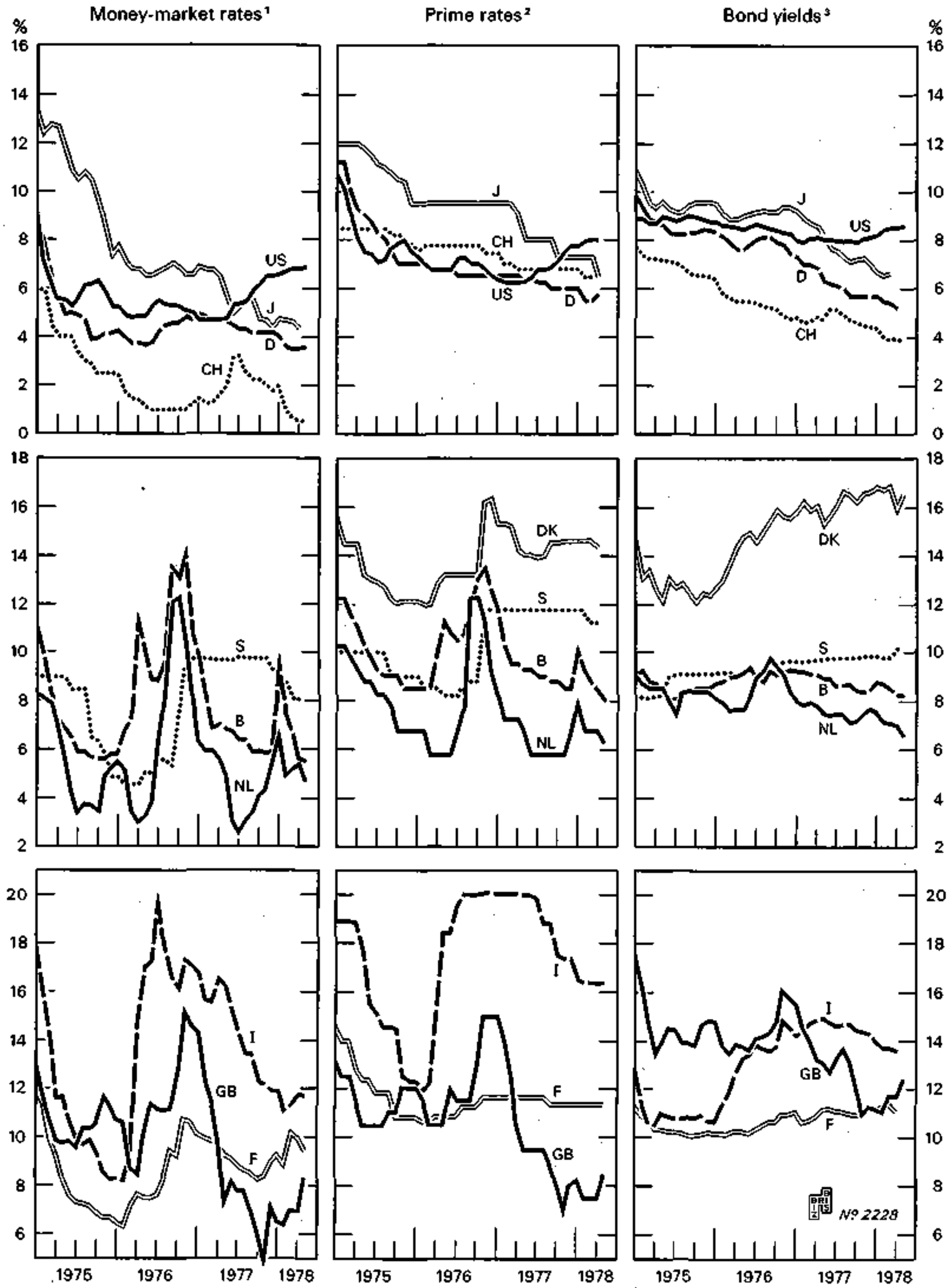
Consumer instalment credit also expanded rapidly in the United States. Together with the increase in mortgage credit, this caused a sharp rise in the ratio of personal-sector indebtedness to disposable income. In Germany, too, consumer credit grew at a fair pace. Elsewhere, however, the rise in consumer borrowing was quite moderate last year and households continued to accumulate liquid assets on a fairly large scale. Moreover, in many countries declines in rates of inflation and in interest rates helped to make good some of the capital losses suffered earlier by households.

Interest rates.

Differences in economic developments and policies in the three largest industrial countries were strikingly reflected in the behaviour of interest rates at both short and long term.

Short-term interest rates in the United States, which had changed very little on balance over the previous two years of economic recovery, moved up by some 2–3 percentage points between April 1977 and the spring of this year. The rise was not, however, evenly spread over the year. The increase in the Federal funds rate came in four stages, separated by periods of stability. The rises coincided with phases of very rapid growth in the money supply — to some extent resisted by the Federal Reserve. In Germany the three-month interbank rate had risen gradually in the course of 1976 as the Bundesbank reined in banks' free reserves in an effort to moderate the growth of central-bank money. Last year, with the authorities

Short and long-term interest rates.



Note: B = Belgium, DK = Denmark, F = France, D = Germany, I = Italy, J = Japan, NL = Netherlands, S = Sweden, CH = Switzerland, GB = United Kingdom and US = United States.

¹ Representative rates. (For the United States, Federal funds; for Japan, call money; for France, day-to-day money; for Italy, interbank sight deposits; for other countries, three-month money-market instruments.) ² Minimum rates charged by commercial banks for cash credits to first-class borrowers. For Denmark, average lending rate; for Germany, lower end of range for large current-account credits. ³ Representative rates. (For the United States, Aaa corporate bonds; for Denmark, mainly mortgage bonds; for Belgium, the Netherlands, Sweden and the United Kingdom, government bonds; for other countries, various other public-sector bonds.)

facilitating a renewed rise in bank liquidity, the rate fell by nearly 1 percentage point in the months up to August. Then, although the banks had unutilised rediscount facilities and access to Bundesbank credit at favourable rates in the form of open-market transactions involving repurchase agreements, the three-month money-market rate settled just above the level of the lombard rate and did not move down significantly until that rate was lowered in December. In Japan the call-money rate fell by 2 percentage points in 1977 and early 1978, with steep falls in the spring and autumn in conjunction with a progressive easing of monetary policy, which brought the Bank of Japan's discount rate to 3½ per cent. — its lowest level since the Second World War. In Switzerland, the country which had achieved unrivalled success on the inflation front, money-market rates remained well below those in other countries despite a short-lived rise in the spring and summer of 1977, when the authorities took advantage of a temporary weakening of the Swiss franc to intensify their efforts to moderate monetary expansion.

Bank prime lending rates in the United States rose by 2 percentage points between April 1977 and May 1978: in the process there was a narrowing of the rather wide margin between these rates and commercial paper rates which had emerged in the context of concern regarding credit risks during the recession. In Japan commercial banks' lending rates were reduced last year in step with the Bank of Japan's discount rate. In Germany interest rates on current-account credits responded rather slowly to the decline in money-market rates but rates on mortgage lending declined by nearly 1½ percentage points in the twelve-month period ending in April 1978. In Switzerland mortgage interest rates fell by ½ percentage point in conjunction with further reductions in rates paid on cash bonds issued by the banks.

On the capital market, yields in the United States generally remained remarkably stable in the course of 1977, then rose in early 1978. No doubt the high underlying rate of inflation, which by early 1978 seemed to be rising, was the main influence. The market was not subjected to major borrowing pressures from either the public or the private sector. In Germany long-term interest rates continued to decline fairly rapidly until the autumn, by which time the margin between these rates and money-market rates was unusually narrow. Following short-term rates, yields moved further down in early 1978 to establish new post-war lows. In Switzerland bond yields declined quite sharply in the winter and spring of this year but still seem high in relation to the rate of inflation; for technical reasons institutional investors were apparently reluctant to commit funds at long term at low nominal rates. Bond yields may have remained fairly high in real terms in Japan, too, despite their substantial decline in nominal terms.

In Europe falls in money-market rates during the spring and summer were fairly widespread. Belgium and the Netherlands had warded off speculative attacks on their currencies in the exchange markets and were taking steps to ease bank liquidity. When new pressures emerged within the European "snake", Belgian and Dutch money-market rates responded in the now familiar way, only to fall again in early 1978. In Denmark and Sweden, on the other hand, short-term interest rates were held close to the high levels to which they had been raised in 1976, even after the Swedish krona left the "snake" and the Danish krone was devalued within it in August. Only limited declines were encouraged in early 1978. In Belgium and the Netherlands capital-market rates, influenced to different degrees by the rise in short-term rates in late 1977, fell very little on balance between early 1977 and the spring of this year, bearing in mind the slowdown of inflation in these countries. Large-scale borrowing on the market by the public sector and, in the case of the Netherlands, by the banks in response to restrictions on the growth of their monetary liabilities may have been an influence. In Sweden bond yields remained stable during 1977 and rose in March 1978, while in Denmark there was a further rise in 1977, followed by a limited decline in early 1978.

Short-term interest rates dropped very steeply during 1977 in Italy and the United Kingdom and a fall also occurred in France in January–September, in conjunction with improvements in these countries' external positions and the general weakening of the dollar. In France money-market rates moved up sharply in early 1978 when the French franc came under pressure, but by April were back to mid-1977 levels. In the United Kingdom the downward movement in interest rates was checked briefly in May–June in the context of uncertainties regarding the official money supply and exchange rate objectives. Subsequently, the pound was floated and the authorities encouraged a rise in money-market rates, which by then stood very low in relation to bond yields even though the latter had also undergone a sharp fall. In early 1978, against the background of fresh uncertainties regarding the prospects for inflation, both short and long-term interest rates moved upwards.

Whereas in the United Kingdom developments in money-market rates were broadly reflected in movements in prime lending rates, these rates recorded little change during the year in France, while in Italy they were adjusted downwards only with a delay. Bond yields remained fairly stable during 1977 in Italy and France; in early 1978 there was a temporary rise in France and a decline in Italy.

III. DOMESTIC POLICIES FOR GROWTH, PRICE STABILITY AND EXTERNAL ADJUSTMENT.

Viewed in terms of growth and employment, the past year has been one of disappointed expectations. Industrial countries other than the United States drifted further from their desired path of gradual expansion. And the modest goal of a return to satisfactory employment levels by the turn of the decade was in jeopardy only a year or so after it had been formulated. On the other hand, helped in some cases by currency appreciation, inflation rates in most industrial countries have further receded in line with expectations.

In the spring of 1977 hopes had been strong that economic expansion could continue in a context of national economic policies differentiated to take account of external adjustment requirements and of differences in inflation rates. In the event, the actual paths followed by individual countries did not add up to a consistent whole. On the one hand, among the so-called "locomotive" countries, recovery in the United States proceeded quite strongly, but economic activity in Japan and Germany fell well short of expectations. On the other hand, diverse restrictive actions taken in a large number of developed and developing countries, usually for both external and domestic reasons, set off contractionary forces of unexpected strength. On balance, these disparate tendencies contributed to a marked slowing-down of real output and trade growth and to extensive exchange rate realignments.

Since last autumn a number of countries, not least Japan and Germany, have introduced new expansionary measures. In consequence, there is now some hope, tempered by last year's disappointments, that output in the industrial countries will move on an upward, more convergent course. But such an outcome can by no means be taken for granted; its realisation may well depend upon further stimulatory action being taken by those countries best placed to do so.

It cannot be ignored, however, that there have been substantial differences in the way in which countries perceive existing problems of national stabilisation and international adjustment — differences that will continue to influence policy choices and the course of events. These differences express themselves partly in the weight given to the broad targets of policy: inflation, unemployment and external adjustment. But they are also reflected in the varying importance attached to cyclical as opposed to structural imbalances and, following in part from this, to the rôle of demand management as opposed to reliance on market adjustment forces and selective measures. Practically everywhere, moreover, discretionary action to stimulate demand has become more problematical as a result of the growing sensitivity of market participants to changes in prices, wages and financial conditions. Against this background, national authorities have been experimenting further with innovative policy approaches and techniques, such as monetary targets and incomes policies, to achieve moderate growth together with a continued slowing-down of inflation.

A considerable risk remains that recovery will continue to falter if countries go on seeking solutions to their problems on a narrow national plane. This realisation has led national authorities to discuss the feasibility of a more concerted approach that would reciprocally ease the external constraints facing many countries.

Policy problems in long-term perspective.

However, before turning to policy strategies and techniques, it would seem appropriate to take a brief retrospective look at the emergence and development of today's common problems.

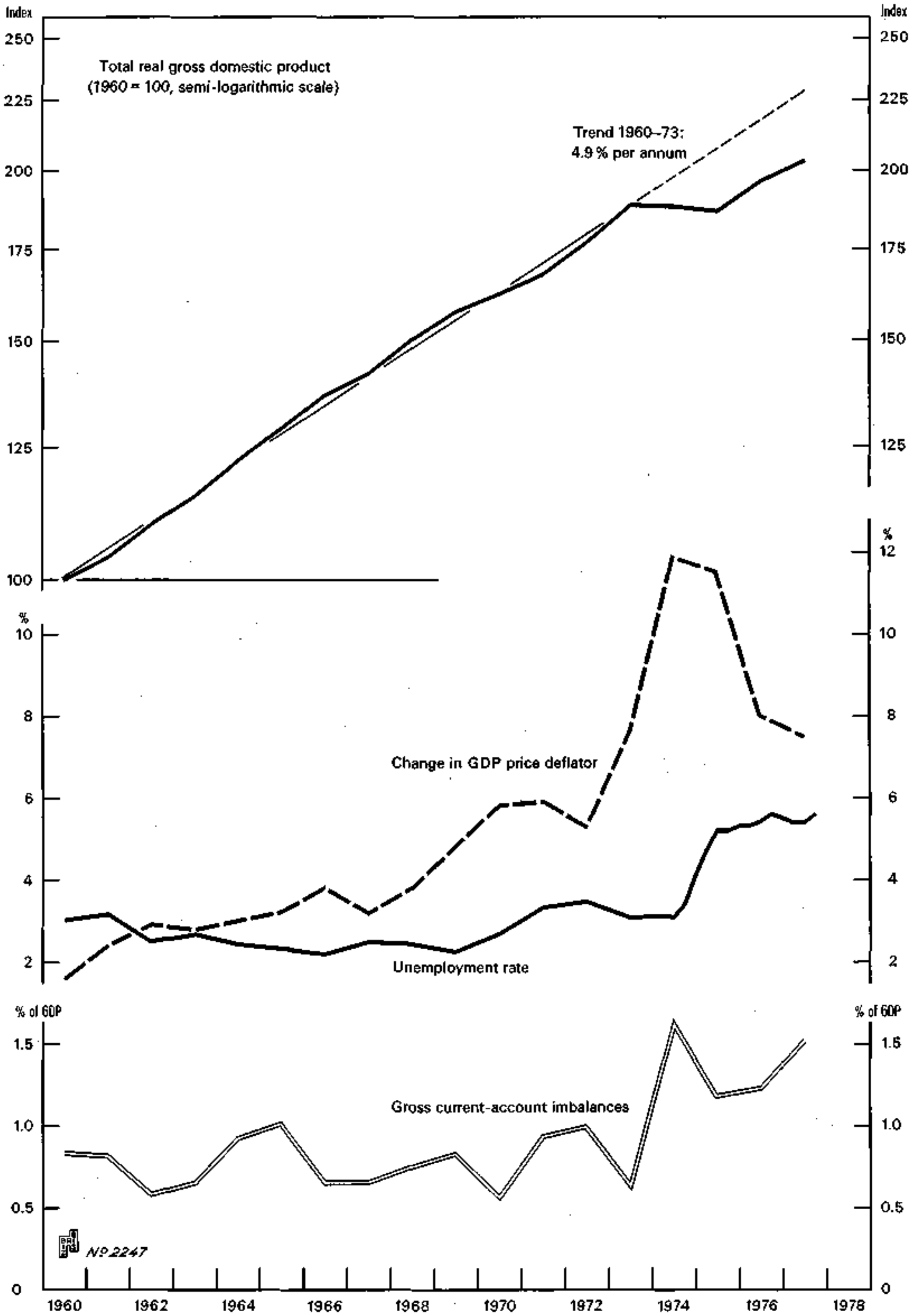
As reflected in the accompanying graph, the present situation in the industrial countries has no precedent in the post-war period. Compared with the previously established trend of output, the current growth recession is by far the deepest and the longest yet experienced. In addition, since the output trough in 1975 the recovery has been below even the relatively modest growth target agreed among the governments of the countries concerned. Not surprisingly, therefore, the rise in total unemployment has been the sharpest since the war and its continuation at a very high level parallels the continuation of output levels below previous trends.

The graph also shows that the superlatives do not end here. Inflation and the extent of external imbalance have also reached new peaks since the oil crisis — though the former has now abated quite significantly. Although the acceleration in the rate of increase of domestic prices was most pronounced in 1973–74, the situation had been deteriorating perceptibly for perhaps a decade before this. In Europe especially, wage-cost pressures had surfaced in the second half of the 1960s, and the United States had experienced excess demand pressures at the time of the war in Vietnam. Moreover, largely as a consequence of the transmission mechanism under fixed exchange parities, rates of monetary expansion were high throughout the industrial world. The situation was therefore already rather fragile when governments turned simultaneously to expansionary policies in 1972 and 1973. Then, on top of the short but rapid rise in demand and output which ensued, there came a series of unhappy accidents such as bad harvests and the like, further fuelled by speculation in some non-perishable commodity markets, which contributed to an alarming increase in primary commodity prices. And of course the whole episode was capped by the massive administered rise in the price of oil in 1973–74.

The last event naturally gave considerable impetus to price inflation, but it also seriously exacerbated existing payments imbalances. The lower section of the graph gives a very crude measure of gross current-account imbalances in the OECD area. It is merely the sum of the absolute current-account positions (that is, ignoring signs) of all OECD countries expressed as a percentage of nominal output. Despite the simplicity of the measure, the message conveyed is clear, namely that international payments disequilibria have attained unprecedented proportions in the most recent period.

In sum, governments have in these years failed to achieve any of the four post-war goals of macro-economic policy: growth, high employment, stable prices and external equilibrium.

OECD countries: Growth, inflation, unemployment and external imbalance.



However, just as signs of growing inflationary problems were discernible prior to the oil crisis, so there was some tendency for unemployment rates to edge up earlier. In part, of course, the two may well have been linked, governments being pushed towards some demand restraint in order to counteract inflationary pressure. Many, however, perceive in addition some increase in the rôle played by structural factors. Some of these might have arisen in the labour market itself — the mismatching of the skills of job-seekers and the requirements of job vacancies. Others might be connected with the higher levels of unemployment compensation which now prevail, giving greater incentive, for example, to lengthen the period spent searching for a new and more congenial job. Still further structural elements in unemployment may lie in the failure to adjust industrial structures sufficiently quickly to new patterns of demand, to the requirements of external equilibrium or to the growth of industries in some developing countries.

Whatever the precise impact of such factors, the graph nevertheless gives the clear impression that another element played a strong rôle in 1974–75, namely a deficiency of demand compared with potential supply. The marked deviation of output from its previous trend was accompanied, after the normal lag, by a pronounced rise in unemployment both of the labour force and of the capital stock.

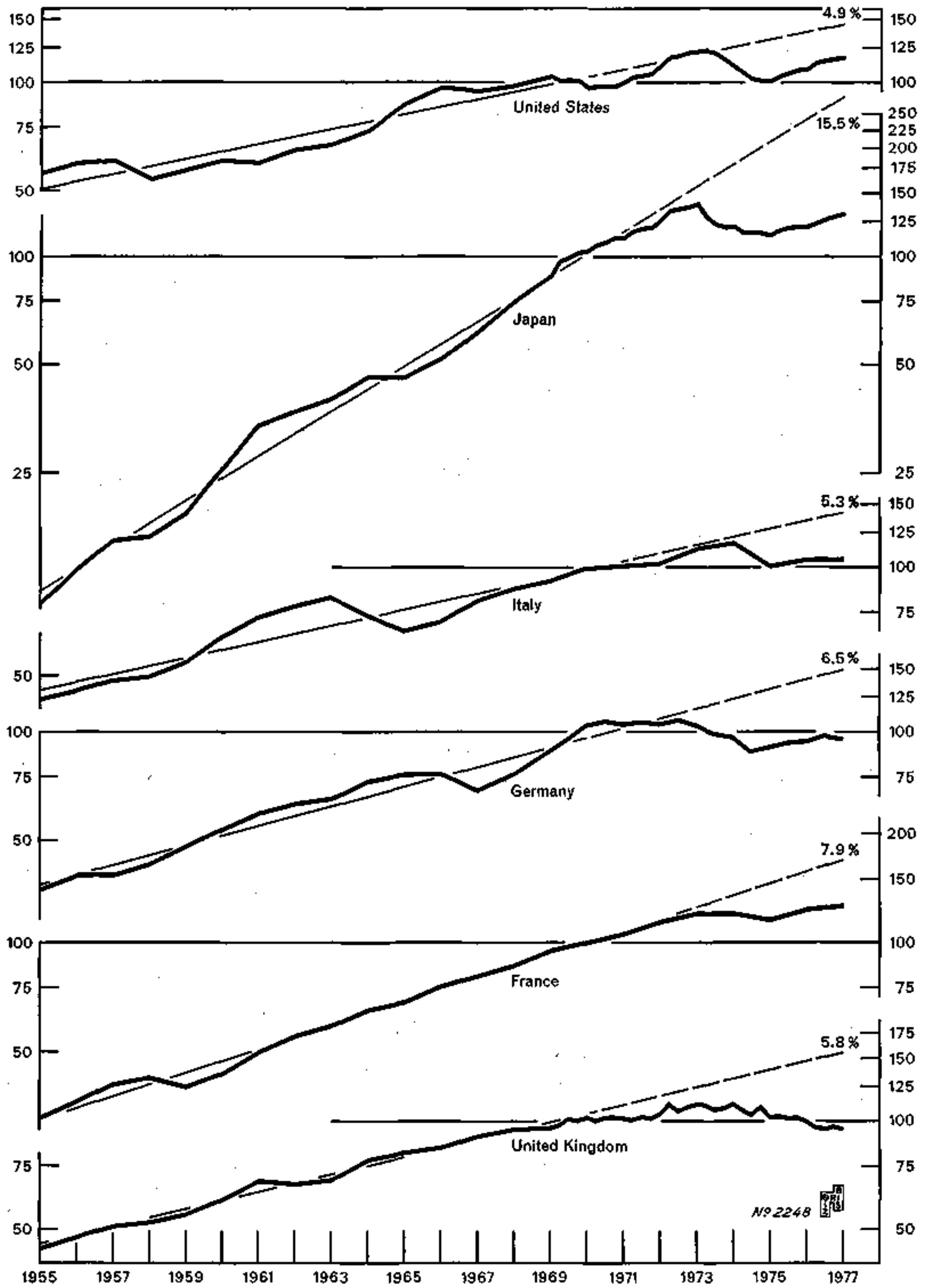
The demand-contractionary effects of the oil price rise and the resulting OPEC surplus are now commonly acknowledged by economic observers. Some of the "low absorber" oil-producing countries in effect sharply increased their saving without investment there or elsewhere rising proportionately. Governments in the major oil-importing countries found themselves apparently required to run what came to be known as "oil deficits" in order to offset the OPEC surplus, which would have meant allowing budget deficits to widen further. But even without this inhibition, there never in fact emerged an acceptable formula for sharing out the counterpart of the OPEC surplus. Reactions to balance-of-payments deficits were varied but in some cases tended to be of the traditional domestic restraint kind.

There were, however, other constraints on both governments and private spending agents. Inflation no doubt played a key rôle both in a fairly direct manner and by raising the degree of uncertainty faced by decision-makers. One clear example in many countries was the way in which personal savings ratios rose as inflation accelerated. This may have been an attempt to rebuild the real value of financial wealth, which was being seriously eroded by high rates of inflation and also by capital losses on securities as interest rates rose. But of course general uncertainty, especially about employment prospects, may also have played a part.

Business fixed investment spending has also weakened sharply during the recession by comparison with previous trends, as is reflected in the graph on page 43. Sluggishness of total demand and the accompanying rise in idle plant capacity have no doubt been important contributory influences. But again inflation is almost certainly an inhibiting factor. For not only does it give rise to uncertainties about the future trend of sales, given that governments might feel forced to act restrictively, but pressure from the cost side has in many countries led to an erosion of profit margins. Such a development is, of course, to some degree usual in a recession, but in certain countries profitability had been on a downward trend

The real growth of non-residential fixed investment.*

Annual and quarterly indices: 1970 = 100 (semi-logarithmic scale).



* Includes public-sector investment. Trend lines relate to the years 1960–73.

for some time before the oil crisis. It is this circumstance which raises doubts in some minds as to whether stimulative policies could now have their usual output and employment effects. In other words, investment might not respond even to higher demand until the underlying cost/price situation has become more favourable. Uncertainties about exchange rates are another inhibiting factor. The prolonged and sizable shortfall of investment in comparison with previous trends also raises serious doubts about the possibility of returning to near the former trend of total output increase. Such a considerable shortfall may well be reducing the output capacity of the capital stock, particularly since some of the investment which is taking place is connected with new environmental standards or structural adaptation to the change in relative energy prices, rather than with capacity expansion. We may therefore be witnessing some slowdown in the underlying potential growth rate of output in the industrial world, especially if such weak investment trends continue.

On top of the depressive effects of the OPEC surplus and cautious private spending behaviour, governments have in some respects been a conservative influence. It is not just that many countries wished to slow down the upward trend of public spending — the resulting deflationary impact could have been offset by cutting taxes. More important is the extent to which caution has been observed in regard to net government spending, that is to say budget deficits. This may seem a paradoxical statement after a period in which budget deficits have reached not only record absolute levels, but also record proportions of gross national product. The point is, however, that the oil producers' surplus and the abnormal ex ante savings/investment imbalance in other countries took an unusually large amount of demand out of the system. Only governments, it seemed, could put it back, but at the expense of very large fiscal deficits. In the minds of both governments and the public, however, such deficits are inextricably bound up with the risk of causing worse inflation. And, indeed, it is often through the budget deficit that new money is created which can cause, or accommodate, inflationary pressures. There has been a stalemate between the desire to replace missing demand, on the one hand, and a reluctance to accommodate cost inflation, on the other.

Policy strategies a year ago.

By the spring of 1977 continued economic recovery was seen to depend heavily upon developments in the United States, Japan and the strong-currency countries of western Europe. Elsewhere policies of restraint, related partly to external requirements, were being put into force or were in prospect. Three large countries — the United Kingdom, France and Italy — were in the midst of major stabilisation programmes. Austria, Belgium and the Netherlands found restrictive policies necessary to keep their currencies in line with the Deutsche Mark. And there was a patent need for a number of smaller European countries to reduce their persisting external deficits. Outside western Europe, too, similar needs were evident in many countries, both more and less developed.

In global adjustment terms, what was broadly implied was the need for some reversal of the contrasting rôles played by various countries after the oil price rise.

While in the initial phase a number of countries had taken measures to sustain demand and employment, the United States, Germany and Japan had sharply restrained their economies in the interests of combating inflation. Now it was time for the pendulum to swing the other way, with the three major economies being expected to give impetus to world demand, thus facilitating the adjustment efforts of other countries.

Although in some quarters the "locomotive" approach was challenged from the start, official forecasts of real output growth in 1977 (about 5 per cent. in the United States and Germany, 6.7 per cent. on a fiscal year basis in Japan) did lend it some credibility. Stimulatory fiscal measures had been taken in all three countries, and the authorities in each of them had underscored their resolve to take additional action if necessary to keep output moving along the desired medium-term path of moderate growth consistent with declining inflation rates.

Beneath the surface, however, substantial differences were apparent both in economic circumstances and in policy approaches. In the United States the authorities felt that, leaving aside the question of energy policy, the way had been cleared for a period of sustained demand expansion. In their view corporate balance sheets had undergone a major restructuring, cost/price relationships were more or less back to normal, wage behaviour was moderate and existing economic slack would provide adequate insurance against a rekindling of inflation. In Germany, however, confidence in demand management was much less sanguine, partly because of the sensitivity of financial markets to a discretionary policy stimulus but partly also because the rise of labour costs relative to prices in the 1970s was held to be a structural problem. Thus, although there was a recognised need to increase business profitability and investment, it was believed that any demand stimulus beyond certain narrow limits would tend merely to activate further rises in prices, wages and interest rates. Hence the only route to sustained expansion lay in very moderate policies conducted in the context of monetary targets aiming at a gradual market-oriented return to full price stability.

In Japan willingness to reflate had been conditioned by memories of the 1973–74 bout of inflation and an awareness of longer-term structural problems, both real and financial. Indeed, it had been Japan's efforts to adjust quickly to a slower long-term rate of growth, perhaps half as high as the earlier trend, that had exacerbated its cyclical slump and external surplus. The reflationary measures so far introduced had been applied in cautious doses and with little immediate effect.

There were other potential sources of demand strength apart from the three major economies. The Netherlands and, by international standards, Belgium had strong current-account positions, and any weakness shown by their currencies was relative to the standard required to keep up with the Deutsche Mark within the "snake" arrangement. In Belgium fiscal policy was guardedly expansive, aimed partly at stimulating flagging investment, while in the Netherlands policy action was constrained by continuing efforts to reduce the relative size of the public sector and to bring credit expansion under better control. Switzerland, moreover, had a remarkably large current-account surplus, but as unemployment was low it judged the surplus to be mainly structural and not amenable to demand management. To some extent Germany and Japan also viewed themselves as having structural external surpluses.

In other countries, many of which had accumulated large external deficits over several years, restrictive measures were the order of the day.

After putting together a comprehensive programme consisting of a monetary target, public expenditure restraints, an incomes policy and international financial support arrangements, the United Kingdom managed to apply effective curbs to domestic expenditure. Although industrial output declined during the year and the external accounts turned round sharply, the need to bring down inflation continued to be given priority. Tax concessions in the March 1977 Budget were made broadly conditional upon continued restraint on the wages front.

In Italy, too, output was already heading downwards in the spring of 1977 as a result of earlier measures of restraint. These had included increases in taxes and in charges for public services and the introduction of a compulsory savings scheme in respect of increases in incomes above a moderate level. At the same time, some modification of existing wage-indexation arrangements was achieved and, to encourage investment, the burden of social security charges on industry was further reduced.

In France policy strategy in the spring of 1977 was still basically that set out in the anti-inflationary programme introduced the previous September. The principal elements of this programme (the "Barre Plan") consisted of a monetary growth target for 1977, a tightening of fiscal policy combined with some stimulus to public and private investment, a partial price freeze and an incomes policy involving wage norms applicable in both the public and the private sectors. In early 1977, against a background of improved price performance but slowing output growth, only moderate fiscal measures were taken to sustain investment and consumption.

In various other industrial countries persisting large external deficits and continuing inflation had necessitated the maintenance or tightening of restrictive policies. In Finland the severe monetary and fiscal restraint programme adopted in 1976 was continued into 1977. Denmark and Austria also adopted a more restrictive monetary and fiscal stance, while Norway moved further in the direction of monetary restraint. On the other hand, in Canada, following an earlier reduction in the target for monetary growth, fiscal policy was made more expansionary, with some encouragement being given to business investment. Sweden, which had long been taking measures to sustain domestic demand, also continued to pursue relatively expansionary policies. Among the southern European countries, Spain, Portugal and Greece were all operating under the influence of policies adopted to reduce inflation and very large external deficits.

Divergences in behaviour patterns.

Economic developments last year, though in some individual respects encouraging, added up in global terms to an unsettling picture. A general feature was the vigour with which a large number of high-inflation, deficit countries pursued their aims of stabilisation and adjustment. In retrospect, it is doubtful whether any imaginable degree of motive force from the stronger countries could have kept world demand on a buoyant upward course against the overall drag implicit in these developments, which were dictated as much by domestic considerations as by external ones. On the other hand, the failure of the stronger countries, with the exception of the United States, to provide a more sustaining stimulus to world demand almost certainly tilted the balance towards much slower real growth.

One of the contractionary influences was the appreciation of various currencies vis-à-vis the US dollar. This appreciation implied, in the short run at least, a decline in the profitability of export industries in some western European countries and Japan and thus came as a further blow to business confidence and investment prospects. For the United States these developments also touched on sensitive issues. To what extent, given the international rôle of the dollar and the continuing lack of an effective energy policy, was it in the United States' own long-term interests to put domestic expansion before international monetary stability? And where, if a trade-off between the two actually existed, did the interests of other countries lie?

The economic and financial developments of 1977–78 have been described in detail in Chapter II. In brief, the upswing in the United States followed quite traditional cyclical lines. Though the recession had been deep and protracted, easy credit-market conditions had given a strong impetus to housing construction and spending on consumer durable goods, with business fixed investment finally showing signs of a sound recovery. In Germany, on the other hand, a continuing squeeze on profits, the unexpected weakness of foreign markets, institutional difficulties in launching planned energy-related investment projects and continuing efforts towards budget consolidation added up to slower-than-expected growth. In Japan fiscal conservatism and a rising exchange rate, against a background of radically changed growth prospects, large excess capacity and a heavy overhang of stocks, resulted in the persistence of very weak domestic demand, notwithstanding the strong momentum of exports. In practically all other countries, with policies leaning in varying degrees towards restraint and external demand tending to weaken, output growth slowed down or gave way to actual decline.

One of the principal lessons to emerge from this experience is an analytically familiar one: that external current-account positions continue to be very responsive to relative changes in domestic demand conditions. To illustrate this point in longer-term perspective, the table below shows the behaviour of real domestic demand, together with real exports and imports of goods and services, over each of the last three four-year cycles, roughly similar internationally in terms of timing. Countries are divided into three groups, with both the groups and the countries within them being ranked according to the degree to which the average compounded growth rates of domestic demand in the 1973–77 cycle have fallen short of the corresponding averages in the years 1965–73.

These data help to demonstrate two important propositions. On the one hand, differences in economic growth performance among countries have, if anything, been even smaller in the 1973–77 period than in the earlier ones. Thus, despite the alleged insulating effect of floating exchange rates, the real transmission mechanism (as distinct from the financial one) seems to function much as before, and the recession has been truly global in scope. On the other hand, divergences in individual countries' growth behaviour *from their own past performances* appear to have been a major contributing factor to the diverging pattern of external imbalances.

Changing cyclical patterns of expansion and external adjustment.*

Countries	Real growth of: domestic demand			Real growth of: exports of goods and services			Real growth of: imports of goods and services			Balance of payments on current account	
	1965–69	1969–73	1973–77	1965–69	1969–73	1973–77	1965–69	1969–73	1973–77	1973	1977
	in percentages, at compounded annual rates									in billions of US dollars	
Japan	11.4	9.4	1.6	15.6	11.8	13.1	15.3	13.7	3.3	−0.1	11.0
Switzerland	3.5	4.7	−2.1	11.8	6.8	3.4	9.0	9.2	0.7	0.3	3.7
Italy	6.2	4.9	0.5	11.8	7.1	8.2	13.3	9.9	1.2	−2.7	2.3
Finland	3.3	6.4	0.7	10.1	7.2	1.1	5.1	8.8	−0.6	−0.4	− 0.2
Spain	6.2	6.8	2.0	13.0	13.5	4.5	8.0	10.9	0.8	0.6	− 2.3
United Kingdom	1.9	4.0	−1.4	6.6	6.4	4.1	5.1	8.0	0.8	−2.2	0.0
Denmark	5.1	3.6	0.9	7.0	7.6	2.6	7.6	8.0	0.9	−0.5	− 1.6
France	6.2	5.5	2.5	10.3	13.5	6.0	13.8	11.8	4.6	−0.7	− 3.2
Germany	3.5	4.4	1.5	10.3	7.8	4.8	7.3	8.6	5.4	4.3	3.9
Netherlands	5.5	4.0	2.5	9.9	11.8	1.8	9.9	9.2	1.9	2.4	0.3
Belgium	4.4	5.5	2.7	9.9	10.9	3.9	10.2	10.6	4.4	1.2	− 0.3
Australia	4.9	4.8	2.7	8.1	7.0	3.7	4.3	6.0	4.8	0.5	− 2.7
Austria	3.8	7.0	3.3	8.8	11.9	3.8	6.4	14.0	5.4	−0.4	− 3.0
Canada	5.3	5.7	3.6	11.4	7.6	2.2	10.1	7.6	4.2	0.0	− 4.0
United States	4.2	3.3	1.9	6.2	8.8	2.8	11.6	5.9	2.4	−0.4	−20.2
Sweden	3.6	1.7	1.9	8.4	9.9	0.5	7.5	5.7	4.1	1.2	− 3.3
Norway	3.8	5.3	5.4	8.6	6.2	5.1	6.2	8.2	6.4	−0.3	− 4.9

* Countries are ranked according to the extent to which the annual growth rates of their domestic demand in the period 1973–77 differed from the corresponding growth rates over the years 1965–73.

Looking more closely at the latter proposition, the first group of countries consists of those in which the setback in domestic demand performance in 1973–77 has been most pronounced compared with previous behaviour. Concurrently, in all of these countries, there was a marked increase in real exports in relation to imports, suggesting that the relative weakness of domestic demand helped to improve net exports at the expense of other countries. Denmark, France, Italy and the United Kingdom are understandably in this group, particularly as their current accounts were already in large deficit even before the oil price increase. Moreover, these countries, together with Spain and Finland, were generally hard hit by terms-of-trade changes after 1973. But, viewed internationally, the presence at the top of this group of Japan, and Switzerland on its smaller scale, proved to be very disturbing. Both countries would argue that structural factors, associated with a sharp change in growth prospects, have been a major reason.

At the other extreme, the third group consists of countries where domestic demand was relatively well sustained over the years 1973–77 as a whole, often as a result of deliberate policy. The United States, it is true, was a late-comer to this group, following its buoyant expansion over the past year or so. All these countries experienced very large setbacks in their current-account positions between 1973 and 1977.

In the middle group are Germany, the Netherlands and Belgium, whose current-account surpluses declined somewhat between 1973 and 1977. Thus, with domestic demand performance on balance nearer the international average, results on external account recorded little net change. Interestingly, Germany showed a very high price elasticity of demand for imports of goods and services and, indeed, ranked in 1973–77 above most countries in terms of real import growth. But, as exports also rose considerably, its external surplus declined only moderately. For Belgium and the Netherlands, both with higher inflation rates than Germany, continued participation in the "snake" arrangement necessitated relatively restrictive monetary policies over the years 1973–77.

All in all, the results recorded in the table make disconcerting reading. In response to the oil crisis, which itself affected countries in varying degrees, national authorities have reacted at the domestic level in quite disparate ways, the outcome being a wide spectrum of external surpluses and deficits. Are these differences somehow basically rooted in the economic, financial and institutional structures of the countries concerned? Or are they more simply a matter of differences in the attitudes and priorities of the respective policy-making authorities? It has been said of the Bretton Woods system that it was too inflexible to accommodate the wide differences in country behaviour. But even with flexible exchange rates, wide divergences in external positions have brought extreme pressure to bear on many deficit countries — pressure that has begun to endanger the foundations of free trade and payments.

New responses and present policy stances.

Developments over the past year have evoked many new policy responses, as described in Chapter II, and have paved the way for further action. The latest contractionary phase is well advanced, and the question is whether the path has now been cleared for a fairly generalised increase in economic activity accompanied by an improvement in external balances of payments and a continuation of moderate price behaviour. The answer to this question lies largely in the present policy stances and attitudes of the principal industrial countries.

And the answer is not a simple one. While all these countries share the common aim of achieving satisfactory levels of employment and — within the limits of potential — sustained economic growth, there continue to be fundamental differences on the issue *how* these goals can best be achieved. One view puts emphasis on the short-term need to reduce unemployment by means of a conventional "demand management" stimulus calculated to speed up growth. A contrasting view, stressing rather the need for a protracted recuperation from many years of high inflation and accumulating structural distortions, sees only limited scope for discretionary action to stimulate demand. The differing degrees to which national policies have been influenced by these opposing views help to explain the continuing divergences in countries' actual performances, both domestically and internationally.

As far as the United States is concerned, a sustained expansion of demand has been considered necessary to reduce unemployment, increase profitability and encourage a higher rate of business fixed investment. Against the background of a buoyant private-sector upswing, and with the overall public-sector deficit low by international standards, the Administration has sought to put together a policy mix that would keep real output growing at about 4½–5 per cent. in 1978 and 1979. In January 1978 a programme of tax reductions was proposed, with special emphasis on incentives for investment, in order to offset the effects of fiscal drag and higher social security taxes. A voluntary incomes programme was subsequently introduced, with a 5½ per cent. limit on central-government wage and salary increases and a norm to curb private-sector wage and price rises. However, with wages and prices recently accelerating from an already high rate of increase, US policy-makers have begun to question whether a tax cut of the proposed size would be consistent with the need to bring inflation back under better control.

In Germany the authorities took various steps in the spring and summer of 1977 to stimulate public and private investment. These were followed in September, when the 1978 Budget was announced, by a sizable package of expansionary measures, involving a substantial increase in the public-sector financial deficit in 1978. The expected deficit, though appreciably larger in relation to the gross national product than in the United States, must be seen in the light of high rates of private saving; nevertheless, it has strongly inhibited further policy action. Moreover, as the basic aim remains that of reducing — and even eliminating — inflation, the authorities have adopted a wait-and-see stance until the effects of recent measures can be ascertained. Policies are based on the fundamental assumption that a price-level-oriented policy of demand management will help both to bring down inflation and to alter cost/price relationships so as to encourage investment. While the latter expectation may be optimistic, given that cost/price relationships sometimes lead a life of their own, the authorities believe it to be more soundly based than seeking to increase investment by still more stimulus from the demand side.

In Japan awareness has grown that a belated, sudden shift from a very high to a more moderate rate of growth, though perhaps warranted as a long-term objective, has greatly complicated the country's cyclical and external problems. In recent years, with the growth of domestic demand a shadow of its former self, companies have shown little propensity to invest, the less so because of the cost burden of heavy dependence on borrowed funds and of "lifetime employment" practices. If anything, the very weakness of investment demand, given the ease with which investment goods output can be shifted from domestic to external markets, has led to further dependence on exports. In these circumstances the authorities have stepped up their efforts to stimulate domestic demand, mainly by increasing public expenditure and lowering interest rates, but they have continued to hold back from granting sizable tax reductions.

Japan is aiming to achieve 7 per cent. growth in real output in the fiscal year 1978–79, while Germany has forecast that output will be rising by late 1978 at an annual rate of about 4½ per cent. However, the exchange rate appreciation experienced by both countries has cast an ominous shadow over these prospects.

In countries participating in (or closely linked to) the "snake" arrangement, faster growth in Germany would ease, but not remove, constraints on further policy action. In Austria, Denmark and Norway current-account deficits have been unusually large and restrictive policies continue to be indicated. On the other hand, Belgium and the Netherlands have met with considerable success in bringing inflation rates down, and last autumn the Netherlands announced a moderately expansionary budget for 1978. However, both countries feel themselves inhibited by structural difficulties. The Netherlands, whose external position has benefited for some years from its exports of natural gas, is sensitive to a loss of competitiveness in traditional exports. A closely related problem is the protracted redistribution in favour of labour income at the expense of profits — a process accentuated by workers' responses to the high level of taxation on productive incomes that is needed to cover a heavy burden of transfer payments. In Belgium structural problems are to be seen more in terms of the adjustments required in declining industries, such as steel and textiles.

Switzerland has undertaken no reflationary measures apart from ensuring that monetary targets were sufficient to allow for some recovery in real output, and indeed a moderate cyclical recovery seems to have set in over the past year. However, with a slower growth trend in prospect, partly because of an earlier sharp curtailment in construction capacity and an exodus of foreign workers, the authorities tend to view the huge current-account surplus as largely structural.

Turning to the so-called "convalescent" countries, perhaps the most remarkable turn-round has been experienced by the United Kingdom, largely because of the stabilisation measures put into effect over a year ago but also partly owing to the Government's tenacity in pursuing price and wage restraint for a third year. With inflation still the major preoccupation, the authorities decided in the autumn of 1977 to let the exchange rate appreciate rather than to risk a breach of their monetary target. More recently, the stronger external position and continuing high unemployment have prompted the Government to take stimulatory fiscal action, though it has been tempered by re-emerging concern about accelerating monetary growth and balance-of-payments prospects. The emphasis has been placed almost entirely on tax reductions with a view to enhancing work incentives and strengthening the basis for continued wage restraint.

In three other countries — France, Italy and Spain — stabilisation policies have led to a significant improvement in the external accounts. Indeed, it might now be possible for the authorities to relax their policies to some modest degree should external demand improve. At the same time, the inflation rate remains quite high, especially in Italy and Spain, so that domestic constraints would still inhibit stimulatory action. All these countries expect growth to remain below potential. In Italy adverse trends in terms of a growing burden of public expenditure, a rising share of labour income and a severe weakening of company profitability are all symptomatic of a larger structural problem. In Italy, Spain and other southern European countries, moreover, the problem of unemployment has been intensified by the return of workers from the now slower-growing economies elsewhere in Europe.

Policy instruments and options: An assessment.

In recent years much controversy and pessimism have developed concerning the efficacy of the conventional tools of policy management, particularly with respect to the discretionary use of monetary and fiscal policy. One alleged defect is that activist policies of short-run stimulus tend to be biased in favour of output, employment and income redistribution at the expense of price stability and business profitability. Another is that policy-makers too often get their timing wrong, with the result that policy effects tend in the event to be pro-cyclical. Still another is that participants in goods, labour and financial markets have become increasingly sensitive to the implications of policy changes. In consequence, they tend to react, either as market conditions actually change or in anticipation of such changes, in ways affecting prices, wages and interest rates rather than real output and employment. There is no doubt a good deal of truth in these views, particularly in today's highly organised markets. Not surprisingly, national authorities have been experimenting with new techniques to make their policy efforts more effective.

Monetary targets, interest rates and exchange rates. One significant development in recent years has been the spreading use of publicly announced monetary targets. While this practice is partly a product of the increasing attention given in the 1960s to the monetary aggregates, its adoption was finally prompted more by the outbreak of high inflation combined with growing unemployment in the 1970s. Monetary authorities saw targets as a way of providing the expectational framework needed to bring their economies gradually back to lower inflation rates while at the same time reducing unemployment. In this sense, monetary targeting fitted neatly into a policy strategy of "gradualism" aimed at reducing inflationary expectations and also at coping slowly with problems of structural maladjustment. Moreover, not only were targets readily comprehensible to the public, which could appreciate the link between excessive money creation and inflation, but they could also act as an element of self-discipline for the central bank and fiscal authorities. Among the first countries to adopt targets for monetary aggregates were the United States, Germany, Switzerland, Italy, Spain and Canada. Subsequently, France and the United Kingdom introduced them — initially in the context of broader stabilisation programmes.

In terms of their effects on expectations, one of the principal purposes of monetary targets has been to help shape wage, price and output developments. Thus, by committing themselves in advance to a monetary growth target, the authorities in effect set limits to the extent to which wages and prices could rise without interfering with the fulfilment of expectations regarding real output gains. In practice, targets have generally been set in such a way as to allow for some continuing inflation, though at progressively lower rates, as well as for changes in productivity, capacity utilisation and, perhaps, the income velocity of money. To some extent, therefore, they have served as a kind of incomes policy, or as a reinforcement of such a policy, in that they shift to labour and business responsibility for behaviour inconsistent with the targets, the consequence being lower real output and employment.

Because official targets represent a forward commitment, deviations in money supply growth from the target path tend to unsettle markets, with disturbing implications in terms of inflation and exchange rates. On the other hand, strict adherence to the target path is most easily justifiable if the income velocity of money (or the demand for money) is relatively stable. This stability, as is shown below, is the subject of considerable controversy. Thus, authorities may be torn between trying to achieve more stable money supply growth in line with the targets and departing from them in the short run because of suspected shifts in money demand or to give more weight to, say, interest rates and exchange rates. Some countries try to allow themselves greater flexibility for action by setting ranges rather than specific targets for monetary growth (for example the United States, Canada and the United Kingdom), but this has meant a compromise in terms of market certainty with regard to monetary behaviour.

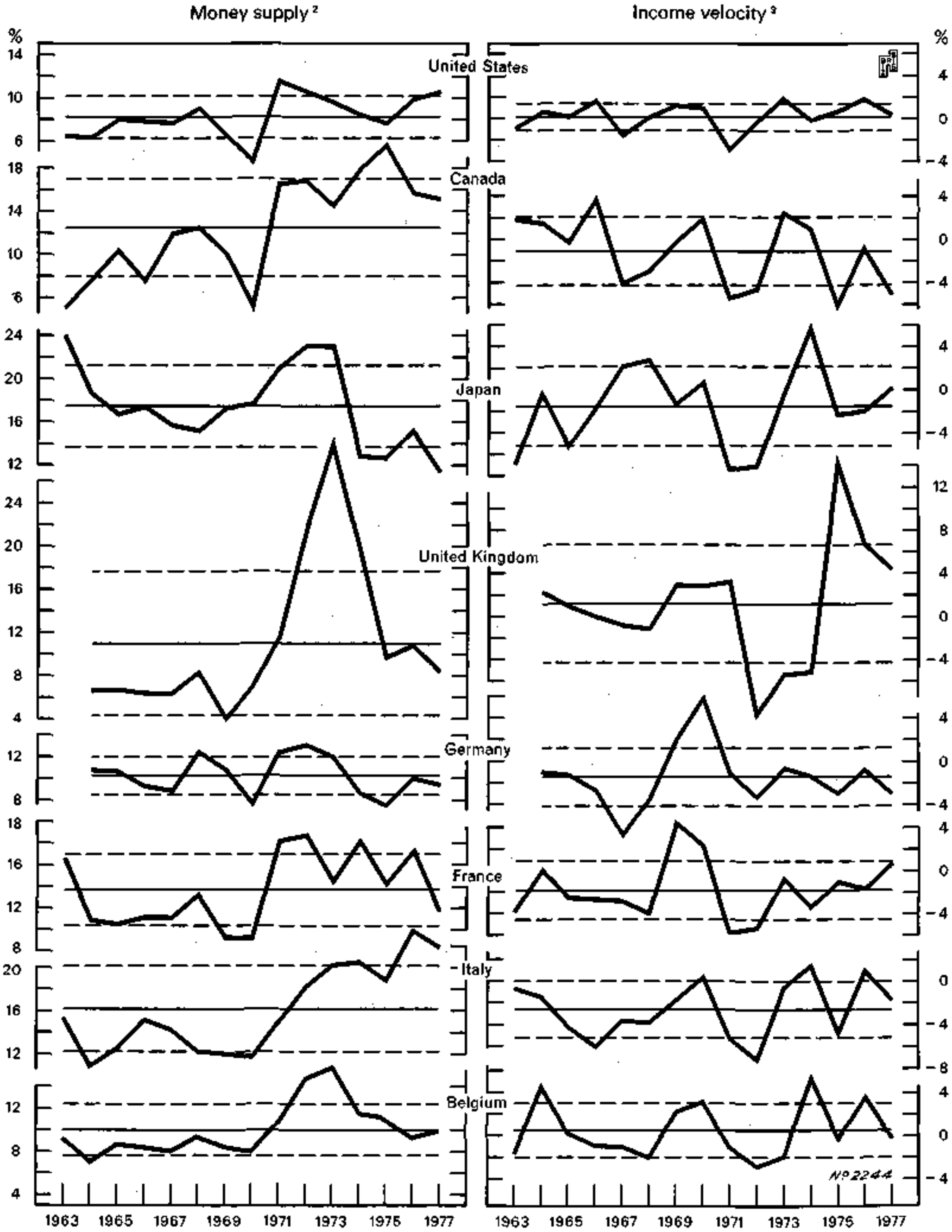
Over the past year, moreover, monetary authorities in various countries have felt it appropriate to depart from their declared targets. In the United States M_1 growth exceeded the upper limit of the target range for much of 1977, the authorities having partially accommodated an apparent increase in the demand for money which was interpreted as a return to normal after an earlier unexpected decline. Whether this overshooting contributed significantly to the concurrent depreciation of the dollar is an intriguing question. At all events, the German and Swiss authorities then felt they had little choice but to intervene heavily to slow down the appreciation of their own currencies. As a result, the growth of central-bank money in Germany moved well above the steady growth path consistent with the target, and in Switzerland monetary growth rose sharply in early 1978. In the United Kingdom, on the other hand, the authorities decided in October 1977 to give up their exchange rate target, based on considerations relating to the competitiveness of non-oil industrial output, in order to keep within their chosen monetary target range.

Might one conclude that monetary authorities are moving, or should move, towards greater flexibility in their adherence to monetary targets? In certain circumstances, yes. It may be recalled that some countries — mainly smaller ones — have expressly rejected the target approach, either in the belief that the demand for money is inherently unstable, or that exchange rate stability is a better route to price stability, or both. For instance, among the countries linking themselves through the "snake" arrangement to the Deutsche Mark, only one — the Netherlands — applies a monetary norm, and that in the form of a national liquidity ratio rather than a monetary target as such. In Japan the authorities apparently feel that the demand for money is not sufficiently predictable to warrant publication of a monetary growth target.

On the other hand, those countries using monetary targets have found them helpful in reducing and controlling inflation and will most probably continue to apply them. The question is whether, now that inflation rates have generally come down quite a lot, the argument for rigid adherence to targets loses some of its force. Under more normal conditions, in other words, greater operational flexibility may be needed to take account of unexpected variations in velocity and the desire for increased exchange rate stability.

One consideration has to do with the stability of the demand for money. In the accompanying graph the left-hand panel shows annual percentage variations in

The variability of the money supply and income velocity.[1]
Annual percentage changes.



[1] The unbroken horizontal line indicates the average annual percentage changes over the whole period in the money supply and in velocity respectively, while the broken lines on either side show the range corresponding to the standard deviation of these changes. [2] M_3 for Germany and the United Kingdom; M_2 for all other countries. Based on annual average data from national sources. [3] Gross national product divided by average money stock.

the broad money supply and the right-hand one shows the corresponding variations in the income velocity of money, i.e. gross national product divided by the money stock. Income velocity, representing the average turnover of money against final output, is closely related to money demand, though it does not take account of the systematic influence of interest rates and certain other factors. However, taking income velocity as a rough indicator, and leaving aside the questions concerning its underlying trend, it seems quite clear that money demand varies substantially over time and in a degree that differs from country to country. Indeed, income velocity appears to be far more stable in the United States than in other countries. And even in the United States its instability has been a source of difficulty for monetary targeting. Hence rigid adherence to monetary targets may at times be destabilising in a short-term context.

Changes in the money supply and income velocity, 1963–77.

Countries	Average growth rate		Standard deviation	
	M_2[1]	velocity[2]	M_2	velocity
	in percentages			
United States	8.3	0.14	1.91	1.26
Belgium	10.0	0.48	2.37	2.50
Italy	16.3	−2.64	4.20	2.84
France	13.7	−1.79	3.28	2.64
Germany	10.3	−1.51	1.72	2.73
Canada	12.5	−1.10	4.55	3.19
Japan	17.5	−1.60	3.78	3.67
United Kingdom	11.0	1.18	6.62	5.46

[1] M_3 for Germany and the United Kingdom. [2] Gross national product divided by the annual average money stock.

External disturbances impinging on exchange rates may also influence official attitudes towards monetary targets in the short run. In Switzerland the authorities have always acknowledged quite explicitly that the need to moderate exchange rate movements might at times have to be given priority over money stock control. And that consideration seems to have been dominant in both Switzerland and Germany much of the time since the autumn of last year. However, in the United Kingdom, where inflation control is still the central economic problem, the authorities opted last autumn to put monetary targets before exchange rate considerations. In the United States, on the other hand, stricter adherence to monetary targets last year would have involved no conflict with the need for greater exchange rate stability.

Fiscal policy. In response to the weakening of economic activity over the past year, a number of countries, not least Japan and Germany, have adopted new stimulatory measures. But in terms of the degree of stimulus the measures taken still reflect basic differences in countries' policy attitudes and priorities.

Whether by deliberate choice or because of unforeseen developments, fiscal policy in many countries became more restrictive in late 1976 and for much of 1977. This is evident from the following table, which for most countries shows a substantial slowing-down in the real growth of public expenditure and in the size of the government's net financial deficit. For reasons already alluded to, particularly those concerning inflation and external adjustment, it is difficult to generalise about this tendency. Beneath the surface, however, there can be detected a growing conservatism in the use of discretionary fiscal policy for economic management. Insofar as this reflects no more than growing disillusionment with economic "fine-tuning", it may be a healthy reaction. In addition, some countries have been seeking, often in a stabilisation context, to correct some of the expenditure excesses of the past. But this being said, taxation and budgetary measures, deployed with due regard for market incentives, are potentially highly versatile and effective policy instruments.

General government: Increase in total expenditure in real terms and net financial deficit.

Countries	Real increase in total expenditure[1]					Net financial deficit (—)				
	1973	1974	1975	1976	1977	1973	1974	1975	1976	1977
	in percentages					as a percentage of gross national product				
United States	3.2	3.2	6.0	2.0	3.0	0.5	— 0.2	— 4.2	— 2.1	— 1.1
Germany	7.3	7.7	6.2	3.6	3.4	1.2	— 1.4	— 5.8	— 3.6	— 2.7
France	5.5	6.0	9.8	4.7	5.0	0.9	0.6	— 2.2	— 0.8	— 1.2
United Kingdom	7.2	10.2	2.3	— 0.4	— 4.8	— 2.5	— 4.0	— 4.8	— 4.9	— 3.3
Italy	3.7	4.2	18.9	0.1	4.8	— 6.3	— 5.9	—14.5	— 9.8	— 9.9
Japan	6.4	4.3	11.1	1.7	7.1	— 2.8[2]	— 3.8[2]	— 7.4[2]	— 7.6[2]	— 7.4[2]
Canada	2.8	8.0	10.3	2.4	5.1	1.0	1.8	— 2.3	— 1.8	— 2.7

[1] Current and capital expenditure plus transfer payments except in the case of Japan (public consumption and investment only). Increase in nominal terms divided by the GNP price deflator. [2] Includes public enterprises.

One factor inhibiting a more flexible use of fiscal policy has been the sheer size of the public-sector deficits that emerged in the wake of higher oil prices, inflation and deep recession. While it has been difficult for policy-makers, and even more for the public, to appreciate the need for such large deficits, they have served for the most part as a necessary offset to unusually high private-sector saving rates and in many cases to oil-related external deficits. In other words, conventional rules of thumb regarding the acceptable size of deficits have been unhelpful. Last year it was encouraging that Japan, for example, decided it would abandon a self-imposed limit, applied for many decades, on recourse to bond issues for deficit-financing purposes.

On the other hand, it is perfectly reasonable, even desirable, that governments lay down norms with respect to the desired growth of public expenditure. There are few countries in which there have not been complaints about excessive public-sector growth, a crowding-out of the private sector, the undue burden of transfer payments and the like. Many countries have begun to deal with this problem by setting medium-term goals with respect to expenditure trends. In Germany, for example, a number of budget measures have had a medium-term orientation, not least the Government's four-year infrastructure programme. In the Netherlands the authorities have formulated medium-term targets designed to reduce the size of the public sector. In the United States, too, the Administration aims at reducing public expenditure as a share of gross national product so as to make more room for private investment.

Of course, slow growth and rising unemployment have prompted most countries to undertake new or accelerated programmes of public investment and other public works. A number of them, Germany being an outstanding example, have seen in these projects an opportunity for outlays that would complement and stimulate private investment. On the other hand, transfer payments, which had already ballooned in most countries for many years, have risen further as a cushion to unemployment and hardship. At the same time, many countries have found that their provisions for social security benefits have tended to blur the line between voluntary and involuntary unemployment and thus to discourage an active search for jobs. Another aspect of public expenditure control lies in the behaviour of public-sector wages. Various countries — among them France, the United Kingdom and the United States — have sought by closer surveillance of public-sector wage bargains to exert some indirect influence on wage developments in the private sector.

Since the size of the public sector itself has tended to limit the scope for new expenditure programmes, many countries have introduced, or are planning, tax reductions of various kinds. In some cases these reductions reflect a deliberate effort to counteract fiscal drag. In the United States the January 1978 proposals, if enacted, would provide not only for personal taxation concessions but also for a permanent reduction in corporate income taxation and an increase in the investment tax credit, which would also be extended to construction projects. In Germany and Japan provisions have been made, partly in the form of additional loan funds, to encourage private investment and residential construction. In Germany personal taxation has also been lowered. In Japan there have been small reductions in personal income-tax rates over the past two years — less than enough to offset fiscal drag and far less than usual in post-war Japanese experience.

In many countries the stimulatory effects of fiscal and budgetary measures taken since last autumn have not yet fully worked through. Some countries, moreover, have only recently taken new measures, while in others, such as the United States, there is a long and uncertain lag between policy formulation and execution. At all events, given the prospects for continued slow recovery, and the need for more countries to support a generalised upswing, further fiscal stimulus will in some cases be appropriate. It may, moreover, need to be broadly based, involving reductions in personal taxation as well as concessions favourable to business investment.

Under present circumstances the task of finding and maintaining the appropriate degree of fiscal stimulus is a formidable one. Many fiscal authorities fear that further stimulus would provoke market reactions which could lead quickly to rising interest rates and a crowding-out of private expenditure. However, given that growth in most countries has fallen below even modest expectations, and that even with some recourse to monetary financing interest rates may rise only with a lag, the risks seem to be limited and worth taking. A number of countries have, moreover, been searching for ways to reduce these risks still further by means of incomes restraint, often as a trade-off against tax concessions.

Incomes policy. In earlier years it was commonly accepted that incomes policy could usefully supplement but not replace conventional measures to regulate aggregate demand. Such a proposition makes eminently good sense if the basic problem is one of excess demand and high capacity utilisation. It will be seen in a different light, however, if national authorities, faced with excess capacity and large-scale unemployment, feel inhibited in applying policy stimulus for fear that they will initiate or exacerbate a wage/price spiral. If this occurs, as appears to be the case in many countries at present, incomes restraint comes to be viewed as a prerequisite to any further action to stimulate demand. Owing to the market power of organised groups and the existing high degree of formal or de facto indexation arrangements, price and wage behaviour has become much more sensitive to actual or expected changes in market conditions, even with large margins of slack. In these circumstances monetary and fiscal stimulus, instead of propelling output and employment to higher levels, simply gives further impetus to the upward spiral of wages and prices.

The logical appeal of an incomes policy is that it offers a way round this dilemma. Insofar as it can ensure a degree of incomes restraint, it widens the scope for more effective use of conventional stimulatory measures. Put in this way, few would deny the desirability of such a policy, provided it were politically feasible and administratively simple and flexible. For trade unions it would mean a labour movement acting in the interests of the labour force as a whole and not just the working members of it. For industry it would imply gains in volume terms outweighing those from price rises. But what seems self-evident in principle may be difficult or impossible to achieve in practice.

Thus, while incomes policies have scarcely had a brilliant history, efforts to formulate them have necessarily continued. The alternative in some countries would be a countervailing struggle between autonomous wage/price inflation and official policies to restrain demand — a sure recipe for chronic "stagflation". On the other hand, these efforts normally stop short of advocating direct price and wage controls, to which countries are driven only in extreme circumstances. As recent experience has shown, countries have sought to deal with wage/price inflation in many different ways.

Germany and Japan, it may be noted, have quite deliberately refrained from efforts to formulate an explicit incomes policy. In Germany monetary growth targets are regarded as a useful framework for labour/management bargaining and price-setting, and they have helped to prevent misunderstandings or false assumptions about the course of monetary policy. In Japan institutional arrangements involving bonus payments, "lifetime employment" and worker organisations at company level have provided a workable alternative to incomes policies. They have enhanced the willingness of workers in hard-pressed firms to accept reductions in real wages or benefits. In Switzerland a rather similar result has been achieved simply through the flexible adjustment, downwards as well as upwards, of bonuses, extra-month payments and other benefits.

The United Kingdom and Canada have for several years now had recourse to quite strict incomes policy measures. Indeed, in its anti-inflation programme introduced in October 1975, Canada adopted a comprehensive set of controls on wages and profit margins, supplemented by fiscal and monetary measures including the adoption of a monetary target. Broadly, the direct control programme appears to have fulfilled its rôle well, and the Government saw fit to discontinue it in the spring of 1978. In the United Kingdom pay restraint policy entered a third phase last August, consisting during this period of a limit of 10 per cent. on pay settlements, with trade unions at the same time refraining from seeking the renegotiation of contracts before twelve months had passed.

Various other countries have taken important steps in the field of incomes policy over the past year or two. In France a norm laid down under the "Barre Plan" limiting the increase in public-sector wages was to act also as a guideline for the private sector. In Italy a compulsory savings scheme was introduced in respect of increases in wages above a certain moderate level and some minor modifications were made to the country's comprehensive indexation arrangements. In Spain the Government decided last October to limit the authorised increase in a firm's total wage bill in 1978 to 20 per cent. — a figure which, given the high rate of inflation, was tantamount to a partial suspension of existing indexation arrangements. Much the same occurred in the Netherlands in 1976, when it was specified that wage and salary increases were not to exceed the standards set by the Government. In Belgium the problem was tackled by suspending the application of indexation arrangements in respect of incomes above certain levels.

In the United States the Administration has sought to achieve incomes restraint on a voluntary basis. The aim appears to be that increases in wages and prices in the private sector should be kept below the average for the past two years, thus permitting a continuing deceleration of inflation.

Another approach — a matter of experimentation in the northern European countries and the United Kingdom — is to try to establish a link between tax concessions and wage restraint. In the United Kingdom, for example, the budget proposals of March 1977 explicitly made certain tax reductions contingent upon subsequent wage results, and the concessions made in the recent budget were accompanied by calls for continued incomes restraint. More systematic versions of this approach have recently come under discussion in the United States. One such scheme would involve tax penalties for firms granting wage increases in excess of a specified norm, while another would grant tax concessions to firms where wage gains were below a given norm. While there are many technical difficulties inherent in schemes of this kind, they address themselves to a central problem of economic management and hence warrant continuing study.

A rôle for international policy co-ordination.

Viewed in terms of policy developments, two particular features emerge from the foregoing analysis. One is that countries have been seeking to evolve new strategies and techniques designed to make their policies more effective. The other is that divergences in individual country behaviour have been a main source of disequilibrium in the recent pattern of international trade and payments. How, and to what extent, these developments may have been interrelated poses an interesting question.

As far as policy effectiveness is concerned, many countries have found monetary targets, medium-term budget planning and incomes policy initiatives helpful in providing a better expectational framework for economic behaviour, though some countries have continued to rely on more conventional policy approaches. In general terms these newer techniques lend themselves particularly to efforts to achieve *domestic* economic goals, perhaps even to the simultaneous reduction of inflation and unemployment. To this extent such techniques may be of interest to surplus and deficit countries alike — and hence it is not a priori possible to say how their use will impinge on the problem of external adjustment.

In other words, increased policy effectiveness, whether based on new techniques or old, still leaves open the question of the degree of emphasis to be given to external policy considerations. Moreover, under floating exchange rates, strong-currency countries have found it possible to concentrate their efforts largely on domestic goals. Thus, under floating rates, perhaps even more than under fixed ones, deficit countries, except for the special case of the United States, have borne the brunt of pressures to adjust. Over the past year, with restrictive adjustment policies in many deficit countries being the dominant influence on world trade, economic activity slowed down almost everywhere, not least in the surplus countries themselves.

The surplus countries continue, understandably, to be concerned about various structural distortions and the problem of inflation control. At the same time, last year's experience has demonstrated the constraint that their policies place on world economic developments, which may then redound to their own disadvantage. Of course, it has also to be recognised that the adjustment policies pursued by many deficit countries were by and large necessary on both domestic and external grounds. As a consequence, the preconditions for a more generalised advance have now become more favourable, especially if the surplus countries are ready to play their part.

In the light of developments over the past decade, it is not implausible that the industrial countries have shifted to a lower trend rate of growth. However, even on the basis of more modest expectations, it is difficult to see how growth can be satisfactorily maintained without a deliberate, sustained effort by surplus countries to increase their domestic absorption of goods and services as time goes on.

IV. INTERNATIONAL TRADE AND PAYMENTS.

Last year's developments in world trade and payments present a mixed picture. On the negative side, the expansion of world trade slowed down considerably under the influence of hesitant growth in both the industrial and developing countries and, in turn, acted as a drag on individual economies; among the oil-importing countries with persistent current payments surpluses, that of Japan increased dramatically and those of Germany and Switzerland remained at the same level as before; the current payments deficit of the United States was the largest ever recorded by that country; moreover, as a result of the US deficit, there was major turmoil in the foreign exchange markets and, for the first time since the beginning of the decade, substantial unwanted accumulation of dollars by certain monetary authorities. On the positive side, both the oil exporters' surplus and the non-oil developing countries' deficit declined further; three major industrial countries — France, Italy and the United Kingdom — as well as a number of other countries, both developed and developing, carried out or initiated stabilisation policies that substantially improved their external accounts; and finally, external financing problems were, in general, probably less troublesome than at any time since the 1973 oil price increase.

World trade.

In 1977 the volume of world trade expanded by only 4 per cent., which was just one-third of the growth rate registered in 1976. World trade growth had already begun to decline in late 1976; by the first half of last year it was down to 2 per cent. at an annual rate and in the second half it came almost to a halt. In view of the signs of a mild revival of activity in the industrial countries at the end of the year, the continued expansion of demand in the oil-exporting countries and the easier financial position of the other developing areas, some pick-up in world trade growth can now be expected; year on year, however, the increase in 1978 is likely to be no greater than in 1977. Contrasting with the slowdown in real trade growth, and partly reflecting the weakness of the dollar, the rate of increase in foreign trade prices expressed in dollars quickened substantially from 1½ per cent. in 1976 to 9 per cent. last year. Consequently, the 1977 rise in the value of world trade — of $130 billion, or 13 per cent. — was broadly similar to that recorded in the previous year and brought the total to $1,140 billion.

The principal cause of the slow growth of world trade in 1977 was sluggish domestic demand in the *developed areas* of the world. This was the case not only in an appreciable number of developed countries which were prevented by balance-of-payments considerations from expanding their economies but also in the surplus countries where no such constraints existed. As a result, the developed countries' total industrial production and import volume, which in 1976 had increased by 9 and 13½ per cent. respectively, grew at annual rates of about 5 per cent. in the

World trade.[1]

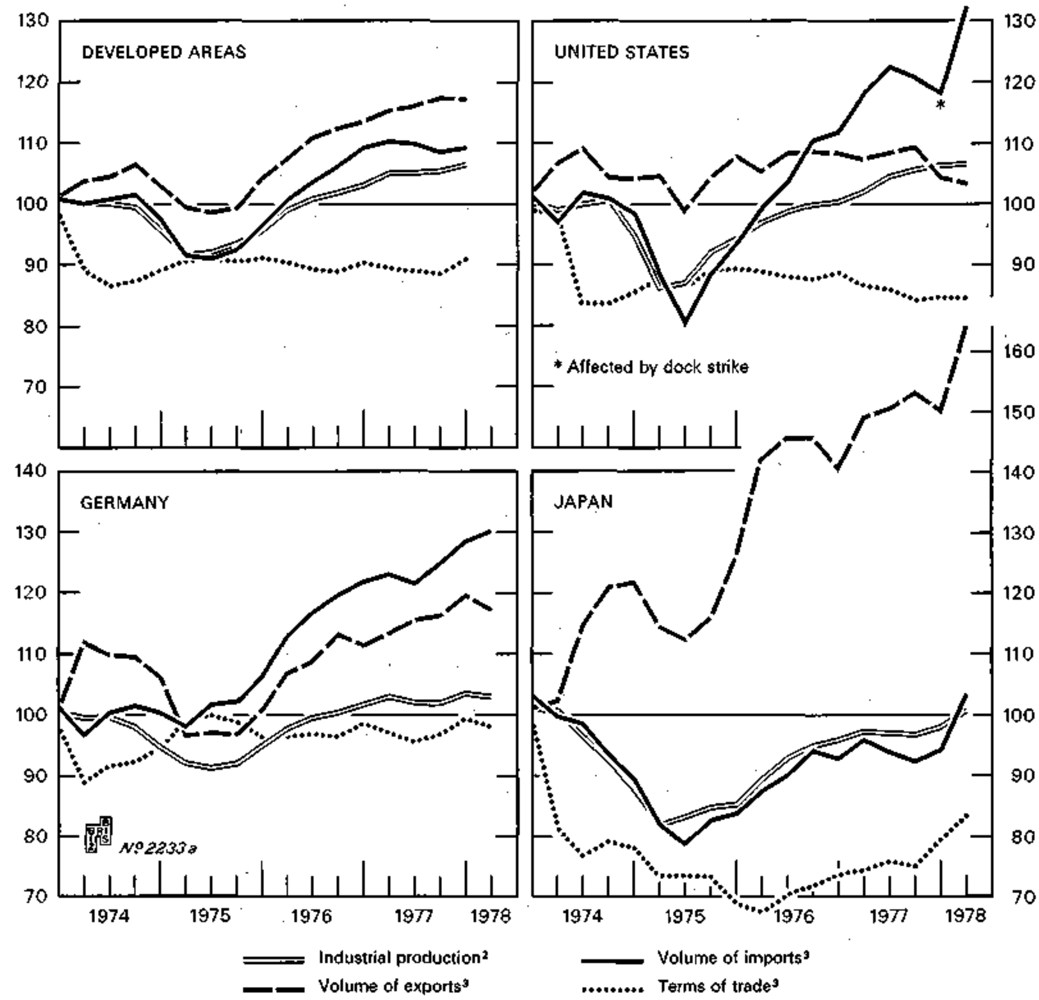
Areas	Exports (f.o.b.)				Imports (c.i.f.)			
	1976	1977 Year	1977 1st half	1977 2nd half	1976	1977 Year	1977 1st half	1977 2nd half
	in billions of US dollars *(volume index 1975 = 100)*							
Developed areas								
Western Europe:								
EEC	324.8	375.7	183.5	192.2	341.4	382.0	192.1	189.9
Other countries	78.4	86.9	42.0	44.9	106.9	118.8	58.6	60.2
Total	403.2	462.6	225.5	237.1	448.3	500.8	250.7	250.1
	(111.4)	*(117.1)*	*(116.7)*	*(117.5)*	*(113.2)*	*(116.1)*	*(117.7)*	*(114.4)*
United States	115.0	120.2	61.1	59.1	129.6	156.7	77.8	78.9
Canada	40.3	43.2	21.8	21.4	40.3	42.0	21.8	20.2
Japan	67.2	80.5	37.4	43.1	64.8	70.7	35.1	35.6
Other countries[2]	26.2	29.5	14.3	15.2	27.0	28.0	13.9	14.1
Total developed areas .	651.9	736.0	360.1	375.9	710.0	798.2	399.3	398.9
	(111.0)	*(115.8)*	*(115.1)*	*(116.5)*	*(113.5)*	*(117.5)*	*(119.0)*	*(116.0)*
Developing areas								
Oil-exporting countries[3] . .	137	148	74	74	70	89	43	46
	(114.0)	*(112.0)*	.	.	*(122.5)*	*(143.0)*	.	.
Other areas	114	133	65	68	139	151	73	78
	(112.0)	*(117.5)*	.	.	*(102.5)*	*(103.0)*	.	.
Total developing areas .	251	281	139	142	209	240	116	124
	(113.0)	*(114.5)*	*(112.5)*	*(117.0)*	*(108.5)*	*(115.0)*	*(111.5)*	*(118.0)*
Centrally planned economies[4]	92	107	50	57	102	114	58	56
Grand total[5] . . .	995	1,124	549	575	1,021	1,152	573	579
	(111.5)	*(115.5)*	*(114.5)*	*(116.5)*	*(112.5)*	*(117.0)*	*(117.5)*	*(116.5)*

[1] Based on customs data; not directly comparable with trade figures in the table on page 66. [2] Australia, Israel, New Zealand, South Africa. [3] OPEC (Algeria, Ecuador, Gabon, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, United Arab Emirates, Venezuela) plus Bahrain and Oman. [4] Bulgaria, People's Republic of China, Czechoslovakia, German Democratic Republic, Hungary, Poland, Rumania and USSR. [5] Volume index excludes centrally planned economies.

first half of 1977, while in the second half of the year industrial expansion was less than 2 per cent. and the volume of imports fell. Taking the year as a whole, developed countries' imports are estimated to have risen by 3½ per cent. in real terms.

The country-by-country pattern of the developed world's import growth was varied last year, even among the three major economies shown in the following graph. As in 1976, although to a lesser extent, the United States continued to provide a powerful stimulus to international trade, with real import growth of 13 per cent. Unlike 1976, however, this rate of expansion was matched by few other developed countries; indeed, only Austria, Ireland, Portugal, Switzerland and Yugoslavia were buoyant enough to generate import growth of 10 per cent. or over. Elsewhere, imports into developed countries either grew only modestly or actually declined. Germany registered an increase of just 4½ per cent., slightly less than Australia and Norway. The imports of the third major economy, Japan, rose by a mere 3½ per cent., not much faster than those of the Benelux countries, Canada, France and the United Kingdom, demand in the last two having been deliberately held back by domestic stabilisation programmes. Those developed countries whose imports actually fell in 1977 included Group of Ten countries such as Italy and Sweden, where there were declines of 2 and 5 per cent. respectively, and other countries such as Denmark, Finland, Greece, New Zealand and Spain, where falls of up to 8 per cent. were recorded. The sharpest cutback, by over 20 per cent., took place in South Africa.

Total developed areas, United States, Germany and Japan: Industrial production, trade volumes and terms of trade, 1974–78.
Quarterly indices: Second half 1973 = 100.[1]



[1] Seasonally adjusted, except terms of trade; figures for first quarter of 1978 are provisional. [2] Excluding construction. [3] On a customs basis.

Partly offsetting the depressive influence of the developed economies, the imports of *oil-exporting countries* rose by a further 17 per cent. in volume last year, but this, too, was slower than the 1976 increase. The "low absorbers" registered by far the fastest growth rates, although the expansionary impact of the import demand of these countries remains relatively small. Indeed, total imports into all oil-exporting countries, despite average annual volume increases of 30 per cent. since the rise in oil prices, accounted for less than 8 per cent. of world imports in 1977.

Elsewhere, the growth of import demand was unspectacular as adjustment programmes took effect. The *non-oil developing countries* raised the volume of their imports by under 1 per cent., even less than in 1976. This very cautious expansion reflected above all the restraints applied to demand by a large number of countries and was an important factor contributing to the substantial financial improvement that the non-oil developing countries, taken as a whole, have experienced during the last two years. In addition, the volume of imports into the *centrally planned economies* appears to have increased only modestly, since the value figures rose by no more than 11 per cent., to $114 billion. Such growth as occurred appears to have been more than accounted for by trade among the eastern European countries. By contrast, the eastern European countries' imports from developed western economies, at $29 billion, were unchanged in value and down considerably in volume, as they acted to reduce further their hard-currency trade deficits. The value of imports into China from the developed West, following a substantial decline in 1976, rose by 9 per cent. last year, to $4½ billion; here, then, there will have been little change in volume terms.

The export growth of all the main groups of countries was weaker last year as a consequence of the sluggish performance of the world economy. This was particularly true for non-oil developing countries, whose real export growth fell back from 12 to 5 per cent. Even more strikingly, the exports of the oil-producing countries showed a small decline after a 14 per cent. increase in the previous year. As well as the impact of the recession, this reflected the inflated level of the importing countries' oil stocks at the end of 1976 and the rising level of oil production outside the OPEC area. As for the centrally planned economies, their exports are estimated to have risen in value by 16 per cent. last year, to $107 billion; sales to developing countries were buoyant, while those to developed market economies appear to have shown little change in volume terms, the value figures advancing by 10 per cent. to $25 billion.

Finally, the exports of the developed countries rose by 4½ per cent., slightly faster than their imports. In general, the highest rates of export growth were registered by those developed countries which were striving to reduce current payments deficits. These included South Africa, with a rise of about 15 per cent., and Canada, Finland, Ireland, Spain and the United Kingdom, with increases of between 9 and 12½ per cent. The only surplus country to show rapid export growth was Switzerland, with a remarkable 12 per cent. At the other end of the spectrum, the exports of Australia, Sweden and the United States were virtually unchanged from 1976 levels, while those of Greece, the Netherlands, Norway and Yugoslavia declined.

Measured in domestic currencies, the rise in the average prices of internationally traded goods accelerated to some extent between 1976 and 1977; in dollar terms the contrast between the two years was much greater, the rate of price increase moving up sharply from 1½ to 9 per cent. The difference between 1976 and

1977 movements in dollar prices to a large extent reflected the different fortunes of that currency on the exchange markets in the two years. As in 1976, the prices of primary commodities showed the largest increase last year, even though the upward movement came to an abrupt halt in the second quarter; year on year the "Economist" dollar index rose by 23 per cent. This figure exaggerates the impact of special situations such as that of coffee, and it is estimated that the export prices of the non-oil developing countries rose by a more modest 12 per cent. overall. By comparison, the export prices of both manufactured products and oil rose by just under 10 per cent. Movements in the terms of trade of the main groups of countries were therefore fairly minor last year.

Balances of payments.

In 1977 there were only relatively small changes in the global pattern of current payments balances, but some substantial shifts took place within the main groups of countries. The combined current-account deficit of the Group of Ten countries and Switzerland increased by $4½ billion to reach almost $10 billion, while that of the other developed countries remained at a substantial $23½ billion. Although weakness of demand in the developed world contributed to a drop, from $40 to 34 billion, in the current surplus of the oil-exporting countries, the non-oil developing countries were able to cut their deficit for the second successive year, from $19 to 15 billion, and the trade deficit of the centrally planned economies, too, is estimated to have declined, from $5 to 1 billion. Within the main groups of countries the biggest changes from 1976 were in the current-account balances of the Group of Ten countries, with the United States moving into very large deficit, the Japanese surplus increasing rapidly and substantial improvements being achieved by France, Italy and the United Kingdom, all of which had recorded sizable deficits in 1976. Among the other developed countries, adjustment programmes produced a number of substantial current-account improvements, although these were cancelled out by setbacks elsewhere. In the non-oil developing countries the whole of last year's gain can be traced to the small number of countries that have accounted for a substantial part of the group's aggregate current-account deficit in recent years. Finally, the reduction in the oil exporters' surplus means that it is now even more heavily concentrated in the hands of the "low absorbers".

Turning to capital movements and other financing flows, the record current payments deficit of the United States was accompanied by substantial capital and short-term bank outflows, so that a deficit of $34 billion had to be financed by additions to foreign official holdings of dollars. At the same time the size of the US deficit lightened the financing burdens of other deficit countries. With a few notable exceptions, other developed countries had easy access to international capital markets, both for private and official borrowing. Similarly, the non-oil developing countries continued to be large-scale market borrowers, although with the further decline in their current external deficit they became, on balance, small net suppliers of funds to the international banking system last year. Borrowing by eastern European countries fell back sharply in 1977, but additional finance was raised by means of larger gold sales. Finally, borrowing by a number of the "high absorbers" among the oil-exporting countries rose considerably last year as their current-account positions deteriorated.

International current-account transactions.[1]

Countries and areas	Trade balance (f.o.b.)			Services and transfers			Current balance		
	1975	1976	1977	1975	1976	1977	1975	1976	1977
	in billions of US dollars								
Developed areas									
BLEU[2]	0.5	− 0.9	− 1.1	0.2[3]	0.6[3]	0.8[3]	0.7	− 0.3	− 0.3
Canada	− 0.5	1.1	2.7	− 4.2[3]	− 5.3[3]	− 6.7[3]	− 4.7	− 4.2	− 4.0
France	1.5	− 4.8	− 2.6	− 1.4	− 1.2	− 0.6	0.1	− 6.0	− 3.2
Germany	17.7	16.7	19.2	−13.6	−12.8	−15.3	4.1	3.9	3.9
Italy	− 1.2	− 4.2	0.1	0.6[3]	1.4[3]	2.2[3]	− 0.6	− 2.8	2.3
Japan	5.0	9.9	17.5	− 5.7	− 6.2	− 6.5	− 0.7	3.7	11.0
Netherlands	1.1	1.6	− 0.5	0.9[3]	1.1[3]	0.8[3]	2.0	2.7	0.3
Sweden	0.7	0.4	0.2	− 2.3	− 2.8	− 3.5	− 1.6	− 2.4	− 3.3
Switzerland	0.2	0.5	0.3	2.4[3]	3.0[3]	3.4[3]	2.6	3.5	3.7
United Kingdom	− 7.2	− 6.3	− 3.2	3.5	4.3	3.2	− 3.7	− 2.0	0
United States	9.0	− 9.3	−31.2	2.6[3]	7.9[3]	11.0[3]	11.6	− 1.4	−20.2
Group of Ten and Switzerland	26.8	4.7	1.4	−17.0	−10.0	−11.2	9.8	− 5.3	− 9.8
Other countries	−28.1	−28.1	−28.8	7.4	5.7	5.4	−20.7	−22.4	−23.4
Total developed areas	− 1.3	−23.4	−27.4	− 9.6	− 4.3	− 5.8	−10.9	−27.7	−33.2
of which: OECD[4]	*5.9*	*−18.4*	*−23.9*	*−11.0*	*− 6.5*	*− 8.0*	*− 5.1*	*−24.9*	*−31.9*
Developing areas[5]									
Oil-exporting countries	62	73	68	−27	−33	−34	35	40	34
Other areas	−23	−12	− 6	− 6	− 7	− 9	−29	−19	−15
Total developing areas	39	61	62	−33	−40	−43	6	21	19
Centrally planned economies[5]	− 9	− 5	− 1	.	.	.	.	.	.

[1] On a transactions basis. [2] Partly on a cash basis; exports and imports partly c.i.f. [3] Excluding retained earnings on direct investment. [4] Total developed areas excluding Israel, South Africa and Yugoslavia. [5] Partly estimated.

The increase during recent years both in the complexity of international trading relationships and in the volatility of exchange rates, not least in 1977, has added to the statistical problems involved in the analysis of balance-of-payments developments. These problems fall under two main headings: first, the failure of the world current-account balance to sum to zero, and secondly, the distortions introduced by the conversion of data into a common currency, in this case the US dollar. The growing accounting discrepancy in current external transactions reflects a number of factors, including differences of timing and coverage in the recording of exports and imports and inadequate reporting of services and transfers, particularly by recipient countries. The valuation problem is unavoidable where international comparisons are concerned, but it has been heightened by the varying fortunes of the dollar during the 1970s. Consequently, trade unit values expressed in dollars have to be interpreted with caution; flows and balances of goods, services and capital may take on a different appearance when converted from domestic currencies into dollars; and calculations based on stock data, notably those relating to countries' external monetary transactions, ideally require adjustment for valuation changes in order to obtain flows that match the rest of the balance of payments. Such adjustments have not been made in the following descriptions of monetary movements, except in the analysis of the US balance of payments, with the result that, for many developed countries in the table on page 73, the totals for monetary movements data do not correspond exactly to the overall balance-of-payments totals.

Developed countries.

As in 1976, easily the largest shift on current account was in the *United States,* where the deficit widened from $1.4 to 20.2 billion. Once again, the dominant factor was merchandise trade, the deficit on which rose by $22 billion. This was only partly offset by a further increase in the surplus on invisible transactions. Last year's adverse current-account balance was compounded by developments on capital account, where the small net inflow recorded in 1976 gave way to a $7.1 billion outflow. In addition, there were net short-term outflows of $6.5 billion via the banks. The counterpart of the combined deficit of these items was a massive $33.8 billion increase in US net official liabilities, which accumulated at an increasingly rapid rate as pressures against the dollar built up during the latter part of the year.

The most fundamental shift in the US balance of payments since 1975 has been on the import side of the trade account. After registering a $9 billion surplus in 1975, the merchandise trade balance swung to deficits of $9.3 and 31.2 billion in 1976 and 1977 respectively. This deterioration reflects the strength of the US economic recovery in relation to that experienced elsewhere and the growing dependence of the United States on imported oil. Total imports rose by nearly $28 billion in value terms during 1977, following a $26 billion rise in 1976. In real terms, however, there was a marked slowdown between the two years, from 22 per cent. to 13 per cent. — a growth rate that was nonetheless three times that of world trade. Strong domestic demand contributed to a $17.6 billion rise, equivalent to nearly 11 per cent. in volume, in non-oil imports, with purchases of consumer goods, machinery and motor vehicles all registering large increases. Oil imports increased by a further $10 billion, or over 19 per cent. in volume; although domestic oil production rose slightly last year, it was outpaced by consumption growth and additions to petroleum stocks. At $45 billion, oil accounted for nearly one-third of total US imports in 1977, compared with one-ninth in 1973. This increase reflected not only the higher prices of petroleum imports, but also the growth of 35 per cent. in their volume as domestic oil production declined over this period. Moreover, the lack of an effective energy strategy has meant that US oil consumption per unit of national output has fallen significantly less than in other major industrial countries in the past four years.

On the export side, last year's $5.8 billion value increase concealed static volume. Agricultural sales edged up to $24.4 billion, their sluggish progress reflecting the recent series of good world harvests. The rise of nearly $5 billion in non-

United States: Balance of payments.

Items	1975	1976	1977[1] Year	1977[1] 1st quarter	1977[1] 2nd quarter	1977[1] 3rd quarter	1977[1] 4th quarter
	in millions of US dollars						
Current transactions							
Merchandise exports (f.o.b.)	107,090	114,695	120,470	29,455	30,655	30,870	29,490
Merchandise imports (f.o.b.)	98,045	124,015	151,710	36,605	38,310	38,430	38,365
Trade balance	9,045	− 9,320	−31,240	− 7,150	− 7,655	− 7,560	− 8,875
Investment income, net[2]	5,955	9,810	11,935	3,185	3,440	3,165	2,145
Other services and transfers, net	− 3,450	− 1,915	− 905	− 315	− 360	70	− 300
Services and transfers	2,505	7,895	11,030	2,870	3,080	3,235	1,845
Current balance	11,550	− 1,425	−20,210	− 4,280	− 4,575	− 4,325	− 7,030
Capital transactions							
US Government	− 1,765	725	− 1,795	− 425	− 370	− 715	− 285
Direct investment[2]	− 4,850	− 2,420	− 3,480	135	− 1,430	− 440	− 1,745
Portfolio investment	− 2,360	− 5,735	− 960	515	− 600	− 1,260	385
Long-term flows reported by US banks, n.i.e.	− 2,255	1,030	2,185	705	− 930	1,390	1,030
Other	− 1,205	− 2,605	− 95	− 870	− 1,535	2,015	295
Identified capital flows	−12,435	− 9,005	− 4,145	60	− 4,865	980	− 320
Statistical discrepancy	5,660	9,865	− 2,990	1,440	1,080	− 5,170	− 340
Capital balance	− 6,775	860	− 7,135	1,500	− 3,785	− 4,190	− 660
Overall balance[3]	4,775	− 565	−27,345	− 2,780	− 8,360	− 8,515	− 7,690
of which, changes in:							
US official reserve assets	605	2,530	230	390	− 5	− 150	− 5
US liabilities to foreign official agencies	− 3,890	−11,265	−34,075	− 4,680	− 7,005	− 7,550	−14,840
Net official assets	− 3,285	− 8,735	−33,845	− 4,290	− 7,010	− 7,700	−14,845
Net short-term external position reported by US banks, n.i.e.	8,060	8,170	6,500	1,510	− 1,350	− 815	7,155

[1] Quarterly data seasonally adjusted. [2] Excluding retained earnings on direct investment and the reinvestment of such earnings, which amounted to $6.2, 6.1 and 6.3 billion in 1975, 1976 and 1977 respectively. [3] Excludes valuation adjustments.

agricultural exports was due entirely to higher prices; their volume remained below the peak reached in 1974. The poor performance of US exports over the last three years, when world trade in manufactures expanded by 10 per cent., is difficult to explain. Clearly, cyclical factors have played a part; with their heavy bias towards capital goods, US export sales have been held back by the low level of fixed investment in the rest of the industrialised world. In addition, the faster growth of domestic markets may have diverted some potential exports, although there continue to be low levels of capacity utilisation in many sectors of US industry. On the other hand, as illustrated in Chapter VI, the competitive advantage secured in 1973 seems since then to have remained intact, even before the recent renewed fall of the dollar. Nevertheless, there is little doubt that in world markets the US position had deteriorated relative to those of its main competitors, namely Japan and Germany. Between the second halves of 1973 and 1976, for instance, the dollar prices of US manufactured exports rose by nearly 50 per cent., roughly double the corresponding increases for German and Japanese exports. In addition, broad measures of competitiveness ignore the impact both of the growing volume of manufactured goods exported by developing countries and of the erosion of the technological lead formerly enjoyed by the United States.

United States: Foreign trade balances by area, 1971–77.*

Balances vis-à-vis	1971–73 average	1974	1975	1976	1977
	in billions of US dollars				
Western developed areas	− 3.2	4.2	10.0	4.6	− 3.5
of which:					
EEC	*0.4*	*3.0*	*6.2*	*7.6*	*4.4*
Canada	*− 2.5*	*− 2.0*	*0*	*− 2.1*	*− 3.6*
Japan	*− 2.9*	*− 1.6*	*− 1.7*	*− 5.4*	*− 8.1*
Other	*1.8*	*4.8*	*5.5*	*4.5*	*3.8*
Oil-exporting countries	− 0.2	− 8.9	− 6.3	−12.4	−19.2
Non-oil developing areas	0.8	1.9	5.2	− 0.9	− 5.9
Eastern Europe and USSR	0.6	0.6	2.1	2.6	1.6
Unidentified	0.2	0.5	0.5	0.4	0.3
Total trade balance	− 1.8	− 1.7	11.5	− 5.7	−26.7

* On a customs census basis; exports f.a.s., imports f.a.s. from 1975 (previously f.o.b.).

The above table shows the impact of recent developments on the pattern, by area, of the US foreign trade balance; it also indicates the extent to which the shift of the US trade account into deficit has contributed to a better balance in the rest of the world. Between 1975 and 1977 the $38 billion deterioration in the US foreign trade balance was fairly evenly distributed among the developed countries, the oil exporters and the non-oil developing countries. Within the developed area, however, three-quarters of the corresponding trade gains accrued to Japan and Canada, while vis-à-vis the EEC and the other developed countries the United States continued to run a substantial surplus. In addition, although the surge in US oil imports has been partly offset by higher sales to the oil exporters, not only of goods, as recorded in the table, but also of services, the United States has been contributing significantly to the maintenance of large OPEC surpluses at a time when other major countries have been doing the opposite. On the other hand, an increase of over 50 per cent. between 1975 and 1977 in the value of US imports from the non-oil developing countries, particularly from the emerging industrial nations in Asia and Latin America, has been an important factor easing the balance-of-payments constraints on these countries.

One of the stronger components of the US balance of payments has been the invisibles account, the surplus having climbed from $2.5 billion in 1975 to $7.9 and 11 billion in the last two years. This improvement largely reflects a $6 billion increase in net investment income between 1975 and 1977, despite the relatively depressed economic conditions abroad. Among other service and transfer items the biggest shift occurred in the balance on military transactions; traditionally a deficit item, it registered a small surplus in 1976 and one of $1.4 billion in 1977, mainly as a result of substantially higher military sales abroad.

Coinciding with last year's adverse trends on current account, capital transactions moved sharply from a small surplus to a $7.1 billion deficit. This was the net outcome of a reduction in identified capital outflows and a much larger adverse shift to a net outflow in the balance of unidentified items. At $4.1 billion, net identified capital outflows were less than half those in 1976. The deficit on portfolio investment declined by $4.8 billion, net long-term banking inflows doubled to $2.2 billion and there was a $2.5 billion fall in "other" net identified outflows, mainly corporate transactions. Partly offsetting these changes, net outflows for direct investment rose from $2.4 to 3.5 billion and government transactions swung round from a $0.7 billion inflow to a more normal $1.8 billion outflow as advance payments for military exports were not repeated on the scale of 1976. The balance of unidentified transactions, in sharp contrast to the inflows totalling $15.5 billion registered in 1975 and 1976, produced a $3 billion outflow last year. During the first half of last year there were still net inflows, amounting to $2.5 billion, but in the third quarter, as pressure suddenly built up against the dollar, these gave way to an unprecedented $5.2 billion net outflow, which continued, although at a much reduced rate, in the fourth quarter. Looking at the entire capital account, net outflows were at their strongest, at $3.8 and 4.2 billion, in the second and third quarters respectively; in the fourth quarter, when easily the biggest change was in the balance of unidentified transactions, they appear to have reacted to the widening interest differentials in favour of the United States.

On current and capital account combined, the United States recorded an overall deficit of more than $27 billion last year, after having been in virtual balance in 1976. In addition to this overall deficit there was a net short-term outflow of $6.5 billion via the banks, with the result that net official external liabilities increased by $33.8 billion. During the first three quarters of last year the banking sector had on balance been a net borrower of short-term funds, to the modest extent of $0.7 billion. In the fourth quarter, however, the banks' net lending abroad shot up by no less than $7.2 billion, including an increase of $8.9 billion in their gross claims, mainly on their branches in the Caribbean and Far Eastern offshore centres.

With reserve assets rising by just $0.2 billion during the year, the movements in the overall balance and short-term bank flows were closely matched by the growth of liabilities to foreign official institutions, which rose at an ever-increasing rate during the year, culminating in a $14.8 billion increase in the final quarter. For the year as a whole, these liabilities grew by over $34 billion, a large part of which reflected intervention purchases by several industrial countries as they attempted to moderate the appreciation of their exchange rates vis-à-vis the dollar. Not all of these interventions were solely of that kind, however, since during the first nine months of the year, the main purchasers of dollars were the United

Kingdom and Italy, both of which were rebuilding reserve positions that had been severely depleted in 1976. Separate estimates of US liabilities to oil-exporting countries are not available, but it appears that they accounted for no more than one-fifth of last year's total increase in US liabilities to official institutions.

In the first quarter of 1978 US imports continued ro rise rapidly and the trade deficit widened to $11.2 billion, pointing to a further worsening on current account. In addition, long and short-term outflows on capital account and via the banks continued, reflecting, and contributing to, renewed downward pressure on the dollar. As a result, net US liabilities to foreign official institutions rose by $14.5 billion, about the same as in the preceding quarter, as foreign central banks again intervened to moderate the downward movement of the dollar. In April the deficit on current account appears to have been more than covered by inflows of funds on capital account and through the banks, as evidenced by the much stronger performance of the dollar.

In sharp contrast to the US picture, the current-account surplus of *Japan* showed a substantial rise last year, from $3.7 to 11 billion. The whole of this change stemmed from the trade balance, with the traditional deficit on invisibles widening slightly. Outflows on capital account, although up from $0.8 to 3.4 billion, were insufficient to prevent a large rise in reserve assets.

Japan's trade surplus continued its inexorable rise in 1977, climbing from $9.9 to 17.5 billion. An important factor boosting the surplus — at least temporarily — was the strength of the yen, which helped to generate a 9 per cent. improvement in the terms of trade. On the volume side exports grew by only 3 per cent. in 1977, although this has to be seen in the light of their dramatic 23 per cent. rise the year before. The growth of imports also slowed down, from 10½ to 3½ per cent., as a result of slack domestic demand. It may be added that, in view of the constantly changing quality mix of Japanese exports and the rapidly rising exchange rate, the 1977 trade statistics may have overstated the rise in the prices of exports and correspondingly understated their volume growth, a possibility which would appear to be confirmed by national income statistics.

The Japanese trade surplus has now widened by almost $14 billion since 1973. By 1977 the terms of trade were still nearly 25 per cent. below the level of that year but, as illustrated in the graph at the beginning of this chapter, this had been more than offset by an increase of no less than 52 per cent. in the volume of exports and a decline of 2½ per cent. in that of imports. Japan's trade surplus (f.o.b.) with the oil-importing world is estimated to be nearly $30 billion, including substantial surpluses vis-à-vis the United States, the EEC and other European countries.

On capital account, the authorities attempted to encourage outflows last year by easing the limits on foreign issues of yen-denominated bonds on the Tokyo market. Moreover, market conditions helped discourage Japanese companies from raising funds abroad. As a result, net exports of long-term capital climbed from $1 to 3.2 billion, with the outflow increasing as the year went on. The main change occurred in portfolio transactions, where the net inflow dropped from $3 billion in 1976 to $0.7 billion. In addition, there was a rise, from $0.6 to 1.4 billion, in the net outflow of trade credits. In view of the substantial appreciation of the yen last year, net movements of short-term capital were surprisingly small; indeed, they registered a small net outflow of $0.3 billion during the year, compared with a slightly smaller net inflow in 1976. In total, net exports of capital amounted to $3.4 billion last year, so that the overall balance-of-payments surplus was $7.6 billion, with the quarterly figures showing a similar pattern to that of the current balance and reaching a peak of nearly $4 billion in the final quarter.

Including valuation changes, the monetary counterparts of the overall surplus were a reduction of $1.2 billion in the net short-term liabilities of the banking sector and a rise of $5.9 billion in net official assets. In the first nine months of the year $2.3 billion of short-term funds flowed out through the banks, thus offsetting nearly two-thirds of the overall surplus. During this period reserve assets rose by $1.7 billion, although liquid foreign currency holdings fell by $1.3 billion as dollars were used to purchase longer-term assets in the United States. In the final quarter, when the large overall surplus coincided with the renewed weakening of the dollar, there was a $1.1 billion net short-term inflow through the banks, including an increase of about $2 billion in their gross external liabilities in yen, and a $5 billion rise in official reserve assets.

During the first three months of this year surpluses of $5.8 and 4 billion were registered on the trade and current accounts respectively. At the same time there was a $0.9 billion net inflow on capital account and a further $2.5 billion increase in the banks' net external short-term liabilities, contributing to a rise of $6.8 billion in net official monetary assets.

Three major developments dominated *Germany's* balance of payments in 1977: the earlier decline of the current-account surplus came to a halt; net long-term capital exports again assumed sizable proportions so that the basic balance of payments went into deficit; and there was a rapid acceleration in net short-term capital inflows, both bank and non-bank, in the second half of the year which produced a substantial increase in reserves as a result of official intervention to moderate the appreciation of the Deutsche Mark.

The current-account surplus, at $3.9 billion, was unchanged from its 1976 level. The trade surplus rose by $2.5 billion to $19.2 billion, the second largest ever recorded; and there was an offsetting increase in the customary invisibles deficit to $15.3 billion, due mainly to substantially higher net tourist expenditure and a fall in net investment earnings.

The outturn on trade account seems to have been largely the result of cyclical factors. The 5 per cent. growth in export volume, slightly faster than the estimated growth rate of world trade, was considerably below the 13½ per cent. achieved in 1976. In addition, export prices rose in DM terms by only 1½ per cent. Competitive pressures resulting from the appreciation of the Deutsche Mark limited exporters' freedom to raise prices; indeed, in the second half of the year export prices declined temporarily as the Deutsche Mark strengthened further, thus imposing a severe squeeze on German exporters' profit margins. Balance-of-payments constraints on trading partners and cyclical factors also strongly affected Germany's export pattern.

Developed countries: Balances of payments.[1]

Countries	Years	Current balance[2]	Capital balance[2]	Overall balance[3]	Adjustments[4]	Adjusted overall balance (=total external monetary movements)[5]
		In millions of US dollars				
Austria	1976	– 1,470	430	– 1,040	– 25	– 1,065
	1977	– 2,970	1,830	– 1,140	– 55	– 1,195
Belgium-Luxembourg[6]	1976	– 295	– 715	– 1,010	270	– 740
	1977	– 310	– 1,630	– 1,940	– 380	– 2,320
Canada	1976	– 4,230	4,710	480	255	735
	1977	– 4,020	1,255	– 2,765	– 85	– 2,850
Denmark	1976	– 1,915	1,985	70	70	140
	1977	– 1,645	2,620	975	60	1,035
Finland	1976	– 1,165	950	– 215	– 10	– 225
	1977	– 190	230	40	60	100
France	1976	– 5,970	1,905	– 4,065	280	– 3,785
	1977	– 3,200	4,350	1,150	– 270	880
Germany	1976	3,890	– 3,125	765	75	840
	1977	3,920	– 2,915	1,005	– 405	600
Greece[6]	1976	– 1,085	1,020	– 65	.	– 65
	1977	– 1,280	1,295	15	.	15
Ireland	1976	– 265	410	145	75	220
	1977	– 230	240	10	10	20
Italy	1976	– 2,850	1,470	– 1,380	375	– 1,005
	1977	2,285	135	2,420	– 55	2,365
Japan	1976	3,680	– 770	2,910	15	2,925
	1977	11,045	– 3,440	7,605	– 505	7,100
Netherlands	1976	2,690	– 3,890	– 1,200	530	– 670
	1977	255	– 1,455	– 1,200	225	– 975
Norway	1976	– 3,785	3,650	– 135	310	175
	1977	– 4,935	4,635	– 300	5	– 295
Portugal[6]	1976	– 1,245	65	– 1,180	– 130	– 1,310
	1977	– 1,495	15	– 1,480	340	– 1,140
Spain	1976	– 4,295	2,465	– 1,830	– 200	– 2,030
	1977	– 2,255	2,765	510	– 940	– 430
Sweden	1976	– 2,430	1,695	– 735	– 60	– 795
	1977	– 3,325	3,835	510	– 70	440
Switzerland	1976	3,500	– 825	2,675	.	2,675
	1977	3,660	1,000	4,660	.	4,660
Turkey	1976	– 1,965	45	– 1,920	.	– 1,920
	1977	– 3,400	2,880	– 520	.	– 520
United Kingdom	1976	– 1,950	– 1,460	– 3,410	90	– 3,320
	1977	– 15	10,030	10,015	– 330	9,685
United States	1976	– 1,425	860	– 565	265	– 300
	1977	–20,210	– 7,135	–27,345	170	–27,175
Yugoslavia	1976	165	825	990	.	990
	1977	– 1,800	1,965	165	.	165

Note: Wherever possible, capital balances and overall balances of payments are shown exclusive of changes in commercial banks' short-term foreign positions, which, together with changes in net official monetary positions, are treated as financing items.

[1] On a transactions basis. [2] For a large number of countries current and capital-account figures exclude retained earnings on direct investment and the corresponding reinvestment of such earnings. [3] Equal to the sum of actual transactions; excludes, wherever possible, valuation gains or losses in monetary items resulting from exchange rate movements. [4] Differences mainly due to valuation adjustments and discrepancies in coverage. [5] Equal to the sum of the last two columns in the table on page 79. [6] Partly on a cash basis.

Rises in the value of exports to the United States and OPEC of 26 and 20 per cent. respectively contrasted with stagnant exports to France, Italy and eastern Europe, and actual declines in sales to the Scandinavian members of the European joint float. Thanks mainly to the continued strong expansion of exports to OPEC countries in 1977, Germany for the first time achieved a trade surplus, of $0.6 billion, with this group.

Against the background of slackening domestic economic activity the growth in the volume of imports fell steeply from 16½ per cent. in 1976 to 4½ per cent. in 1977. Imports from the United Kingdom, Japan, Austria and the non-oil developing countries registered the largest increases. By categories of goods, the volumes of imports of raw materials and semi-processed goods were virtually unchanged from the previous year's levels as stockbuilding of these commodities came to an end, while imports of finished goods continued to expand strongly.

Most of the renewed appreciation of the Deutsche Mark took place towards the end of last year, too late to reduce the trade surplus in 1977. In fact the trade surplus increased significantly, to $6.4 billion, during the last quarter of the year, with exchange rate expectations probably having caused exports to be brought forward and imports to be delayed.

On capital account net long-term outflows, which had been negligible in 1976, expanded strongly to $4.9 billion. As a result, the basic balance shifted between the two years from a surplus of $3.7 billion to a deficit of $1 billion. The resurgence of net long-term outflows originated largely in the private sector where, mainly as a result of higher purchases of foreign securities by German residents, net long-term capital exports quadrupled to $4.2 billion. In addition, there was a reversal of net official long-term transactions from an inflow of $1 billion to an outflow of $0.7 billion. A high rate of domestic saving, fairly liquid conditions in the banking sector and an interest rate differential in favour of all major foreign financial markets appear to have been the main factors behind this steady long-term outflow, which was only brought to a halt by December's exchange-market disturbances. The whole of the increase in net long-term capital exports was offset by a $5 billion swing, to an inflow of $2 billion, in net short-term capital flows. These inflows consisted almost entirely of foreign borrowing by the non-bank private sector. For the whole year Germany had an overall payments surplus of $1 billion, slightly larger than the one recorded in 1976.

In addition to the external monetary surplus there was a $4.3 billion net short-term inflow through the banks, so that net official monetary assets rose by $4.9 billion during the year. However, with the exception of July, when official intervention contributed to a temporary rise of $0.9 billion in net official assets, the first three quarters of 1977 witnessed on balance a modest reduction of $0.3 billion in the net official monetary position. In the banking sector, a net short-term outflow of $0.9 billion in the first quarter was followed by net inflows of about $2.7 billion during the second and third quarters. During the final quarter of the year, when there was strong upward pressure on the Deutsche Mark, gross short-term inflows into the banks, predominantly in domestic currency, totalled $7 billion, and the banks' net short-term external liabilities increased by $2.5 billion. Net official assets rose by $5.2 billion during the quarter, largely as a result of official intervention to moderate the appreciation of the Deutsche Mark.

During the first quarter of 1978 the current account recorded a surplus of $1.5 billion, up by $0.5 billion on the corresponding period of 1977. This increase was entirely the result of a rise in the trade surplus. In addition there were net capital inflows amounting to $2 billion. The net external monetary position improved by $3.6 billion, just over two-thirds of which, or $2.3 billion, was reflected in an increase in net official assets.

Switzerland's current-account surplus amounted to $3.7 billion in 1977, slightly more than in the preceding year. In relation to gross national product the surplus measured 5.8 per cent. and was easily the highest recorded in any industrial country. The volume increases of both exports and imports, at 12 and 10 per cent. respectively, significantly exceeded the industrial countries' average performance. The strong growth of exports, even more notable in a situation of slackening world trade, partly reflected the strengthening of the competitive position of Swiss industry which resulted from the relative stability of the effective exchange rate between the spring of 1976 and the third quarter of 1977 and from stable domestic cost/price trends. The substantial rise in import volume took place against the background of an increase in domestic economic activity greater than in most other industrial countries. However, with the terms of trade falling back almost to their 1975 level, the trade surplus was nearly halved to $0.3 billion. This decline was more than offset by a $0.4 billion increase in the invisibles surplus.

On capital account the policy of encouraging outflows continued. Gross issues of Swiss franc bonds and medium-term notes by non-residents, together with some outflows via investment trusts, totalled $5.6 billion in 1977, about the same magnitude as in 1976. However, the strengthening of the franc encouraged an acceleration of foreign bond redemptions, which doubled to $0.8 billion. Consequently, identified net long and medium-term capital outflows amounted to $4.8 billion, somewhat less than the previous year's figure. At the same time, net inflows of unidentified capital increased significantly, particularly when speculative pressures built up towards the end of the year. For the year as a whole, they amounted to $5.8 billion, against $4.4 billion in 1976. As a result, the overall balance recorded a surplus of $4.7 billion, as against $2.7 billion in 1976. The bulk of the net monetary surplus was reflected in a $4 billion improvement in the banks' net external assets, with the remaining $0.7 billion going into reserves. However, end-year window-dressing operations, viz. swaps of US dollars between the commercial banks and the Swiss National Bank as a means of assisting banks to meet reserve and liquidity requirements, conceal the underlying movements in the net official reserves and the banks' net external positions. Excluding these swaps, the 1977 increase in net official monetary assets comes to $2.6 billion, twice the amount of the preceding year, as the banks' relatively strong domestic liquidity position at the end of 1977 reduced their need for swapping US dollars to less than half of the amount used at the end of 1976.

Among the major industrial countries seeking a better balance-of-payments position last year, *Italy* achieved the largest improvement, with its current account moving from a \$2.8 billion deficit to a \$2.3 billion surplus. The 1976 trade deficit of \$4.2 billion was fully eliminated, largely as a result of restrictive domestic demand management. The volume of imports was 2 per cent. below the 1976 level, beginning to decline in the first quarter and reaching its low point in the third quarter. Export volume, on the other hand, showed an increase of 7 per cent., year on year. There was also a 2½ per cent. gain on the terms of trade, with large rises in both export and import prices, so that in value terms exports increased almost twice as fast as imports. Owing mainly to a good tourist season, the invisibles account also strengthened appreciably, to show a surplus of \$2.2 billion.

On capital account net inflows shrank from \$1.5 billion in 1976 to \$0.1 billion in 1977, primarily reflecting a reversal in net trade credits from an inflow of \$2.1 billion to an outflow of \$0.7 billion. With the capital account almost in equilibrium, Italy's overall balance recorded a surplus of \$2.4 billion, against a deficit of \$1.4 billion a year earlier. Net short-term inflows through the banks, which had amounted to \$2.3 billion in 1976, continued to be heavy in the first half of last year; by July the net short-term indebtedness of the Italian banks had risen by a further \$4.3 billion, to \$7.3 billion. During the rest of the year this was reduced on balance by \$0.9 billion. Taking 1977 as a whole, Italy's net official monetary position, excluding the effects of the revaluation of gold, improved by \$5.8 billion, gross assets increasing by \$5.3 billion and gross official liabilities declining by \$0.5 billion. All of this took place after April, when the policy of keeping the dollar exchange rate close to Lit. 880 allowed the authorities to make substantial market purchases of dollars. The decline in official monetary liabilities was the net outcome of a number of transactions: between March and June Italy drew nearly \$0.3 billion from the Bundesbank under the 1974 loan agreement, as well as \$0.5 billion from the EEC and \$0.1 billion as the first tranche of a new stand-by agreement for more than \$0.5 billion concluded with the IMF; in the third quarter repayments totalling \$1.1 and 0.5 billion were made to the IMF and the Bundesbank respectively.

During the first quarter of 1978 Italy's overall balance remained in surplus, as indicated by an improvement of around \$0.8 billion in the net external monetary position. Although gross reserves declined by \$0.7 billion, net official assets rose by \$0.3 billion as sizable repayments of official debt were undertaken in March. These repayments included \$0.5 billion to the Bundesbank, \$0.4 billion to the EEC as the first tranche of a medium-term loan received in 1974 and \$0.4 billion to the IMF in respect of a 1974 stand-by credit.

France also achieved a marked improvement on current account last year, its deficit shrinking from \$6 to 3.2 billion. About three-quarters of this change occurred on trade account, while the deficit on invisibles was halved to \$0.6 billion, entirely as a result of higher net receipts from services. Furthermore, total net capital inflows increased by \$2.5 billion, so that the overall balance of payments improved by \$5.3 billion, to a surplus of \$1.2 billion.

The trade balance improved steadily during 1977, the deficit falling from \$4.8 to 2.6 billion. Two-thirds of this deficit was recorded in the first six months, on a seasonally adjusted basis. With the terms of trade worsening a little, this better outcome was more than accounted for by volume developments. In particular, imports rose by less than 1 per cent., largely reflecting the impact of restrictive domestic demand policies. In addition, savings in fuel imports were achieved as the adverse effects of the 1976 drought wore off. At the same time, exports rose by 6½ per cent. and, in outpacing world trade growth, appear to have benefited from the effective depreciation of the franc in 1976. Exports of industrial goods showed the biggest gains, sales to the United Kingdom, the United States and the developing countries having been especially buoyant.

On top of the improvement in the current balance, total net capital inflows more than doubled last year, from $1.9 to 4.4 billion. Long-term capital transactions accounted for nearly half of this change, the net outflow falling from $1.1 billion to zero. The net proceeds of long-term borrowing from foreign banks increased from $1.7 to 2.7 billion, while direct and portfolio investment transactions produced a net inflow of $0.9 billion, almost double that recorded in 1976. But these inflows continued to be more than offset by net outflows of long-term trade credits which, at $3.7 billion, were $0.4 billion higher than in 1976. Inflows of short-term, especially unidentified, funds rose appreciably last year, from $3 to 4.4 billion. Including valuation changes, other than for gold, the external monetary counterparts of the overall surplus were a rise of $0.8 billion in net official assets and a very small reduction in the net short-term liabilities of the banking system.

Seasonally adjusted customs data for the first quarter of this year suggest that the foreign trade balance worsened slightly by comparison with the fourth quarter of 1977, but nevertheless remained close to equilibrium. On an unadjusted basis the deterioration was rather larger, by $0.7 billion, to a deficit of $0.5 billion. This was accompanied by a weakening of the franc prior to the March elections. However, outflows of funds were checked by a sharp increase in short-term interest rates in February and were then partially reversed in the latter part of March. Over the quarter, net official monetary assets fell by less than $0.4 billion.

A combination of domestic restraint and the growing impact of North Sea oil shifted the current account of the *United Kingdom* from a deficit of $2 billion to virtual balance in 1977 as a whole, including a surplus in the second half. However, this was overshadowed by the transformation on capital account — with a net inflow of $10 billion — brought about by the revival of confidence in sterling.

The elimination of the $2 billion 1976 current deficit was more than accounted for by a reduction of $3.1 billion in the trade deficit. A small part of the trade improvement stemmed from a terms-of-trade gain of about 2 per cent. and the rest from volume changes, with exports rising by 9¼ per cent. and imports by only 2¼ per cent. Excluding fuels, real export growth was 8 per cent., a creditable performance in view of the depressed state of world demand. Despite stagnant domestic demand, the volume of non-fuel imports increased by over 6 per cent., including a 13 per cent. rise in imports of finished manufactured goods. On invisibles account the surplus slipped back from its peak of $4.3 billion in 1976 to $3.2 billion, as foreign oil companies began to remit North Sea profits and as the interest payments on official and private borrowing continued to mount.

On capital account, a net outflow of $1.5 billion in 1976 gave way to a net inflow of $10 billion last year. The recovery was broadly based as confidence returned and as inflows were encouraged by favourable capital and exchange-market conditions. Private direct investment transactions produced a net inflow of $2.3 billion compared with a $0.6 billion net outflow in the previous year; net inflows for investment in securities, including government stocks, rose from $1 to 2.8 billion, and other identified capital flows swung round by $3.2 billion to generate net inflows of $1.1 billion. The surplus on capital account was further boosted by unidentified inflows, which increased by no less than $4 billion, to $4.5 billion.

With the current account in equilibrium, the United Kingdom thus registered an overall surplus of $10 billion, a turn-round of $13.4 billion by comparison with 1976. In addition to this surplus there was a $2.2 billion net inflow of funds through the banks, representing a partial reversal of the $3.2 billion net outflow that occurred in 1976, although the composition of the flow was entirely different. In 1976 the dominant feature had been a $2.5 billion decline in official sterling balances; last year these showed little change, an underlying increase having been offset by the Government's issue in April of the equivalent of $0.7 billion of foreign currency bonds to official sterling holders. By contrast, the 1977 increase in the banks' net external liabilities was more than accounted for by a $2.6 billion addition to private sterling balances. Official monetary transactions also generated an inflow of funds last year. In addition to drawings of $2 billion on the IMF stand-by credit, the Government and other public-sector bodies borrowed a net $1.9 billion on the Euro-currency market. Reserve assets showed a massive $16.4 billion gain, nearly all of it in the first ten months of the year, to reach $20.6 billion. In net terms, the official external monetary position improved by $11.9 billion.

In the first quarter of 1978 the current-account balance moved erratically and returned to a seasonally adjusted deficit of $0.4 billion, following the $0.6 billion surplus recorded in the previous three months. Reserve assets fell by $0.2 billion after net repayments of $0.4 billion borrowed under the exchange cover scheme. The underlying increase in reserves, however, came to an end in March as sterling began to weaken on an effective basis. In April, despite a swing in the current account to a record $0.6 billion surplus, heavy intervention was necessary to support the exchange rate. Official reserves fell by an unprecedented $3.3 billion, only one-third of which was accounted for by debt repayments. These included a $0.9 billion repurchase from the IMF and net repayments of $0.3 billion on Euro-currency borrowings.

In the case of the *Netherlands*, the $2.7 billion current surplus of 1976 nearly vanished, mainly as the result of a deteriorating trade performance. Exports, in particular of commodities other than gas and oil, fell sharply during the first half of 1977, partly reflecting a loss of competitiveness. For the year as a whole the volume of exports dropped 2¼ per cent. below the previous year's level, while real imports expanded by 2 per cent. Consequently, the trade account moved from a $1.6 billion surplus in 1976 to a deficit of $0.5 billion.

The virtual disappearance of the current-account surplus coincided with a reduction in net capital outflows from $3.9 to 1.5 billion. Heavy foreign demand for Dutch securities, particularly from German and Swiss residents, caused the balance on portfolio transactions to shift from a small outflow in 1976 to a $1.8 billion inflow. With the contraction of the current surplus fully offset by the

Developed countries: External monetary positions.[1]

Countries	End of year	Gold[2]	Net foreign exchange	Claims on, or liabilities to, IMF	Total official assets (net)	Commercial banks (net)	Total foreign assets (net)	Changes[3]: Official assets (net)	Changes[3]: Commercial banks (net)
		in millions of US dollars							
Austria . . .	1976	850	3,005	510	4,365	–2,220	2,145	– 45	– 1,020
	1977	895	2,770	510	4,175	–3,225	950	– 190	– 1,005
Belgium-Luxembourg	1976	1,760	2,155	1,405	5,340	–2,635	2,705	– 575	– 165
	1977	1,790	2,000	1,440	5,230	–4,845	385	– 110	– 2,210
Canada . . .	1976	880	2,480	1,500	4,860	680	5,540	– 300	+ 1,035
	1977	935	1,315	1,355	3,605	– 915	2,690	– 1,255	– 1,595
Denmark . .	1976	75	530	170	775	350	1,125	– 75	+ 215
	1977	80	1,320	205	1,605	555	2,160	+ 830	+ 205
Finland . . .	1976	35	355	– 150	240	– 710	– 470	– 145	– 80
	1977	40	425	– 175	290	– 660	– 370	+ 50	+ 50
France . . .	1976	12,840	3,295	1,245	17,380	.	.	– 2,890[4]	– 895
	1977	16,720	4,110	1,185	22,015	.	.	+ 785[4]	+ 95
Germany . .	1976	4,965	25,935	4,510	35,410	–1,335	34,075	+ 3,495	– 2,655
	1977	4,995	31,195	4,085	40,275	–5,600	34,675	+ 4,865	– 4,265
Greece . . .	1976	150	– 145	– 270	– 265	30	– 235	– 55	– 10
	1977	160	– 220	– 200	– 260	40	– 220	+ 5	+ 10
Ireland . . .	1976	20	1,685	130	1,835	– 520	1,315	+ 305	– 85
	1977	20	2,215	135	2,370	–1,035	1,335	+ 535	– 515
Italy.	1976	9,320	– 400	–2,765	6,155	–2,995	3,160	+ 1,265[4]	– 2,270
	1977	11,260	4,415	–1,775	13,900	–6,450	7,450	+ 5,820[4]	– 3,455
Japan. . . .	1976	860	13,340	1,865	16,065	-14,125	1,940	+ 3,520	– 595
	1977	920	18,785	2,270	21,975	-12,935	9,040	+ 5,910	+ 1,190
Netherlands .	1976	2,295	3,470	1,665	7,430	– 890	6,540	+ 320	– 990
	1977	2,305	3,645	1,845	7,795	–2,230	5,565	+ 365	– 1,340
Norway . . .	1976	40	1,885	390	2,315	– 175	2,140	+ 215	– 40
	1977	45	1,170	400	1,615	230	1,845	– 700	+ 405
Portugal. . .	1976	1,125	– 865	– 190	70	30	100	– 1,090	– 220
	1977	1,025	– 1,185	– 290	– 450	– 590	–1,040	– 520	– 620
Spain	1976	600	4,240	– 560	4,280	–3,805	475	– 1,040	– 990
	1977	610	5,460	– 635	5,435	–5,390	45	+ 1,155	– 1,585
Sweden . . .	1976	235	1,805	395	2,435	535	2,970	– 595	– 200
	1977	250	2,935	405	3,590	– 180	3,410	+ 1,155	– 715
Switzerland .	1976	3,515	9,255	290	13,060	9,525	22,585	+ 2,600	+ 75
	1977	3,515	9,740	475	13,730	13,515	27,245	+ 670	+ 3,990
Turkey . . .	1976	145	– 2,990	– 370	– 3,215	.	.	– 1,920	.
	1977	155	– 3,480	– 410	– 3,735	.	.	– 520	.
United Kingdom .	1976	890	– 9,600[5]	–1,320	– 10,030	.	.	– 6,540	+ 3,220[6]
	1977	940	4,320[5]	–3,425	1,835	.	.	+ 11,965	– 2,180[6]
United States	1976	11,600	– 91,660[7]	6,930	– 73,230	13,865[8]	-59,365	– 8,745	+ 8,445
	1977	11,720	-126,015[7]	7,575	-106,720	20,180[8]	-86,540	– 33,490	+ 5,315
Yugoslavia .	1976	60	1,980	– 360	1,680	.	.	+ 990	.
	1977	65	2,025	– 245	1,845	.	.	+ 165	.

[1] For most countries the figures do not correspond exactly to published ones. [2] In France and Italy gold is valued at market-related prices; in one-third of the countries it is valued at $42.22 per ounce and in the remainder via SDRs, being converted to dollars at prevailing dollar/SDR rates. [3] The sum of the last two columns is equal to the adjusted overall balance in the table on page 73. [4] Excludes changes arising from revaluation of gold. [5] Includes, as liabilities, government foreign currency bonds and Euro-currency borrowing and other public-sector borrowing under the exchange cover scheme. [6] Includes changes in the banks' foreign currency *positions vis-à-vis non-residents*, in their sterling claims on non-residents and in all sterling liabilities to non-residents, official and private. [7] Equals convertible currency assets minus bank-reported liabilities to foreign official institutions. [8] Banks' short-term claims on foreigners minus their short-term liabilities to non-official foreigners.

decline in net capital exports, the overall deficit, at $1.2 billion, was the same as in 1976. Including valuation changes, the net external monetary position deteriorated by only $1 billion, with net short-term banking inflows of $1.4 billion and an increase in net official assets of $0.4 billion. The improvement in the net official monetary position occurred entirely during the second and third quarters, when the guilder's strong position in the "snake" forced the authorities to intervene. Net inflows through the banks were concentrated in the last three quarters of the year, after a first-quarter net outflow of $0.6 billion.

Developments in *Canada's* balance of payments last year were dominated by a very marked reduction in net capital inflows, as a result of which the overall balance shifted into substantial deficit. On current account relatively buoyant conditions in the US economy caused the trade surplus to rise by $1.6 billion to $2.7 billion; this gain, however, was almost fully neutralised by higher net payments for invisibles, with the result that the current deficit of $4 billion was only marginally lower than that recorded the year before.

On capital account the total net inflow declined from $4.7 to 1.3 billion. Net long-term inflows, at $4.1 billion, were only half as large as in the previous year. In particular, net new Canadian bond issues abroad fell off from $8.3 to 4.6 billion. Narrowing interest rate differentials vis-à-vis the United States, lower borrowing requirements of some provinces and domestic political uncertainties appear to have been the major factors behind this development. With net short-term capital outflows of almost the same magnitude as in 1976, the overall balance swung from a $0.5 billion surplus to a $2.8 billion deficit. The corresponding deterioration in the overall external monetary position included a decline of $1.2 billion in net official assets, essentially dollar reserves, and a $1.6 billion net short-term inflow through the banks. More than half of the reserve loss occurred in the first quarter of the year, when the Canadian dollar was under heavy pressure on the exchange markets.

The current account of *Belgium-Luxembourg* closed in 1977 with a deficit of $0.3 billion, exactly the same as in the preceding year. A slight deterioration, to $1.1 billion, in the trade deficit was offset by an increase in net receipts from invisibles. On capital account total net outflows more than doubled to $1.6 billion, mainly as a result of an increase, from $0.8 to 1.5 billion, in long-term bank lending abroad. Consequently, the overall deficit widened from $1 to 1.9 billion, the main monetary counterpart of which was a $2.2 billion deterioration in the net external short-term position of the banks. By contrast, the net official monetary position deteriorated by only $0.1 billion, although there were some significant movements in the course of the year. During the first ten months net official assets rose steadily by $0.6 billion; in November and December, however, when the Belgian franc came under pressure in the European joint float, the authorities incurred liabilities of $0.6 billion to the European Monetary Co-operation Fund as a result of support operations. In early 1978 the pressure on the franc eased, these liabilities were paid off and net official monetary assets resumed their rising trend.

Having deteriorated in each of the previous three years, the current-account position of *Sweden* worsened by a further $0.9 billion in 1977, to a record deficit of

$3.3 billion. The rise in the current deficit was largely attributable to higher net payments for invisibles, particularly in the form of investment income and travel expenditure. For the year as a whole the trade account showed a small surplus of $0.2 billion, half of that recorded in the previous year. The underlying trend of trade flows, however, changed markedly after the 10 per cent. devaluation of the krona in late August. A third-quarter trade deficit of $0.3 billion was followed by a $0.4 billion surplus in the fourth quarter; the improvement continued during the first three months of 1978.

On capital account the most notable feature of 1977 was the Government's decision to borrow abroad directly in order to cover the large budget and external payments deficits. The Government raised the equivalent of $2 billion, with the result that net long-term capital inflows increased from $0.3 billion in 1976 to $2.3 billion in 1977. With net short-term capital inflows remaining close to the previous year's levels, total net capital inflows rose from $1.7 to 3.8 billion. As a result, the overall balance swung from a deficit of $0.7 billion to a surplus of $0.5 billion. In addition there was a net short-term inflow of $0.7 billion via the banks. Consequently, for the year as a whole Sweden's net official monetary position improved by $1.2 billion. Official reserve movements went through three distinct phases, however. In the period to May the reserves rose by $0.8 billion; in the following three months, despite substantial government borrowing, they fell by $0.6 billion, as the authorities intervened heavily prior to the August devaluation of the krona. During the remainder of the year they recovered by $1 billion, and in the first four months of 1978 they rose by a further $0.5 billion.

The *developed countries outside the Group of Ten and Switzerland,* many of which have since 1974 been struggling with obstinately large payments deficits, experienced a slight further increase in their aggregate current-account deficit during 1977, to $23.4 billion. This disappointing performance for the group as a whole conceals some pronounced changes in both directions in the positions of individual countries. Thus, three countries which followed a strict course of demand restraint throughout 1977 recorded remarkable improvements on current account. In Spain the deficit was reduced by a substantial $2 billion to a total of $2.3 billion; a $1 billion decline in Finland's deficit brought its current account close to equilibrium; and, as a result of a massive $3 billion swing, South Africa recorded a surplus, amounting to $1 billion. In addition, Israel managed to halve its current deficit, to $0.5 billion. More than offsetting these improvements, however, were sharp deteriorations in the current balances of five countries all of which, in varying degrees, experienced relatively buoyant import demand, terms-of-trade losses and deteriorating invisibles accounts. Austria's and Australia's deficits doubled to $3 billion and $2.7 billion respectively; Norway's deficit rose by $1.1 billion to an unprecedented $4.9 billion, equivalent to 14 per cent. of gross domestic product; that of Turkey widened by a further $1.4 billion to $3.4 billion; and in Yugoslavia the 1976 surplus proved short-lived and gave way to a $1.8 billion deficit.

Despite the magnitude of their current deficits, few of these countries encountered serious financing difficulties last year. Looking at the group as a whole, the pattern of financing broadly resembles that of the preceding year, in that the bulk of the current deficit was financed by borrowing in international financial

Current-account transactions of developed countries outside of the Group of Ten and Switzerland.[1]

Countries and areas	Trade balance (f.o.b.)			Services and transfers			Current balance		
	1975	1976	1977	1975	1976	1977	1975	1976	1977
	In billions of US dollars								
Austria	− 1.39	− 2.54	− 3.79	1.07	1.07	0.82	− 0.32	− 1.47	− 2.97
Denmark	− 1.31	− 2.88	− 2.66	0.80	0.97	1.01	− 0.51	− 1.91	− 1.65
Finland	− 1.63	− 0.58	0.53	− 0.56	− 0.59	− 0.72	− 2.19	− 1.17	− 0.19
Greece[2]	− 2.51	− 2.74	− 3.23	1.44	1.66	1.95	− 1.07	− 1.08	− 1.28
Iceland	− 0.14	− 0.02	− 0.01	0	0	− 0.01	− 0.14	− 0.02	− 0.02
Ireland	− 0.46	− 0.61	− 0.81	0.44	0.35	0.58	− 0.02	− 0.26	− 0.23
Norway	− 2.85	− 3.50	− 3.99	0.37	− 0.29	− 0.94	− 2.48	− 3.79	− 4.93
Portugal[3]	− 1.67	− 2.11	− 2.53	0.85	0.87	1.03	− 0.82	− 1.24	− 1.50
Spain	− 7.39	− 7.33	− 6.02	3.85	3.03	3.76	− 3.54	− 4.30	− 2.26
Turkey	− 2.84	− 2.60	− 3.60	0.99	0.64	0.20	− 1.85	− 1.96	− 3.40
Yugoslavia	− 2.99	− 1.88	− 3.59	1.96	2.05	1.79	− 1.03	0.17	− 1.80
In western Europe	−25.18	−26.79	−29.70	11.21	9.76	9.47	−13.97	−17.03	−20.23
Australia	2.13	2.03	0.91	− 2.75	− 3.45	− 3.58	− 0.62	− 1.42	− 2.67
New Zealand	− 0.81	− 0.24	− 0.10	− 0.54	− 0.74	− 0.90	− 1.35	− 1.98	− 1.00
South Africa	− 0.75	− 0.36	2.30	− 1.73	− 1.61	− 1.30	− 2.48	− 1.97	1.00
In the southern hemisphere	0.57	1.43	3.11	− 5.02	− 5.80	− 5.78	− 4.45	− 4.37	− 2.67
Israel	− 3.47	− 2.74	− 2.20	1.19	1.71	1.70	− 2.28	− 1.03	− 0.50
Total	−28.08	−28.10	−28.79	7.38	5.67	5.39	−20.70	−22.43	−23.40

[1] On a transactions basis. [2] On a cash basis. [3] Partly on a cash basis.

markets, by both public and private sectors. Gross new borrowings by all countries in this group from banks in the Group of Ten countries and Switzerland and from foreign branches of US banks in the Caribbean area and the Far East totalled $16 billion in 1977, against $14 billion in the previous year. The remainder of the financing consisted largely of short-term capital inflows, with, in contrast to 1976, little use being made of IMF credit or official reserves. In fact the aggregate official reserves of this group of countries rose by $1.6 billion last year. However, these gains were limited to a fairly small number of countries, among which were Denmark, Ireland and Spain.

Oil-exporting countries.

After having risen in 1976, the current payments surplus of the oil-exporting countries resumed its downward trend last year; at $34 billion, it was $6 billion below the previous year's figure. Most of this decline occurred on trade account, where the surplus dropped from $73 to 68 billion, mainly as a result of volume changes, the group's terms of trade having risen slightly. On the import side, volume growth remained fairly strong, although continuing to decelerate. In value terms, imports were more than one-quarter higher, pointing to a volume increase of nearly 17 per cent., down from almost 23 per cent. a year earlier. As in 1976, the fastest import growth was recorded by the four main "low absorbers", Kuwait, Libya, Saudi Arabia and the United Arab Emirates, whose combined imports rose by

40 per cent. in value. In contrast, the oil producers' exports fell slightly in volume terms as a number of factors combined to depress foreign demand for their oil; these included sluggish economic conditions in the industrial world, higher production outside the traditional oil-exporting areas, high oil stocks at the end of 1976 and the impact of conservation measures. Current-account data for individual oil-exporting countries are not yet available for 1977, but to judge from trade figures, a number of the "high absorbers", including Algeria, Ecuador, Nigeria and Venezuela, appear to have registered current deficits last year. Consequently, the "low absorbers" now account for an even higher proportion of the oil exporters' combined surplus.

The reduction in the combined current-account surplus of the oil-exporting countries has been accompanied by increased borrowing by a number of them on international financial markets. As a group, their gross liabilities to banks in the Group of Ten countries and Switzerland, and to the branches of US banks in the offshore centres, rose by $11.3 billion, compared with $9.8 billion in 1976. In addition, international bond issues by oil exporters amounted to $0.8 billion in 1977, considerably more than in the previous year. The major borrowers were to be found among the "high absorbers", including Algeria, Ecuador, Iran and Venezuela, but there were also instances of project-related borrowing by major surplus countries, in particular the United Arab Emirates.

Oil-exporting countries: Estimated deployment of investible surpluses.[1]

Items	1974	1975	1976	1977
	in billions of US dollars			
Bank deposits and money-market placements:				
Dollar deposits in the United States	4.0	0.6	1.6	0.4
Sterling deposits in the United Kingdom	1.7	0.2	− 1.4	0.3
Deposits in foreign currency markets	22.8	9.1	12.6	11.9
Treasury bills in the United States and the United Kingdom	8.0	− 0.5	− 2.2	− 1.0
Total	36.5	9.4	10.6	11.6
Long-term investments:				
Special bilateral arrangements	11.9	12.4	10.3	11.7
Loans to international agencies	3.5	4.0	2.0	0.3
Government securities in the United States and the United Kingdom	1.1	2.4	4.4	4.3
Other[2]	4.0	7.0	8.5	5.9
Total	20.5	25.8	25.2	22.2
Total new investments	57.0	35.2	35.8	33.8

[1] Source: Bank of England. [2] Including equity and property investments in the United States and the United Kingdom, and foreign currency lending.

The increased borrowing by oil-exporting countries probably means that their investments, the estimated deployment of which appears in the above table, are now being inflated by some redepositing of borrowed funds. This, together with the lag of payments behind oil exports, may explain why the funds available for investment, down by $2 billion to $33.8 billion in 1977, did not fall as sharply as the current surplus of these countries. Last year saw a slight rise, to 34 per cent., in the proportion of funds placed at short term, with deposits in foreign currency markets continuing to be the dominant form of investment. Direct short-term placements in the United States and the United Kingdom were run down for the second successive year. Among long-term transactions, special bilateral arrangements, including loans to developing countries, rose slightly, while investment in US and UK Government securities was the same as in 1976. By contrast, with the ending in 1976 of subscriptions to the IMF oil facility, loans to international agencies fell from $2 billion to almost zero. Last year's currency unrest also appears to have left its mark on the pattern of investment; direct flows to the United States fell by one-quarter, to $9 billion, including a slowdown between the two halves of the year. In addition, although the bulk of last year's increase in the oil exporters' foreign currency deposits was denominated in dollars, diversification into other currencies became particularly marked in the closing months of the year. Finally, their sterling investments showed a small rise last year, in sharp contrast with the decline of nearly $2 billion in 1976.

Non-oil developing countries.

Following the substantial improvement of $10 billion in their combined current-account position in 1976, the non-oil developing countries reduced their total deficit by a further $4 billion last year, to $15 billion. This was little more than half the 1975 figure and, allowing for the growth in trade volumes and prices, was no greater than in the years immediately preceding the oil price increase. The 1976–77 decline in the deficit is all the more impressive if account is taken of the steady increase in interest payments on foreign borrowing.

The favourable impact of both price and volume trends on the group's current-account balance moderated markedly between 1976 and 1977; the terms-of-trade gain was halved, to 2½ per cent., while real export growth dropped from 12 to only 5 per cent. Real import growth also slowed, to less than 1 per cent. This cautious expansion of demand was largely attributable to the continued efforts of individual countries to correct their external payments positions. Indeed, more than the whole of the 1977 reduction in the group's collective current-account deficit can be accounted for by five relatively advanced countries, all of which have pursued restrictive domestic policies. Argentina, Brazil, Mexico, South Korea and Taiwan improved their current payments positions by about $5 billion last year, thereby diminishing their share of the group's aggregate deficit from one-half to about one-third in 1977. The other members of the group, especially in Africa, experienced a combined deterioration of roughly $1 billion on current account in 1977.

Turning to the financing of the non-oil developing countries' current deficit, total net inflows of private capital and funds from official sources (other than the IMF) declined in 1977 by $3 billion to $25 billion. As official flows are likely to have continued on an upward trend, their share in total financing must have risen appreciably in 1977. With a higher share of the combined current-account deficit now falling upon the group's less advanced members, a larger rôle for concessionary finance of this type seems appropriate. At the same time, with funds readily available on attractive terms in international financial markets, the non-oil developing countries' gross liabilities to banks in the Group of Ten countries and Switzerland and to the branches of US banks in the Caribbean and the Far East rose by a further $11 billion last year. As a result of borrowing and other capital inflows in excess of financing needs, these countries were able to make small net repayments to the IMF and they accumulated official reserves rapidly last year. The $9.4 billion increase in reserves was not far short of that recorded in 1976, bringing the ratio of the non-oil developing countries' total reserves to their total imports close to the level that prevailed before the oil price increase.

Centrally planned economies.

In 1977 the overall trade deficit of the group of centrally planned economies fell for the second consecutive year, to reach just $1 billion, as most of the countries concerned continued their efforts to curb the growth in their hard-currency indebtedness. No detailed information is available on these countries' invisible transactions, but it is likely that the rise in eastern Europe's net interest payments — estimated to have totalled about $2 billion in 1977 — will have prevented the decline in the trade deficit from being fully reflected in their current payments.

In trade with the western developed countries, eastern Europe's deficit fell by more than $2 billion last year, to $6 billion; with the exceptions of Hungary and Rumania, all countries recorded improvements, including sizable reductions in the deficits of Poland and the USSR. Policies aimed at restoring a more sustainable trade position with the developed West were applied to both imports and exports. The maintenance of imports at their 1976 level in dollar terms implied a significant drop in volume; new incentives to spur export growth proved insufficient to counter the adverse effects of the slowdown in economic activity in the West and exports advanced in nominal terms by 10 per cent., suggesting little change in their volume. In contrast, the trade of the eastern European countries with one another and their exports to developing countries are reported to have been buoyant. This might in part be attributable to the growing tendency to operate multilateral settlement schemes both among themselves and in their transactions with developing countries. Finally, China's trade surplus is estimated to have risen a little further last year, to $1.8 billion. This figure conceals a sizable deficit, of $1.2 billion, with developed market economies, which was more than offset by substantial surpluses vis-à-vis the developing countries.

As regards the financing of the trade deficits of eastern Europe, two major elements are identifiable. First, as indicated in Chapter VI, there were substantial gold sales by the USSR. In 1977 these sales were worth approximately $1.8 billion, sufficient to cover four-fifths of the USSR's trade deficit with developed market economies. This represented a significant increase — due largely to the rise in gold prices — over 1976, when sales were estimated at $1.4 billion, or about one-third of the trade deficit of the USSR. Secondly, the eastern European countries increased their net indebtedness vis-à-vis western banks by a further $4 billion last year. As for China, the main counterpart of its trade surplus was to be found in a substantial $1 billion rise in its net claims on western banks.

V. THE INTERNATIONAL CREDIT AND CAPITAL MARKETS.

1977 was another year of strong growth in the international financial markets. Despite a slackening in the pace of world economic recovery, slower growth in international trade and shrinking balance-of-payments financing requirements, the combined volume of net credit outstanding through the international banking sector and through the international bond markets may be estimated to have expanded in dollar terms by around $100 billion, or roughly the same amount as in 1976. However, under the impact of the liquidity-creating effects of the US external payments deficit, the growth of the markets has become increasingly supply determined. Interbank competition for new business has stiffened and the banks' lending margins have been squeezed, sometimes to a degree that can hardly be considered in the interest of the stability of the market as a whole.

Claims on non-residents held by banks in Group of Ten countries (including Switzerland) and by the branches of US banks in offshore centres rose by $109 billion in current dollars to a total of $657 billion. These figures include a substantial amount of redepositing of funds among the reporting banks themselves. Excluding the double-counting which results from this kind of interbank activity, "net" international bank credit may be estimated to have expanded by $75 billion to a total of $405 billion, compared with an increase of roughly $70 billion in 1976. The slight acceleration between the two years is, however, more apparent than real. In 1977 the appreciation of the Deutsche Mark, the Swiss franc, the yen and some other currencies used on a major scale in international banking substantially raised the dollar value of the banks' assets and liabilities in these currencies. The effects of these valuation changes on the dollar figure for the net growth of international bank credit may be estimated at over $10 billion, whereas in 1976 they appear to have amounted to only $5 billion.

In contrast to 1976, when lending from the United States or through the offshore centres of the Caribbean had been the most dynamic element in international bank activity, in 1977 growth was particularly strong in the European centres. Banks in the eight reporting European countries accounted for 74 per cent. of the total increase in the external claims of all reporting banks, whereas in 1976 their share had amounted to "only" 53 per cent. The renewed prominence of the European centres was also reflected in the development of the "net size" of the narrowly defined Euro-currency market. Excluding double-counting due to the redepositing of funds among the reporting banks but including foreign currency operations with the domestic non-bank sector, the amount of Euro-currency credit intermediated by the banks in the reporting European countries may be estimated to have expanded by $53 billion to a total outstanding of $300 billion.

For lack of appropriate data, the figures given above in respect of total international banking activity do not include the positions of banks, other than branches

Estimated lending in international markets, changes in external claims of banks in domestic and foreign currencies and international bond issues.

Lenders	Changes 1975	1976	1977	Amounts outstanding 1977
	in billions of US dollars			
Banks in European Group of Ten countries and Switzerland	+ 50.5	+ 55.7	+ 80.6	433.6
of which in foreign currency (Euro-currency market)	*+ 42.9*	*+ 47.2*	*+ 68.5*	*373.8*
Banks in Canada and Japan	− 0.3	+ 4.8	+ 0.8	39.8
Banks in the United States	+ 13.6	+ 21.3	+ 11.5	92.6
Branches of US banks in offshore centres[1]	+ 15.0	+ 23.8	+ 16.4	91.3
Total (all reporting banks)	+ 78.8	+ 105.6	+ 109.3	657.3
minus: double-counting due to redepositing among the reporting banks	38.8	35.6	34.3	252.3
A = Net new international bank lending[2]	40.0	70.0	75.0	405.0
Euro-bond and foreign bond issues	22.8	34.3	35.0	.
minus: redemptions and repurchases	3.3[3]	4.3[3]	5.5[3]	.
B = Net new international bond financing	19.5	30.0	29.5	.
A+B = Total new bank and bond financing	59.5	100.0	104.5	.
minus: double-counting[4]	2.5[3]	3.5[3]	4.5[3]	.
Total net new bank and bond financing	57.0	96.5	100.0	.

[1] Bahamas, Cayman Islands, Panama, Hong Kong and Singapore. [2] *In addition to direct claims on end-users,* these estimates include certain interbank positions: first, claims on banks outside the reporting area, i.e. outside the financial and offshore centres, the assumption being that these "peripheral" banks will not, in most cases, borrow the funds from banks in the financial centres simply for the purpose of redepositing them with other banks in these centres; second, claims on banks within the reporting area to the extent that these banks switch the funds into domestic currency and/or use them for direct foreign currency lending to domestic customers; third, a large portion of the foreign currency claims on banks in the country of issue of the currency in question, e.g. dollar claims of banks in London on banks in the United States; here again the assumption is that the borrowing banks obtain the funds mainly for domestic purposes and not for *re-lending to other banks in the reporting area;* a deduction is made, however, in respect of working balances and similar items. While the persistence of some element of double-counting in these estimates cannot be ruled out, it should be noted on the other hand that there are gaps in the statistics and the figures available at present do not cover all international bank lending. [3] These figures are based on very rough *guesses* and are inserted here mainly for purposes of illustration. But although the margins of error are large in relation to the size of the figures, they are unlikely to alter significantly the figure for total net new international financing. [4] Bonds taken up by the reporting banks, to the extent that they are included in the banking statistics as claims on non-residents; bonds issued by the reporting banks mainly for the purpose of underpinning their international lending activities.

of US banks, in the offshore centres of the Caribbean and Far East. There can be little doubt, however, that these market segments also continued to grow strongly. Nor do the figures cover Bahrain, where the assets of offshore banks rose by $9.5 billion to a total of $15.7 billion, an increase of over 150 per cent.

Turning to the international bond markets, new issues totalled $35 billion, thus slightly exceeding the very large volume registered in 1976. This strong performance was due to the ebullience of the Euro-bond market, where the volume of new issues rose from $15.4 billion in 1976 to $19.4 billion, an amount more than four times the size of that recorded during the cyclical trough of 1974; indeed, if private placements are excluded, the issue volume was ten times as large as in 1974. Foreign issues in national markets did not equal their 1976 results, contracting from $18.9 to 15.6 billion. This was not due to any general decline in the receptiveness of the markets, but for the most part reflected a smaller volume of Canadian issues in the United States and fewer issues by international institutions.

Main influences.

Despite the continuity of growth, 1977 was in some respects a year of transition and change. At the end of 1976 there had been concern, essentially of a prudential nature, about the banks' exposure in balance-of-payments financing and the soundness of the financial position of the debtor countries. By the end of 1977 the focus of concern had shifted to macro-economic questions, notably the rôle of the international financial markets in exchange rate volatility and international liquidity creation.

The main factors which helped to bring about this change in emphasis were the sharp deterioration in the US balance of payments and the declining surplus of the OPEC countries. In 1976 the disappearance of the US current-account surplus, together with the large volume of foreign lending by banks in the United States, had already led to substantial reserve gains by oil-importing countries. In 1977, however, the movement of the US current account into massive deficit in conjunction with quite large non-bank capital outflows meant that, even in the absence of any net foreign lending by banks in the United States, the funds available in the international financial markets would have exceeded balance-of-payments financing requirements in the rest of the world.

In effect, the US balance-of-payments deficit influenced conditions in the international financial markets from two directions: it tended to reduce the demand for balance-of-payments finance and to increase the supply of funds available for international lending.

To begin with the demand side, the conjunction of a $20 billion current-account deficit in the United States with a $6 billion drop in the OPEC countries' surplus necessarily implied a corresponding improvement in the current-account balance of other oil-importing countries. Other Group of Ten countries (including Switzerland) shifted from a combined current deficit of $4 billion in 1976 to a surplus of over $10 billion. The combined deficit of developing countries, which had fallen from $29 billion in 1975 to $19 billion in 1976, narrowed further to $15 billion; at this level, it was fully offset by non-bank capital inflows, so that, in sharp contrast with earlier years, these countries as a group became net suppliers of funds to the banks in the international markets. Eastern European countries were also successful in reducing their current-account deficit, by an estimated $3–4 billion.

On the sources side of the international financial markets the US deficit affected the supply of new funds in a number of ways. First, it had as its counterpart very substantial official foreign exchange accruals by other oil-importing countries, a considerable part of which was placed in markets outside the United States, notably in the Euro-currency market and, to a smaller extent, in the international bond markets. Secondly, it contributed to an easing of monetary conditions in other oil-importing countries, particularly those with external payments surpluses, which added to the flow of private funds into the international financial markets. Moreover, in order to counteract undue upward exchange rate pressures or reduce the need for official intervention in the exchange markets, the authorities of the surplus countries themselves tended to encourage money exports by their commercial banks. Finally, the speed with which some debtor countries had been able to improve their balance-of-payments and reserve positions was itself one important factor whetting the banks' appetite for further lending.

In addition to these direct and indirect consequences of the US payments deficit, a number of other influences continued to stimulate the flow of funds to the international financial markets. One was the persistent weakness of investment activity in some of the main industrial countries. Domestic credit demand was correspondingly slack, so that the banks in these countries tried to re-lend abroad the funds for which they could find no attractive outlets at home. Moreover, the reluctance to invest, combined in some cases with an improvement in cash flows, meant that the non-bank sectors in these countries also had surplus funds at their disposal, a substantial part of which found their way into the international issues markets and the international banks. The wholesale character of their business and the high degree of freedom from reserve requirements enabled banks in the international markets to offer large depositors more favourable conditions than could the banks in the national markets. Finally, OPEC countries remained important suppliers of new funds to the international markets.

By reducing the balance-of-payments financing requirements of other oil-importing countries and simultaneously increasing the supply of funds available on international markets, the US payments deficit, together with the other expansionary influences on the sources side of the markets, tended to produce lending conditions that were highly favourable to borrowers. Fortunately, at least for lenders, demand for international finance proved to be quite responsive.

For one thing, the improvement in balance-of-payments positions outside the OPEC countries and the United States was not spread uniformly throughout the rest of the world. Developed countries outside the Group of Ten remained in large deficit and heavily dependent on Euro-finance, while eastern Europe also still needed to take up funds on western financial markets. Even within the developing world, whose aggregate current balance of payments showed a substantial improvement, a number of countries remained dependent on financial accommodation from the international markets. Furthermore, OPEC countries, which had sharply increased their borrowing in 1976, remained large takers of funds, partly owing to the contraction of their current-account surpluses, partly in order to provide for future payments deficits and partly for the financing of large domestic investment projects.

Moreover, borrowing demand by other countries, too, did not solely depend on current balance-of-payments financing requirements. The years following the oil price increases had seen a sharp deterioration in the international financial positions of a large number of oil-importing countries. Some had not been able to finance the whole of their additional oil payments through borrowing abroad and by 1976 their reserves had fallen to rock bottom. And even in several of the deficit countries that had avoided reserve losses the expansion in import bills and the cyclical instability of demand for their exports, contrasting with the rigidity of their sharply increased external debt service obligations, suggested the need for a stronger cushion of reserves. These countries were thus eager to take advantage of the easy conditions in the international financial markets and to borrow for the purpose of reconstituting and strengthening their gross reserve positions.

In addition to these various types of official or officially encouraged borrowing, there was the usual demand for funds for financing large investment projects, for liquidity reasons and for other conventional purposes. Moreover, the relatively low cost of Euro-credits induced heavy recourse to Euro-finance even by residents of surplus countries. Finally, hedging operations and outright speculative activities connected with exchange rate uncertainties tended to boost the supply of and demand for Euro-currency funds, particularly in the second half of the year.

Given the abundance of new supplies, however, the responsiveness of demand was not sufficient to prevent a further easing of market conditions. Continuing a trend that was already apparent in the latter part of 1976, the scramble for prime borrowers pushed the margins charged by banks over LIBOR as low as ⅝ percentage point in some cases; even the margins asked of some borrowing countries of lower credit standing declined to levels that can hardly have left very much room for the banks to build up adequate reserves against losses. Matters were made worse for the banks by the inclination of earlier borrowers to take advantage of the easy market conditions to refinance themselves on more favourable terms. They were able to do this fairly painlessly since the penalties for premature repayments had been negotiated at a time when the banks had not foreseen the emergence of outright borrowers' markets. Moreover, the list of eligible borrowers and borrowing countries has tended to lengthen, as have maturities, and the average size of individual loans has again risen.

The US payments deficit was, moreover, one of the factors contributing towards a substantial contraction in the US banks' share in new international bank lending in 1977. By adding to liquidity creation abroad and producing very easy conditions in the international markets at a time when US short-term interest rates were beginning to rise, the US deficit tended to render foreign lending less attractive for banks in the United States. Another dampening influence was the growing public concern in late 1976 about the US banks' international risk exposure; in addition, some US banks may have found themselves approaching their self-imposed lending limits vis-à-vis individual countries. As a result, the "locomotive" rôle in international bank lending was to some extent taken over by the banks in surplus countries such as Germany, where domestic economic recovery was tapering off in 1977 and where interest rates were still declining. Compared with their US counterparts, banks in these countries still had a relatively low international risk exposure at the end of 1976. With domestic credit demand weak, they sought to achieve abroad the expansion of profits and balance sheets which they could not obtain at home, thereby sometimes squeezing lending margins to an extent hardly acceptable to banks in a somewhat less favourable position.

These developments are reflected in the US banks' external assets, the growth of which slowed down from $11.7 billion in the first nine months of 1976 to only

$2.6 billion in the corresponding period of 1977. Taking into account the increase in their external liabilities, the US banks actually switched from $6.6 billion of net money exports to $0.8 billion of net money imports, thereby offsetting a substantial part of the deterioration in the US current-account deficit. Had confidence in the dollar been sustained, the widening interest differentials in favour of the United States would undoubtedly have encouraged a continuing inflow of bank funds, thereby skimming off some of the excess liquidity in international markets and financing part of the US current-account deficit. However, in the last quarter of 1977 the adverse tide of sentiment against the dollar meant that interest rate differentials became unimportant in comparison with potential gains or losses from exchange rate movements. The resultant demand for dollars for hedging or outright speculative purposes together with end-year influences again led to very large outflows of funds through the US banking system, which continued in early 1978 in sharp contrast to the usual seasonal pattern. This outflow, which over the four-month period from October 1977 to January 1978 amounted to about $8.5 billion (net of the increase in the banks' external liabilities), aggravated the downward pressure on the dollar and added still further to the liquidity available in the international financial markets.

The geographical pattern of international banking flows.

The table on page 92 seeks to provide an overall picture of the sources and uses of international bank funds by showing the development of the reporting banks' assets and liabilities vis-à-vis individual countries and groups of countries. However, the banks' positions vis-à-vis Group of Ten countries and offshore centres largely reflect the rôle of these countries as market centres and cannot in general be used as an indicator of their importance as original suppliers and ultimate users of bank funds. The interest in this table lies therefore above all in the information it provides on the reporting banks' positions vis-à-vis countries outside the reporting area.

Claims of reporting banks on bank and non-bank residents in this outside area, which had increased by about $50 billion in 1976, rose by roughly $45 billion last year. Perhaps the most notable feature was the pronounced slowdown in new lending to non-oil developing countries from nearly $18 billion in 1976 to $11.3 billion. At the same time, new deposits received from these countries, which had accelerated sharply in 1976, continued to expand at a rapid pace, by $12.9 billion. As a result, the non-oil developing countries, which had borrowed a net amount of nearly $30 billion in the three years from 1974 to 1976, became net suppliers of new funds to the banks in the international markets to the extent of $1.6 billion last year, a turn-round that must have surprised even the most optimistic observers of the international financial scene. This would seem to suggest that, despite many doubts, international bank lending did not discourage serious balance-of-payments adjustment efforts. In fact, it appears that those developing countries that have been the largest borrowers of funds from the international banking sector showed the strongest improvement in current-account balances in 1976 and 1977 (see Chapter IV).

External positions, in domestic and foreign currencies, of banks in the Group of Ten countries and Switzerland and of the offshore branches of US banks.[1]

	1975 December	1976 December	1977 March	1977 June	1977 September	1977 December
	in billions of US dollars					
Banks' claims on:						
Group of Ten countries and Switzerland	235.1	269.5	264.4	272.9	282.2	319.7
of which: Reporting European area	*165.4*	*192.7*	*187.4*	*197.8*	*201.7*	*239.6*
United States	*30.7*	*33.3*	*33.6*	*34.0*	*40.2*	*39.1*
Canada	*7.1*	*9.4*	*10.5*	*10.9*	*11.3*	*11.6*
Japan	*31.9*	*34.1*	*32.9*	*30.2*	*29.0*	*29.4*
Offshore banking centres[2]	61.9	83.5	84.8	88.9	89.4	97.8
Other countries in western Europe	31.8	42.7	44.0	48.0	51.8	56.5
Australia, New Zealand and South Africa	9.0	11.8	12.0	12.3	12.7	13.7
Eastern Europe	21.6	28.8	28.2	29.6	30.1	32.9
Oil-exporting countries	14.3	24.1	26.1	29.7	31.9	35.4
Non-oil developing countries	63.0	80.9	80.6	83.4	86.5	92.2
of which: Latin America[3]	*43.5*	*57.4*	*57.1*	*58.3*	*60.3*	*64.0*
Middle East	*3.3*	*4.4*	*4.0*	*4.1*	*4.2*	*4.6*
Other Asia	*12.9*	*14.7*	*15.1*	*16.1*	*17.1*	*18.1*
Other Africa	*3.3*	*4.4*	*4.6*	*4.9*	*4.9*	*5.5*
Unallocated[4]	5.7	6.7	6.7	7.4	7.8	9.1
Total	442.4	548.0	547.0	572.2	592.4	657.3
Banks' liabilities to:						
Group of Ten countries and Switzerland	270.1	319.6	316.0	332.0	340.0	384.0
of which: Reporting European area	*209.1*	*240.5*	*233.6*	*246.9*	*252.5*	*290.3*
United States	*42.0*	*56.3*	*60.0*	*65.8*	*68.1*	*73.9*
Canada	*9.9*	*12.6*	*13.3*	*12.2*	*12.6*	*12.5*
Japan	*9.1*	*10.2*	*9.1*	*7.1*	*6.8*	*7.3*
Offshore banking centres[2]	40.9	56.0	57.0	61.7	65.8	71.1
Other countries in western Europe	31.1	32.6	29.8	30.5	33.9	38.7
Australia, New Zealand and South Africa	2.1	2.4	2.0	2.4	2.7	2.4
Eastern Europe	6.3	7.6	5.6	5.5	6.0	7.8
Oil-exporting countries	51.8	64.2	68.0	72.7	73.1	77.6
Non-oil developing countries	37.0	49.8	51.8	54.6	58.0	62.7
of which: Latin America[3]	*16.3*	*22.3*	*22.1*	*22.7*	*23.7*	*25.9*
Middle East	*6.0*	*7.3*	*7.6*	*8.2*	*9.4*	*10.1*
Other Asia	*10.6*	*14.9*	*16.0*	*17.8*	*18.6*	*20.0*
Other Africa	*4.1*	*5.3*	*6.1*	*5.9*	*6.3*	*6.7*
Unallocated[4]	8.9	11.7	11.4	12.3	13.5	14.0
Total	448.1	543.9	541.6	571.7	593.0	658.3

Note: The figures in this table are partly based on estimates.
[1] Offshore branches of US banks in the Bahamas, Cayman Islands, Panama, Hong Kong and Singapore. As from September 1977 these figures also cover the branches of US banks in Lebanon, but the amounts involved are very small. [2] Bahamas, Barbados, Bermuda, Cayman Islands, Hong Kong, Lebanon, Liberia, Netherlands Antilles, New Hebrides, Panama, Singapore and West Indies. [3] Includes those countries in the Caribbean area which cannot be considered as offshore banking centres. [4] Includes international institutions other than the BIS.

The 1977 slowdown in new lending to non-oil developing countries was fully accounted for by banks in the United States and US banks' branches in offshore centres. New credits from banks in the other Group of Ten countries (including the affiliates of US banks located in these countries) showed some increase, from about $6.6 to 7.3 billion. The smaller rôle of US banks was partly related to a deceleration in borrowing demand from Latin America (excluding OPEC members), where the US banks are usually the dominant lenders. Thus the reporting banks' claims on that area showed an expansion of "only" $6.6 billion, after one of $13.9 billion in 1976. New credits to Brazil contracted from about $6.5 billion in 1976 to $1.7 billion and those to Mexico from roughly $4.5 to 1.5 billion. This meant that in 1977 lending to developing countries was more broadly spread than in previous years, when Brazil and Mexico alone had accounted for at least half of total new takings, although it was still concentrated on a fairly small number of relatively well-to-do countries within that group. Moreover, new lending to non-oil countries in the Middle East also slowed down, whereas credits to developing countries in "Other Asia" accelerated, from $1.8 to 3.4 billion.

The $12.9 billion expansion in the reporting banks' liabilities vis-à-vis the developing countries was distributed fairly broadly, with Latin America accounting for a much smaller share — $3.6 billion — than on the assets side. On a net basis Latin America was therefore the only borrower, while developing countries in other areas were net suppliers of funds to the international banking sector. It may be added that the $25.7 billion total of new deposits received by the reporting banks from non-oil developing countries over the last two years compares with a simultaneous increase of $20.3 billion in these countries' official foreign exchange holdings.

The place of developing countries as the heaviest borrowers was taken over in 1977 by developed countries outside the Group of Ten with persisting large current-account deficits. New claims on these countries accelerated from $13.7 billion in 1976 to $15.7 billion, while new deposits received from them jumped from $1.8 to 6.1 billion, which suggests that on the whole they had no difficulty in financing their external payments shortfalls in the international markets. Spain, Denmark and Australia were the largest net borrowers of funds, with net takings of about $1.7, 1.7 and 1.5 billion respectively.

New lending to eastern Europe amounted to $4.1 billion, about $3 billion less than in 1976. Hungary and Poland were the largest borrowers, obtaining about $1.2 and 0.9 billion respectively, whereas claims on the Soviet Union showed only a marginal increase, after a $2.5 billion rise in 1976. In the case of Hungary, however, the figures overstate the country's external debtor position, since Hungary finances its entire foreign trade with funds raised in the international banking sector. The other eastern European countries, in contrast, rely heavily on trade credit which, in large measure, does not show up in the international banking statistics.

New credits to oil-exporting countries, which had jumped from only about $3 billion in 1975 to nearly $10 billion in 1976, amounted to $11.3 billion last year. At the same time, these countries continued to be important suppliers of new funds, their deposits with the reporting banks going up by $13.4 billion, compared with an increase of $12.4 billion in 1976; however, the acceleration between the two years is due entirely to valuation changes. Moreover, if these exchange rate effects are excluded, new deposits from OPEC countries seem to have been only marginally larger than new bank credits to these countries. In other words, in 1977 OPEC

External positions, in domestic and foreign currencies, of banks in the Group of Ten countries and Switzerland and of the offshore branches of US banks.[1]

In millions of US dollars, end-December 1977.

Liabilities/assets vis-à-vis		Liabilities	Assets
Group of Ten			
Belgium-Luxembourg	HCJU	27,416	38,664
France	HCJU	39,378	34,515
Germany, Federal Rep.	HCJU	23,981	36,202
Italy	HCJU	13,354	20,664
Netherlands	HCJU	24,207	17,354
Sweden	HCJU	3,224	7,742
Switzerland[2]	CJU	73,684	15,628
United Kingdom	HCJU	85,074	68,752
Canada	HJU	12,464	11,604
Japan	HCU	7,263	29,450
United States	HCJ	73,930	39,087
Total		383,995	319,662
Other countries in western Europe			
Andorra		90	4
Austria	HCJU	7,178	8,019
Cyprus		420	152
Denmark	HCJU	3,055	8,559
Finland	CU	1,227	4,215
Gibraltar		66	7
Greece	CJU	3,477	3,651
Iceland	C	124	300
Ireland	HCJ	2,042	2,449
Liechtenstein		419	508
Malta		690	11
Monaco		174	353
Norway	CU	2,616	6,216
Portugal	CU	1,103	1,516
Spain	CU	7,893	11,015
Turkey	CJU	590	2,573
Vatican		100	—
Yugoslavia	CJU	1,994	2,995
Residual	HCJU	5,487	3,949
Total		39,745	56,492
Other developed countries			
Australia	CJU	988	4,443
New Zealand	CJ	312	869
South Africa	CJU	793	7,166
Residual	HC	345	1,244
Total		2,438	13,722
Eastern Europe[3]			
Albania		61	2
Bulgaria		445	2,345
Czechoslovakia		444	1,259
German Democratic Republic		707	4,145
Hungary		872	4,219
Eastern Europe (contd.)			
Poland	JU	384	6,791
Rumania	J	195	1,186
Soviet Union	CJU	4,222	10,554
Residual	HCJU	455	2,407
Total		7,785	32,908
Caribbean area			
Bahamas	JU	19,867	40,154
Barbados		26	21
Bermuda	JU	4,034	1,072
Cayman Islands	U[4]	12,710	14,546
Cuba	JU	260	1,278
Dominican Republic		10	203
Haiti		9	15
Jamaica		52	305
Neth. Antilles	U	2,311	1,960
Panama	JU	7,050	9,261
Trinidad and Tobago	U	759	166
West Indies (UK)	U	880	514
Residual	HCJU	3,539	5,162
Total		51,527	74,657
Latin America			
Argentina	JU	4,333	4,507
Belize		18	9
Bolivia		178	469
Brazil	JU	6,312	22,652
Chile	JU	798	1,446
Colombia	JU	1,319	1,661
Costa Rica		154	281
Ecuador	JU	641	1,541
El Salvador		72	120
Guatemala		139	240
Guyana		43	47
Honduras		90	179
Mexico	JU	5,769	19,296
Nicaragua		41	402
Paraguay		103	41
Peru	JU	452	2,965
Surinam		124	17
Uruguay	U	573	259
Venezuela	JU	8,204	7,766
Residual	HCJU	5,511	6,979
Total		34,894	71,077
Middle East			
Oil-exporting countries:	J[5]		
a) Low absorbers: Kuwait, Qatar, Saudi Arabia and the United Arab Emirates		32,520	3,832

Liabilities/assets vis-à-vis		Liabilities	Assets
Middle East (contd.)			
b) High absorbers:			
Bahrain, Iran, Iraq, Libya and Oman		18,826	10,354
Other countries:			
Egypt	JU	2,751	1,104
Israel	JU	3,802	2,660
Jordan		668	96
Lebanon	U	3,633	515
Syria	U	697	173
Yemen		1,025	36
Yemen, P.D. Republic		240	11
Residual[6]	HCJU	9,619	3,492
Total		73,781	22,273
Other Africa			
Algeria	J	2,000	2,265
Angola		149	40
Benin		35	4
Botswana/Lesotho		41	46
Burundi		48	2
Cameroon		90	117
Cape Verde Islands		11	—
Central African Empire		18	25
Chad		13	3
Congo		66	120
Djibouti		42	1
Equatorial Guinea		—	13
Ethiopia		239	5
Gabon		162	375
Gambia		21	3
Ghana	U	143	230
Guinea		31	51
Guinea-Bissau		8	—
Ivory Coast		523	539
Kenya	J	834	136
Liberia	JU	1,265	4,530
Madagascar		56	20
Malawi		100	51
Mali		15	4
Mauritania		50	24
Mauritius		49	11
Morocco	U	932	869
Mozambique		103	12
Niger		31	22
Nigeria	J	753	499
Rhodesia		46	54
Rwanda		93	2
São Tomé and Principe		20	—
Senegal		71	111
Sierra Leone		71	14
Somalia		139	12
Sudan		151	366

Liabilities/assets vis-à-vis		Liabilities	Assets
Other Africa (contd.)			
Tanzania		305	18
Togo		40	43
Tunisia		359	209
Uganda		98	17
Upper Volta		12	19
Zaire	U	416	833
Zambia	J	152	331
Residual	CU	1,204	1,988
Total		11,005	14,034
Other Asia			
Afghanistan		172	—
Bangladesh		97	26
British Oceania		116	85
Brunei		1,247	20
Burma		17	13
China	JU	2,421	266
Fiji		127	42
French Polynesia		8	52
Hong Kong	JU	7,086	9,863
India	JU	1,875	495
Indonesia	JU	2,351	3,692
Kampuchea		24	—
Korea N.	J	44	480
Korea S.	JU	3,030	5,257
Laos		5	—
Macao		25	1
Malaysia	JU	1,998	1,241
Nepal		59	—
New Hebrides		71	132
Pakistan	JU	636	290
Papua-New Guinea		174	132
Philippines	JU	1,828	2,761
Sikkim/Bhutan		88	25
Singapore	HJU	7,914	9,468
Sri Lanka		205	6
Taiwan	JU	3,504	3,409
Thailand	JU	1,189	2,009
US Trust Territory of the Pacific Islands		99	44
Vietnam		97	128
Residual	CU	1,276	1,032
Total		37,763	40,948
International institutions	U	6,511	2,719
Unallocated	HCJU	9,819	8,758
Grand total		658,283	657,250
Memorandum item:			
Oil-exporting countries	HJU	76,258	34,633

Note: A full country breakdown of the reporting banks' liabilities and assets is available only for banks in Belgium-Luxembourg, France, the Federal Republic of Germany, Italy, the Netherlands, Sweden and the United Kingdom and for the offshore branches of US banks. For banks in the other reporting countries — Canada, Japan, Switzerland and the United States — the country breakdown is less than complete and its extent is indicated by the use of the letters C (Canada), J (Japan), H (Switzerland) and U (United States). The liabilities of banks in the United States exclude US Treasury bills and certificates held in custody by the banks on behalf of non-residents.

[1] Offshore branches of US banks in the Bahamas, Cayman Islands, Panama, Lebanon, Hong Kong and Singapore. [2] Positions vis-à-vis the BIS are included under Switzerland, except for the US banks, which report them under the residual for "Other countries in western Europe". [3] Excluding positions of banks located in the Federal Republic of Germany vis-à-vis the German Democratic Republic. [4] Figures for the US banks' liabilities and assets vis-à-vis the Cayman Islands are estimates based on other statistical reports. [5] Includes positions of Japanese banks vis-à-vis Kuwait, Saudi Arabia, the United Arab Emirates, Iran, Iraq and Libya only. [6] Includes, partly on an estimated basis, the positions of US banks vis-à-vis Middle Eastern countries other than Egypt, Israel, Lebanon, Syria and Libya (which is included under the residual for "Other Africa").

countries ceased to be large net suppliers of new funds to the international banking sector.

Nearly 60 per cent., or $7.7 billion, of new deposits received from OPEC countries was in dollars. About $1.5 billion of the $5.7 billion increase in the dollar value of their deposits in other currencies would seem to have been due to valuation changes. However, the currency composition of new OPEC deposits changed markedly in the course of 1977. In the first half of the year OPEC countries supplied $8.5 billion, nearly 90 per cent. of which was in dollars, and in the second half $4.9 billion, nearly all of which was in other currencies. On a net basis OPEC countries were borrowers of dollars in the second half of 1977, to the extent of about $4 billion, and suppliers of funds in strong currencies, to the extent of $2 billion (after adjustment for valuation effects).

Funds placed with banks in the United States and their branches in offshore centres accounted for only about 12 per cent. of total new OPEC deposits in 1977. Somewhat surprisingly, the bulk of new funds, about $10.5 billion, seem to have come from the "high absorbers", which were naturally also the largest borrowers, obtaining over $9 billion in new credits. The "low absorbers" supplied about $3 billion and borrowed about $2 billion. Saudi Arabia was of course the largest net depositor, while Bahrain (which acts mainly as an offshore banking centre), Iran and Venezuela were important both as suppliers and takers of new funds.

Turning to the reporting area, claims of banks on Group of Ten countries and the offshore centres rose by $65 billion, while their liabilities vis-à-vis these countries went up by about $80 billion. These positions vis-à-vis the "inside" area, however, are inflated by a substantial amount of double-counting, due to redepositing among the reporting banks. Nevertheless, some interesting features emerge. One is the very large increase of $14.4 billion in the other reporting banks' liabilities vis-à-vis banks (including the BIS) and non-banks in Switzerland. The size of this increase reflected in large measure the very considerable Swiss domestic savings surplus and foreign currency funds placed by Swiss banks in the international markets on behalf of non-resident customers. On the other hand, the claims of reporting banks on Switzerland showed on balance a slight decline over the first nine months of the year, but rose by $3.1 billion during the final quarter under the combined impact of end-year operations and developments in the exchange markets.

Another notable feature was the acceleration from $14.3 billion in 1976 to $17.7 billion last year in the expansion of the liabilities reported by banks vis-à-vis the United States; this was in sharp contrast to the pronounced slowdown in the growth of external assets reported by banks in the United States itself. It would appear that US non-bank corporations and other entities tended to transfer part of their surplus liquidity to the international markets, and particularly to the offshore centres, in order to take advantage of higher interest yields. It may be estimated that in 1977 these non-bank capital outflows from the United States amounted to about $6–7 billion. Exchange rate considerations do not seem to have played a major rôle, since the outflows occurred exclusively in the first nine months of the year. The $5.9 billion increase in liabilities recorded by the reporting banks vis-à-vis the United States in the last quarter was entirely vis-à-vis the US banking sector. The reporting banks' claims on the United States expanded by $6.9 billion in the first nine months of the year, but declined by $1.1 billion during the fourth quarter.

Assets of banks outside Germany, including the Luxembourg affiliates of German banks, vis-à-vis German residents rose by $7.9 billion, a large part of which represented direct credits to the German non-bank sector. The bulk of this flow occurred during the final quarter of the year under the influence of end-year transactions and exchange-market developments.

The claims of reporting banks on Japan, where in earlier years the banking sector had been one of the largest takers of funds in the international markets, fell by $5.1 billion in the first nine months of the year. This decline reflected a gradual shift towards financing some part of Japanese imports with domestic funds and the introduction of a reserve requirement on the Japanese banks' external liabilities in foreign currency, which induced them to book a larger part of their international business through their branches abroad.

Developments in the European market centres.

Having been out-performed in recent years by New York and the offshore centres of the Caribbean and Far East, the European market centres again moved to the fore in 1977. The dollar value of the external assets of banks in European Group of Ten countries and Switzerland rose by $80.6 billion to a total of $433.6 billion. Of this growth, $12.1 billion was in domestic currency, $38.4 billion in dollars and $30.1 billion — by far the largest increase yet recorded — in other foreign currencies. In 1976 the corresponding figures had been $8.5, 33.8 and 13.4 billion respectively. Because of the weakness of the dollar, it was thus in the non-dollar sector of international banking that growth accelerated. However, whereas in 1976 valuation effects had added "only" about $3 and 5.5 billion to the dollar value of the reporting banks' assets in domestic currency and in foreign currencies other than the dollar, in 1977 these exchange rate effects amounted to about $7 and 12 billion respectively.

Over 60 per cent. of the expansion of both external assets and external liabilities occurred in the final quarter of 1977 alone, with the stimulus to the banks' activities coming not only from the usual end-year operations but also from developments in the exchange markets. Dollar weakness tends to affect the banks' assets and liabilities in foreign currencies essentially in two ways. First, the banks will be offered more forward dollars by their customers, who may wish either to sell expected future receipts in dollars or to take positions against the dollar. The banks will usually cover these forward dollar purchases spot by borrowing dollars and switching them into the currencies sold forward. Secondly, non-banks will seek to borrow dollars from the banks for hedging or outright speculative purposes and to build up their deposits in strong currencies. Both types of transaction will result in an increase in the banks' Euro-currency assets and liabilities, notably in the strong currencies. Thus the dollar value of the banks' assets in Deutsche Mark, after rising by only $4 billion in the first nine months of the year, soared by $14.8 billion during the final quarter; for the Swiss franc the two

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

End of month		Dollars: Total	Dollars: of which vis-à-vis non-banks	Other foreign currencies: Total	of which: vis-à-vis non-banks	Deutsche Mark	Swiss francs	Pounds sterling	Dutch guilders	French francs
		in millions of US dollars								
		Assets								
1968	Dec.. .	30,430	5,150	7,270	1,240	3,920	1,820	610	290	240
1969	Dec.. .	47,630	6,090	10,540	2,230	5,990	2,980	580	370	150
1970	Dec.. .	60,370	11,850	17,880[1]	4,680	10,110	5,080	610	560	400
1971	Dec.. .	71,500	14,360	28,630	6,750	16,220	8,180	1,620	700	490
1972	Dec.. .	98,000	18,340	33,840	8,000	20,390	7,780	2,180	720	700
1973	Dec.I .	133,760	23,890	54,840	11,990	31,400	14,590	3,150	1,320	1,750
	Dec.II[2]	132,110	24,730	55,510	13,980	31,410	15,000	3,080	1,240	1,760
1974	Dec.I .	155,450	34,350	58,950	18,030	34,620	14,330	2,040	1,870	1,480
	Dec.II[3]	156,230	34,920	58,940	18,080	34,950	14,420	2,050	1,880	1,480
1975	Dec.. .	190,180	40,870	67,950	20,450	41,620	15,430	1,980	2,100	2,570
1976	March .	188,990	42,000	72,250	20,970	44,130	16,140	2,420	2,500	2,320
	June .	195,990	44,720	70,620	20,780	41,060	17,180	2,310	2,470	2,360
	Sept. .	201,720	46,670	76,160	22,430	45,120	17,590	2,490	3,000	2,360
	Dec. .	224,020	50,820	81,300	22,690	48,680	17,930	2,150	3,780	2,570
1977	March .	222,860	53,380	80,930	23,350	47,030	17,560	2,800	3,930	2,690
	June .	230,960	56,480	85,970	24,070	50,920	17,690	2,780	4,230	2,850
	Sept. .	238,670	59,850	90,430	26,090	52,710	18,490	3,720	3,830	3,370
	Dec.. .	262,430	64,660	111,370	31,040	67,510	22,560	4,420	4,210	3,270
Memorandum item *Positions vis-à-vis residents*										
1975	*Dec.. .*	*66,540*	*17,410*	*22,820*	*6,580*					
1976	*Dec.. .*	*74,740*	*21,330*	*26,920*	*7,560*					
1977	*March .*	*78,670*	*24.820*	*27,490*	*7,960*					
	June. .	*82,770*	*27,910*	*28,540*	*8,400*					
	Sept.. .	*85,510*	*27,400*	*29,170*	*8,440*					
	Dec.. .	*91,630*	*29,060*	*33,300*	*8,930*					
		Liabilities								
1968	Dec.. .	26,870	6,240	6,840	1,530	3,010	2,290	800	250	230
1969	Dec.. .	46,200	10,460	10,520	1,340	4,640	4,030	810	350	210
1970	Dec.. .	58,700	11,240	16,590[1]	2,450	8,080	5,720	940	550	420
1971	Dec.. .	70,750	9,980	26,970	2,740	14,630	7,760	2,110	860	440
1972	Dec.. .	96,730	11,810	35,200	3,620	19,540	8,810	2,210	1,360	1,080
1973	Dec.I .	130,470	16,370	60,960	5,610	32,140	17,060	4,790	2,260	2,160
	Dec.II[2]	131,380	17,470	60,720	5,630	32,020	17,160	4,560	2,260	2,130
1974	Dec.I .	156,180	22,440	64,750	8,100	34,220	18,250	3,560	2,760	2,270
	Dec.II[3]	156,430	22,210	64,340	8,080	34,380	18,290	3,590	2,760	2,270
1975	Dec.. .	189,470	24,280	69,200	6,690	39,940	15,290	3,140	3,550	3,350
1976	March .	189,330	25,310	70,940	7,690	40,330	15,010	3,780	3,630	3,420
	June .	196,140	26,250	69,740	8,000	38,160	15,790	3,730	3,620	3,160
	Sept. .	203,300	27,630	74,680	8,500	41,540	15,960	3,920	3,580	3,100
	Dec.. .	230,040	29,550	80,610	8,970	47,230	15,880	3,980	3,530	3,220
1977	March .	229,080	29,410	81,090	9,530	45,880	16,340	4,510	4,060	3,380
	June .	239,670	31,160	86,400	9,480	49,640	16,540	4,330	4,610	3,650
	Sept. .	247,020	32,520	92,070	10,050	51,400	17,440	5,090	5,030	4,240
	Dec.. .	272,880	34,200	110,560	12,050	64,970	20,870	5,920	4,900	4,400
Memorandum item *Positions vis-à-vis residents*										
1975	*Dec.. .*	*58,170*	*9,400*	*19,760*	*3,210*					
1976	*Dec.. .*	*64,060*	*10,660*	*23,710*	*4,290*					
1977	*March .*	*64,670*	*11,210*	*24,260*	*4,440*					
	June. .	*66,030*	*11,380*	*24,600*	*4,620*					
	Sept.. .	*69,460*	*11,360*	*24,240*	*4,780*					
	Dec.. .	*74,620*	*12,080*	*29,590*	*5,330*					

[1] $570 million of the 1970 increase in assets and $360 million of that in liabilities is due to the inclusion of positions in certain currencies not reported previously. [2] As from December 1973 (December II) the figures no longer include the Euro-currency positions of the BIS (previously reported under the figures for the Swiss banks) but do incorporate certain long-term positions not reported previously. [3] Includes certain long-term positions not reported previously by some of the banks as well as some minor changes in the coverage of the statistics.

corresponding figures were $0.6 and 4.1 billion. However, valuation effects made an important contribution to these fourth-quarter increases.

Dollar weakness also affects the banks' positions in domestic currency. Increased foreign demand for dollar credits will add to the external assets of banks in the United States, whereas the increased supply of foreign deposits in the strong currencies will tend to push up the external liabilities in domestic currency of banks in the strong-currency countries. Thus, in the fourth quarter of 1977 the dollar value of external liabilities in domestic currencies of banks in Germany, Japan and the United Kingdom rose by $10.5 billion, though over $3 billion of this was due to valuation effects. Further large increases occurred during the first quarter of 1978.

With regard to the contribution of individual market centres to the overall increase in foreign currency business with non-residents, banks in the United Kingdom accounted for less than one-third of total asset growth, which reduced their share in outstanding positions from 45 per cent. at the end of 1976 to 42.5 per cent. This decline was due to the relatively slow expansion in the foreign books of the London affiliates of US banks and to an absolute decrease in the external assets of the UK branches of Japanese banks, which (for reasons explained on page 97) cut back their claims on their head offices in Japan. The growth of the external business of other groups of banks in London continued at a rapid pace.

On the other hand, the expansion of activity in Belgium-Luxembourg and France, the most important Euro-currency centres after London, accelerated, with increases in external assets of 35 and 30 per cent. respectively. Part of this strong growth performance is explained by the fact that the relative share of non-dollar Euro-currency business is larger in these centres than in London. In Luxembourg in particular, where the affiliates of German banks play a leading rôle, the dollar value of the banks' positions in Deutsche Mark by now exceeds their positions in dollars.

In terms of growth rates, banks in Italy showed by far the largest expansion in external liabilities in foreign currency, with an increase of $6.5 billion, or 43 per cent. The greater part of this borrowing, which was undoubtedly facilitated by the market's more positive assessment of Italy's economic situation, was used for foreign currency lending to Italian firms, while $2.5 billion was re-lent abroad.

Turning to the strong-currency countries, despite the large capital inflows in connection with the currency unrest in the fourth quarter of the year, there was no decline in the net external creditor position of banks in Germany, since they were also large-scale exporters of funds. The $8.5 billion growth in the dollar value of their external assets resulted in large measure from a $7.7 billion expansion, mostly in domestic currency, in their long-term lending, with the dollar value of short-term external assets in Deutsche Mark actually showing a $0.8 billion decrease. Of the $8.5 billion increase in the banks' liabilities, more than the whole of which occurred during the final quarter of the year, $7 billion was in Deutsche Mark and $5.1 billion was at short term.

The external positions of the Swiss banks were little affected by the currency unrest. Owing to the official defences against capital inflows, such as the negative interest charge on increases in the banks' external liabilities in domestic currency,

External assets and liabilities, in domestic and foreign currencies, of banks in individual reporting countries and of the offshore branches of US banks.

			1975 Dec.	1976 Dec.	1977 March	1977 June	1977 Sept.	1977 Dec.
			in millions of US dollars					
Belgium-Luxembourg	Assets	Domestic currency	1,720	2,440	2,460	2.490	2,710	3,180
		Foreign currencies	39,070	49,420	51,070	52,910	57,420	66,950
	Liabilities	Domestic currency	2,650	3,350	3,490	3,940	4,430	4,360
		Foreign currencies	37,860	47,530	48,980	50,990	55,840	65,470
France	Assets	Domestic currency	1,180	1,450	1,490	1,770	1,990	2,080
		Foreign currencies	39,020	47,990	47,370	49,890	51,500	62,210
	Liabilities	Domestic currency	4,370	3,810	3,950	4,350	4,750	4,500
		Foreign currencies	38,110	48,660	49,930	51,180	52,970	62,970
Germany	Assets	Domestic currency	21,010	25,900	24,800	27,080	26,930	31,450
		Foreign currencies	10,640	14,330	12,930	13,360	14,050	17,280
	Liabilities	Domestic currency	13,620	17,380	16,300	17,680	18,190	24,330
		Foreign currencies	9,310	13,730	11,450	11,620	12,320	15,230
Italy	Assets	Domestic currency	440	260	300	200	270	300
		Foreign currencies	14,980	12,290	10,560	9,580	10,540	14,780
	Liabilities	Domestic currency	1,620	1,420	1,530	1,610	1,630	1,540
		Foreign currencies	15,040	14,950	14,580	16,460	16,960	21,520
Netherlands	Assets	Domestic currency	3,460	4,170	4,160	5,000	5,260	5,240
		Foreign currencies	17,350	22,000	21,100	23,390	22,970	27,180
	Liabilities	Domestic currency	2,150	4,080	4,030	4,570	4,670	5,100
		Foreign currencies	16,370	19,580	18,450	21,290	21,600	25,470
Sweden	Assets	Domestic currency	570	810	870	1,110	970	930
		Foreign currencies	2,570	2,920	2,980	2,950	2,930	3,180
	Liabilities	Domestic currency	580	670	590	750	630	580
		Foreign currencies	1,750	2,290	2,670	2,870	3,050	3,410
Switzerland	Assets	Domestic currency	9,070	10,870	11,730	12,990	14,160	14,500
		Foreign currencies	16,260	18,370	19,250	20,080	20,200	23,010
	Liabilities	Domestic currency	4,630	5,060	4,560	4,640	4,960	5,650
		Foreign currencies	12,020	15,290	14,380	15,850	15,160	18,010
United Kingdom	Assets	Domestic currency	1,700	1,800	1,720	1,820	1,940	2,080
		Foreign currencies	118,240	138,000	138,510	144,770	149,490	159,210
	Liabilities	Domestic currency	9,240	7,130	7,600	8,080	8,840	11,100
		Foreign currencies	128,210	148,620	150,730	155,810	161,190	171,360
Total	Assets	Domestic currency	39,150	47,700	47,530	52,460	54,230	59,760
		Foreign currencies	258,130	305,320	303,790	316,930	329,100	373,800
	Liabilities	Domestic currency	38,860	42,900	42,050	45,620	48,100	57,160
		Foreign currencies	256,670	310,650	310,170	326,070	339,090	383,440
Canada	Assets	Domestic currency	460	460	440	420	440	440
		Foreign currencies	13,390	16,830	17,740	16,900	18,050	17,720
	Liabilities	Domestic currency	2,010	1,960	1,880	2,190	2,030	2,220
		Foreign currencies	12,070	14,520	15,260	15,560	16,380	16,700
Japan	Assets	Domestic currency	1,530	2,080	2,280	2,380	2,820	3,550
		Foreign currencies	18,830	19,560	19,760	16,790	16,580	18,140
	Liabilities	Domestic currency	1,480	1,880	1,910	1,960	2,020	4,110
		Foreign currencies	25,210	27,160	27,880	24,410	23,610	24,470
United States[1]	Assets	Domestic currency	58,310	79,340	75,370	80,040	81,760	90,200
		Foreign currencies	1,460	1,790	2,090	1,980	1,970	2,360
	Liabilities	Domestic currency	58,180	69,910	63,710	70,970	73,320	77,330
		Foreign currencies	560	780	930	750	820	930
Offshore branches of US banks[2]	Assets	Foreign currencies[3]	51,090	74,930	77,990	84,310	87,430	91,280
	Liabilities	Foreign currencies[3]	50,960	74,080	77,910	84,230	87,600	92,050

[1] Excluding US Treasury bills and certificates held in custody on behalf of non-residents. [2] Offshore branches of US banks in the Bahamas, Cayman Islands, Panama, Hong Kong and Singapore. As from September 1977 these figures also cover the branches of US banks in Lebanon, but the amounts involved are very small. [3] Including negligible amounts in domestic currencies.

External assets and liabilities, in dollars and other foreign currencies, of banks in individual reporting countries and of the offshore branches of US banks.

			1975 Dec.	1976 Dec.	1977 March	1977 June	1977 Sept.	1977 Dec.
			in millions of US dollars					
Belgium-Luxembourg	Assets	US dollars	18,670	25,020	25,770	26,760	29,090	33,080
		Other foreign currencies	20,400	24,400	25,300	26,150	28,330	33,870
	Liabilities	US dollars	17,960	22,950	23,510	24,870	27,580	31,760
		Other foreign currencies	19,900	24,580	25,470	26,120	28,260	33,710
France	Assets	US dollars	29,690	36,180	35,920	37,030	38,320	45,160
		Other foreign currencies	9,330	11,810	11,450	12,860	13,180	17,050
	Liabilities	US dollars	27,000	36,050	37,040	37,930	38,620	44,430
		Other foreign currencies	11,110	12,610	11,890	13,250	14,350	18,540
Germany	Assets	US dollars	7,700	10,570	9,420	9,680	10,240	12,710
		Other foreign currencies	2,940	3,760	3,510	3,680	3,810	4,570
	Liabilities	US dollars	7,400	11,290	9,120	9,370	9,750	12,380
		Other foreign currencies	1,910	2,440	2,330	2,250	2,570	2,850
Italy	Assets	US dollars	12,100	9,590	8,120	7,220	7,850	11,480
		Other foreign currencies	2,880	2,700	2,460	2,360	2,690	3,300
	Liabilities	US dollars	11,830	11,860	11,290	12,830	13,240	17,010
		Other foreign currencies	3,210	3,290	3,290	3,630	3,720	4,510
Netherlands	Assets	US dollars	10,400	13,920	13,580	15,160	13,910	15,150
		Other foreign currencies	6,950	8,080	7,520	8,230	9,060	12,030
	Liabilities	US dollars	10,670	12,390	11,300	13,690	13,730	15,460
		Other foreign currencies	5,700	7,190	7,150	7,600	7,870	10,010
Sweden	Assets	US dollars	1,790	2,040	2,050	1,930	2,020	1,970
		Other foreign currencies	780	880	930	1,020	910	1,210
	Liabilities	US dollars	1,020	1,420	1,720	1,850	1,930	2,120
		Other foreign currencies	730	870	950	1,020	1,120	1,290
Switzerland	Assets	US dollars	12,890	14,120	14,770	15,690	15,730	17,070
		Other foreign currencies	3,370	4,250	4,480	4,390	4,470	5,940
	Liabilities	US dollars	9,420	11,800	10,940	12,250	11,440	13,130
		Other foreign currencies	2,600	3,490	3,440	3,600	3,720	4,880
United Kingdom	Assets	US dollars	96,940	112,580	113,230	117,490	121,510	125,810
		Other foreign currencies	21,300	25,420	25,280	27,280	27,980	33,400
	Liabilities	US dollars	104,170	122,480	124,160	126,880	130,730	136,590
		Other foreign currencies	24,040	26,140	26,570	28,930	30,460	34,770
Total	Assets	US dollars	190,180	224,020	222,860	230,960	238,670	262,430
		Other foreign currencies	67,950	81,300	80,930	85,970	90,430	111,370
	Liabilities	US dollars	189,470	230,040	229,080	239,670	247,020	272,880
		Other foreign currencies	69,200	80,610	81,090	86,400	92,070	110,560
Canada	Assets	US dollars	12,640	15,890	16,680	15,980	17,070	16,480
		Other foreign currencies	750	940	1,060	920	980	1,240
	Liabilities	US dollars	11,560	13,880	14,490	14,890	15,660	15,860
		Other foreign currencies	510	640	770	670	720	840
Japan	Assets	US dollars	16,960	17,530	17,790	14,900	14,670	15,930
		Other foreign currencies	1,870	2,030	1,970	1,890	1,910	2,210
	Liabilities	US dollars	24,340	26,200	26,970	23,620	22,800	23,360
		Other foreign currencies	870	960	910	790	810	1,110
Offshore branches of US banks[1]	Assets	All foreign currencies[2] .	51,090	74,930	77,990	84,310	87,430	91,280
	Liabilities	All foreign currencies[2] .	50,960	74,080	77,910	84,230	87,600	92,050

[1] Offshore branches of US banks in the Bahamas, Cayman Islands, Panama, Hong Kong and Singapore. As from September 1977 these figures also cover the branches of US banks in Lebanon, but the amounts involved are very small. [2] Including negligible amounts in domestic currencies.

the banks' Swiss franc liabilities showed no increase over the year if valuation effects are discounted. On the contrary, the Swiss banks continued to be large net exporters of funds, with the dollar value of their net external assets in foreign and domestic currency rising by $5 billion to a total of $13.9 billion. Even when valuation effects are deducted, these capital exports financed virtually the whole of Switzerland's massive $3.7 billion current-account surplus, making a vital contribution towards containing the upward pressure on the Swiss franc. In the fourth quarter of the year there was a large increase in the banks' gross external liabilities in foreign currencies, related in part to the usual end-of-year operations. However, their foreign currency assets also showed a strong rise and, at $0.4 billion, the banks' net external takings were only a fraction of those recorded in the fourth quarter of 1976. In the first quarter of 1978 the banks resumed their large-scale money exports.

Returning to the overall picture, after a $42 billion increase in 1976 the volume of Euro-credit outstanding through the reporting European banks may be estimated to have risen by $53 billion in 1977 to a total of about $300 billion net of double-

Estimated sources and uses of Euro-currency funds.

End of month	Reporting European area: Total[1]	Reporting European area: *of which* Non-bank[2]	United States	Canada and Japan	Other developed countries	Eastern Europe[3]	Offshore banking centres[4]	Oil-exporting countries[5]	Developing countries	Unallocated[6]	Total
	in billions of US dollars										
Uses											
1974 Dec. . . .	61.5	41.3	18.2	18.2	20.4	10.1	26.7	3.5	15.7	2.7	177.0
1975 Dec. . . .	63.0	43.6	16.5	20.2	25.8	15.9	35.6	5.3	19.5	3.2	205.0
1976 March . .	65.0	44.4	16.0	22.4	26.3	17.4	35.0	6.0	19.9	3.0	211.0
June . . .	64.4	45.1	16.8	22.6	27.8	18.5	38.1	6.9	21.3	2.6	219.0
Sept. . . .	68.2	48.3	17.6	22.9	30.1	19.6	38.4	8.1	22.5	2.6	230.0
Dec. . . .	74.4	51.5	18.2	21.6	33.0	20.8	40.8	9.6	24.7	3.9	247.0
1977 March . .	78.7	56.3	17.8	21.8	34.0	20.2	42.1	11.2	24.7	4.5	255.0
June . . .	85.4	61.8	18.9	18.8	35.5	21.4	44.3	12.7	25.5	4.5	267.0
Sept. . . .	88.3	63.1	20.4	18.4	38.9	22.1	43.5	13.6	27.1	4.7	277.0
Dec. . . .	99.2	69.9	21.0	18.7	42.6	23.8	43.7	15.6	30.0	5.4	300.0
Sources											
1974 Dec. . . .	67.8	37.1	11.9	8.7	18.5	5.1	17.8	29.1	15.5	2.6	177.0
1975 Dec. . . .	79.5	39.2	15.4	8.3	19.9	5.4	21.8	34.6	16.2	3.9	205.0
1976 March . .	82.0	40.7	15.0	9.0	20.6	5.0	24.1	34.4	16.5	4.4	211.0
June . . .	81.2	41.8	17.4	9.8	19.3	5.2	26.8	37.4	17.1	4.8	219.0
Sept. . . .	84.3	43.5	17.4	10.0	20.6	5.3	27.0	41.1	18.9	5.4	230.0
Dec. . . .	86.7	45.5	18.8	10.5	21.3	6.4	30.1	45.2	21.3	6.7	247.0
1977 March . .	91.7	47.0	19.4	10.5	19.8	4.7	29.6	47.8	23.4	8.1	255.0
June . . .	97.5	48.7	23.3	8.2	19.7	4.5	31.0	51.1	24.8	6.9	267.0
Sept. . . .	98.7	50.1	23.7	7.8	23.3	4.9	30.9	52.0	26.8	8.9	277.0
Dec. . . .	108.6	54.9	24.9	8.4	26.6	6.4	33.2	54.0	29.5	8.4	300.0

[1] Includes: (a) under "Uses", the banks' conversions from foreign currency into domestic currency and foreign currency funds supplied by the reporting banks to banks in 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 banks in the country of issue of the currency in question (such as funds received in Deutsche Mark from German banks). [2] On the "Sources" side includes trustee funds to the extent that they are transmitted by the Swiss banks to 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] Excludes positions of banks located in the Federal Republic of Germany vis-à-vis the German Democratic Republic. [4] Bahamas, Barbados, Bermuda, Cayman Islands, Hong Kong, Lebanon, Liberia, Netherlands Antilles, New Hebrides, Panama, Singapore and West Indies. [5] Algeria, Bahrain, Brunei, Ecuador, Gabon, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Oman, Qatar, Saudi Arabia, Trinidad and Tobago, the United Arab Emirates and Venezuela. [6] Includes positions vis-à-vis international institutions other than the BIS.

counting. This acceleration was due solely to the strong growth of business within the reporting European area itself; both new lending outside and the inflow of new funds into this area slowed down.

The absorption of new funds by the reporting area increased from about $11.5 billion in 1976 to nearly $25 billion. Direct credits taken up by the non-bank sector rose by $18.4 billion, or 36 per cent. Perhaps somewhat surprisingly, the largest borrowers were German non-banks, which obtained nearly $5.5 billion, mainly in Deutsche Mark, from banks abroad, notably from the Luxembourg affiliates of German banks. This borrowing was largely motivated by the lower cost of Euro-credit and became particularly attractive towards the end of the year when developments in the exchange markets exerted strong downward pressure on Euro-Deutsche Mark interest rates. The Italian non-bank sector obtained $4.3 billion of foreign currency credits, mostly from banks in Italy, a large part of this borrowing being connected with domestic restrictions on lira credit and foreign exchange regulations concerning the financing of exports and imports. The other main takers of Euro-currency credit within the reporting European area were the non-bank sectors of the United Kingdom ($3 billion) and France ($2 billion). The supply of new funds from within the reporting area went up by about $22 billion, viz. by about $3 billion less than the amount of funds employed within it, so that the reporting European countries were net users of Euro-currency funds in 1977.

Claims on Group of Ten countries outside the reporting area showed little change on balance, with increases of $2.8 and 1 billion vis-à-vis the United States and Canada respectively offset by a $3.9 billion reduction in claims on Japan. On the sources side of the market, however, there was a sharp increase of $6.1 billion in new funds obtained from the United States; to this must be added a substantial portion of the $3.1 billion expansion in liabilities recorded by the reporting banks vis-à-vis the offshore centres, since these centres serve in large measure as book-keeping entrepôts for funds from the United States.

The development of the reporting banks' positions vis-à-vis countries outside the Group of Ten closely reflected balance-of-payments trends. Non-oil developing countries became net suppliers of new funds to the Euro-market in 1977, with new deposits of $8.2 billion exceeding their drawings by nearly $3 billion. Conversely, an acceleration in lending to OPEC countries combined with a slowdown in deposits received from these countries produced a sharp contraction, from $6.3 billion in 1976 to $2.8 billion last year, in the net supply of new OPEC funds to the Euro-currency market. Eastern European countries cut back their recourse to Euro-currency credit, from nearly $5 billion in 1976 to $3 billion. Developed countries outside the Group of Ten and Switzerland stepped up their drawings from $7.2 to 9.6 billion, but new deposits received from these countries showed an even sharper increase, from $1.4 to 5.3 billion.

Developments in centres outside Europe.

One significant development last year was the marked slowdown in external lending by banks in the United States and their branches in offshore centres. After increases of $21.4 and 23.8 billion in 1976, the external claims of head offices and branches went up by only $11.4 and 16.4 billion respectively. If the external assets of head offices and branches are consolidated by netting out the positions between the United States and the offshore centres, the slowdown was even more pronounced, from about $30 billion in 1976 to $15 billion.

The most important single element in this deceleration was a reduction in new lending to non-oil developing countries, from just over $11 billion in 1976 to about $4 billion in 1977. As already mentioned, prudential concern in the United States about the US banks' international risk exposure, the squeeze on the banks' lending margins, and smaller borrowing demands from some of the principal Latin American countries were probably the main factors accounting for this development. In addition, the growth of claims on other Group of Ten countries dropped quite sharply from $9.2 to 4.6 billion — partly owing to the smaller funding requirements of US banks' affiliates in those countries. On the other hand, new lending to oil-exporting countries held up relatively well, amounting to $3.7 billion compared with $4.5 billion in 1976.

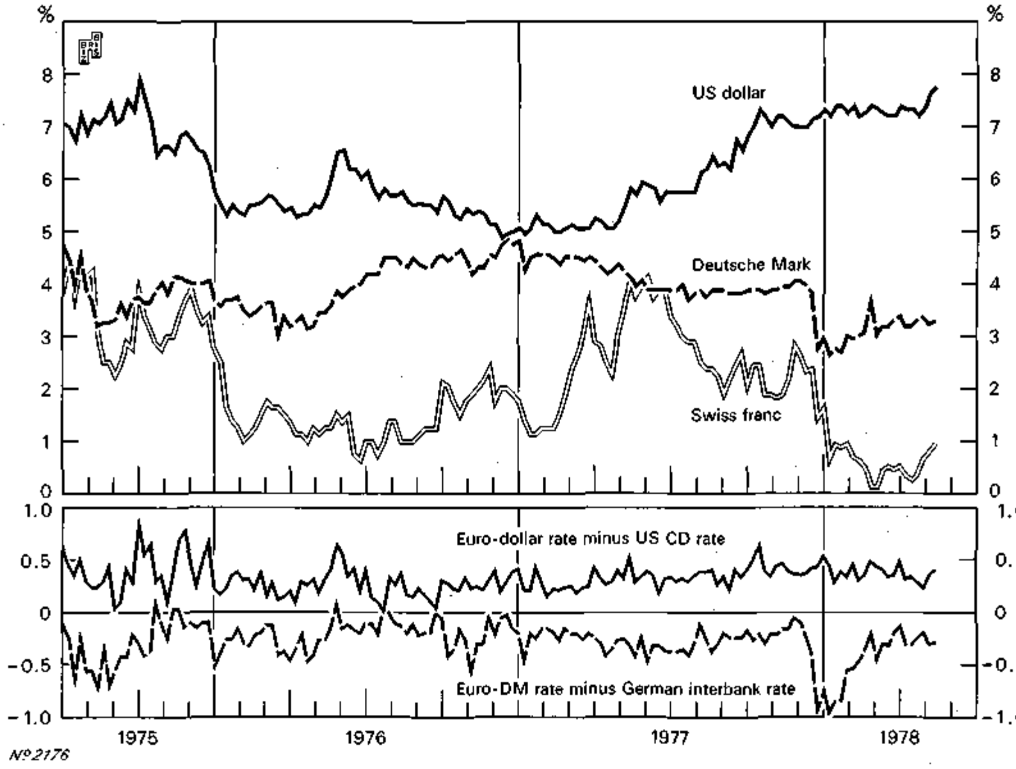
In 1976 the Canadian banks had built up their external assets by $3.4 billion, or by $1 billion net of the increase in their liabilities. This outflow had helped to offset the balance-of-payments surplus resulting from the very large volume of foreign bond issues by Canadian residents. Conversely, in 1977 a sharp contraction in Canadian issues abroad and the emergence of an external payments deficit were accompanied by a slowdown, to $0.9 billion, in the Canadian banks' external lending, while the growth of their external liabilities continued at the same pace as in 1976.

Japan was the only reporting country where the banks' gross external foreign currency assets and liabilities both declined, by $2.7 and 1.4 billion respectively. This was due to the gradual shift towards yen financing of foreign trade and to new reserve requirements on foreign currency liabilities (see page 97). The reduction in the banks' net external debtor position in foreign currency was, however, partly offset by the shift from net assets to net liabilities in their external yen position, owing to a sharp increase in non-resident free yen deposits in connection with the currency unrest in the fourth quarter of the year. These inflows, together with some valuation effects, pushed the dollar value of the banks' external yen liabilities up from $2 billion at the end of September to $4.1 billion three months later. Despite the imposition in November of a 50 per cent. reserve requirement on the increase in such liabilities, the inflows continued at a rapid pace in early 1978, and by the end of March they had risen to nearly four times their level of six months earlier.

Interest rate developments.

Last year saw substantial changes in the structure of Euro-currency interest rates. Whereas Euro-dollar deposit rates moved upwards in line with US domestic interest rates, balance-of-payments developments and exchange rate pressures contributed to an easing of Euro-Deutsche Mark and Euro-Swiss franc rates.

Interbank rates on three-month Euro-currency deposits and differentials over domestic rates.
Wednesday figures, in percentages per annum.

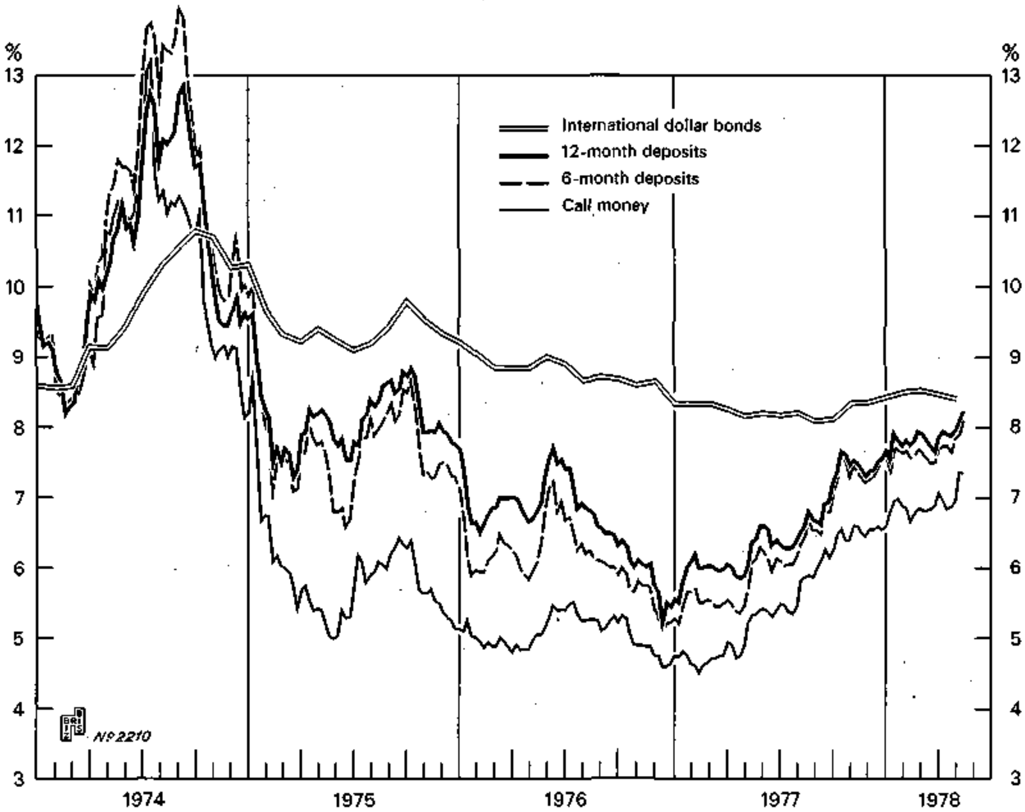


In early 1977 three-month Euro-dollar deposit rates were quoted at around 5 per cent., their lowest level since June 1972. This was about 1 percentage point less than twelve-month rates and 3½ percentage points below Euro-dollar bond yields. The unusually steep yield curve reflected fears of a renewed tightening of US monetary conditions. And when, from the spring onwards, this actually happened, Euro-dollar rates gradually moved up to around 7¼ per cent. by the middle of October and subsequently stabilised at about that level. In contrast to early 1973, when the weakness of the dollar had resulted in a sharp widening in the premium of Euro-dollar rates over comparable US interest rates, during the pronounced exchange-market turbulence in late 1977 and early 1978 the premium of three-month Euro-dollar rates over comparable CD rates in the United States stayed mostly within its normal band of ¼ to ½ percentage point. It would appear that even very small changes in interest rate differentials were sufficient to elicit the money outflows from the United States necessary to restore balance between the demand for and supply of Euro-dollar funds.

The impact of the currency unrest on Euro-currency deposit rates was much more evident in the case of the Deutsche Mark and the Swiss franc. After declining slightly in the spring, Euro-Deutsche Mark rates held fairly steady until December, when the intensification of exchange-market pressures and the introduction in Germany of measures to ward off capital inflows caused the three-month Euro-

Deutsche Mark rate to drop by 1½ percentage points. As a result, its discount in relation to comparable German domestic rates widened temporarily to nearly 1 percentage point and the uncovered yield differential between Euro-dollar and Euro-Deutsche Mark rates rose to over 4 percentage points, its highest level since autumn 1975.

Euro-dollar deposit rates and Euro-dollar bond yields.
Weekly averages and end-of-month rates.



Euro-Swiss franc rates showed much less stability than Euro-Deutsche Mark rates in the early part of 1977. A temporary tightening of domestic monetary conditions facilitated by a slackening of the upward pressures on the Swiss franc caused short-term Euro-Swiss franc rates to rise from 1¼ per cent. at the beginning of the year to 4 per cent. in mid-May. Thereafter, however, the renewed strengthening of the Swiss franc brought about a decline in rates and by the end of the year three-month Euro-Swiss franc rates were down to about 1½ per cent. In contrast to the Euro-Deutsche Mark sector — where some upward adjustment subsequently occurred — the downward movement continued in early 1978 and, as a result of a further tightening in late February of the Swiss regulations against money inflows, Euro-Swiss franc rates temporarily fell to almost zero.

The international bond markets.

Notwithstanding a marked decline in foreign offerings in the United States and Switzerland and the currency unrest in the latter part of the year, total international bond issues reached a new record level of $35 billion in 1977, marginally higher even than the 1976 figure. For the first time since the removal of US controls on capital outflows in January 1974, Euro-bond issues exceeded traditional foreign issues on domestic markets, with total placements increasing by 26 per cent. to $19.4 billion. As in the two preceding years, the Euro-bond market benefited from the abundance of liquidity resulting from the weak domestic demand for credit in the major industrial countries and growing disenchantment with the equity markets. In addition, an increasing volume of funds stemming from the amortisation of earlier issues and from interest payments was reinvested on the market.

The ample availability of funds, supported by growing interest on the part of institutional investors, was most clearly in evidence in the dollar sector during the first nine months of the year when, despite the rise in US short-term interest rates

International bond issues.[1]

Borrowing countries or areas	Years	Euro-bond issues				Foreign issues			
		Total	*of which* US dollars	*of which* Deutsche Mark	*of which* Private placements	Total	*of which* in United States	*of which* in Switzerland	*of which* Private placements
		in millions of US dollars							
Western Europe .	1975	4,880	1,350	1,770	1,760	3,150	850	1,760	1,670
	1976	5,740	3,830	1,330	1,070	5,110	1,240	3,370	2,960
	1977	8,950	5,690	2,710	1,800	4,420	1,230	2,610	2,270
Canada	1975	1,150	610	—	320	3,410	3,110	280	830
	1976	3,000	1,570	40	150	6,080	5,720	370	4,060
	1977	1,950	980	410	60	3,260	2,900	270	1,660
United States . .	1975	310	220	—	80	140	—	40	120
	1976	410	400	—	120	30	—	—	30
	1977	1,310	1,210	10	450	240	—	40	200
Other developed countries[2]. . .	1975	2,230	1,350	700	650	1,030	380	600	670
	1976	2,060	1,500	510	300	1,500	710	790	680
	1977	2,090	1,470	580	330	1,430	670	640	490
Rest of the world[3]	1975	440	230	80	120	550	460	20	230
	1976	1,060	450	270	180	910	690	120	210
	1977	2,600	1,000	1,150	440	1,530	820	330	360
International institutions . .	1975	1,510	1,060	340	860	4,020	1,980	670	1,360
	1976	3,100	2,250	670	1,890	5,300	2,270	790	1,960
	1977	2,450	1,950	240	850	4,730	1,960	810	1,660
Total issues placed	1975	10,520	4,920	3,100	3,790	12,300	6,850	3,530	4,880
	1976	15,370	10,000	2,820	3,710	18,930	10,630	5,440	9,900
	1977	19,350	12,300	5,100	3,930	15,610	7,580	4,700	6,640

Note: Totals for 1975 include revisions which have not been allocated by currencies and markets.
[1] Based on IBRD and OECD sources. [2] Australia, Japan, New Zealand and South Africa. [3] Including eastern European countries.

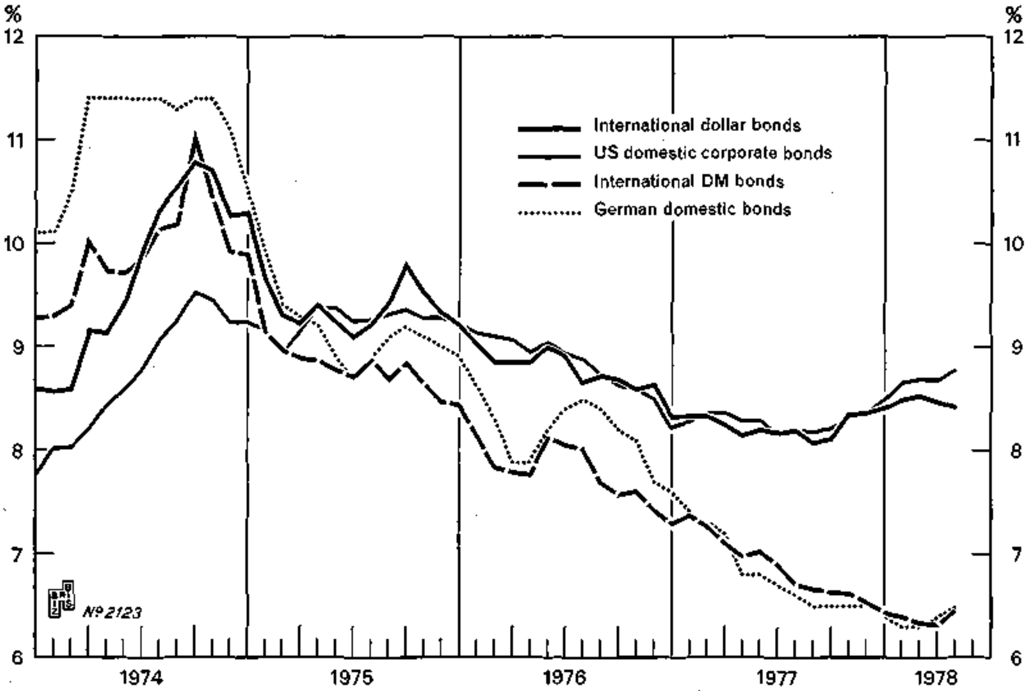
and initial signs of dollar weakness, borrowers were able to raise large volumes of funds on even more favourable terms than before: coupon rates showed some further decline and the average maturity lengthened to nearly ten years from about eight years in 1976. Despite considerable interest in DM-denominated paper, the dollar sector still accounted for nearly two-thirds of new Euro-bond issues.

This situation changed abruptly in October, when in response to the accelerating slide of the dollar and a further rise in US interest rates, demand for dollar bonds cooled off markedly. Investors turned increasingly to assets denominated in other currencies, particularly Deutsche Mark, the share of which in total Euro-bond issues jumped from a quarterly average of 23 per cent. in the preceding nine months to 39 per cent. in the final quarter, while that of dollars shrank to 50 per cent. The strong demand for DM-denominated bonds led to a continued easing of issue conditions in that sector, whereas some tightening took place in the dollar sector. The reopening of the Euro-sterling market also helped to accommodate the demand for non-dollar issues. Activity in the other sectors remained weak, with the exception of some issues denominated in Arab currencies that were placed with OPEC countries.

For the year as a whole, however, the dollar remained the dominant currency, accounting for 64 per cent. of Euro-bond issues, only marginally less than in 1976, while the Deutsche Mark increased its share from 18 to 26 per cent. The share of the Canadian dollar dropped from 9½ to 3½ per cent., for reasons partly connected with its weakness on the exchanges; it nonetheless ranked third, with the rôle played by other currencies remaining very modest. Issues in yen, first introduced in April 1977, were of minor quantitative importance, with only two loans being raised — possibly as a result of the continued reluctance of the Japanese authorities to allow the yen to assume a larger international rôle.

The upward movement of Euro-dollar deposit rates, together with portfolio adjustments induced by exchange-market developments, stimulated activity on the secondary markets, where turnover jumped to record levels. Although some difficulty was at times reported in placing large amounts of dollar paper on account of the rise in short-term rates, Euro-dollar bond yields continued to ease until August, to levels even slightly lower than yields on comparable US domestic securities. As a result, the differential between Euro-dollar bond yields and three-month Euro-dollar interbank rates narrowed from 3¼ percentage points at the beginning of the year to about 1½ percentage points in September, without discouraging the demand for Euro-dollar bonds. In October, however, the weakness of the dollar on the exchanges began to have an impact on market conditions. With investors' interest in dollar bonds flagging, yields began to move up again and ended the year at around 8½ per cent., about ⅜ percentage point above their August low. In contrast, yields on DM bonds continued to decline throughout the year. In early 1978 they stood at around 6⅜ per cent., nearly 1 percentage point below their level of a year earlier. Since short-term Euro-DM rates have also come down the yield curve did not flatten and the differential between DM-denominated Euro-bond rates and three-month Euro-deposit rates has remained within a range of 2.5–3.5 per cent.

Yields on international and domestic markets of US dollar and DM bonds.*
End-of-month figures.



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

Foreign issues in national markets declined from $18.9 billion in 1976 to $15.6 billion last year. In the United States, where foreign issues amounted to $7.6 billion, compared with $10.6 billion in 1976, there was a 46 per cent. drop in borrowing by Canadian entities for exchange rate and interest rate reasons. In Switzerland the year-on-year decline, from $5.4 to 4.7 billion, was entirely accounted for by a slowdown in private placements, with no large-scale borrowing between May and September when domestic monetary conditions temporarily tightened. However, activity resumed at a brisk pace in the autumn as the strengthening of the Swiss franc in the exchange markets and the resultant expansion of liquidity permitted a marked easing of issue conditions.

Traditional issues of foreign bonds in Germany, a borrowing technique used almost exclusively by international institutions, declined from $1.3 to 1.1 billion. Nevertheless, the combined volume of foreign DM issues and Euro-DM issues (which in some ways also have the characteristics of traditional foreign bonds) rose from $4.1 billion in 1976 to $6.3 billion in 1977, thereby increasing the share of the Deutsche Mark in total international bond issues from 12 to 18 per cent.

Foreign issues on the Japanese market rose from $0.3 billion in 1976 to $1.4 billion in 1977, a movement which, concentrated in the second half of the year and apparently still continuing in 1978, was prompted by the Japanese authorities' more liberal policy regarding the issue of yen-denominated bonds by non-residents.

One feature of the international bond markets last year was that the abundance of funds and easy borrowing conditions enabled lesser-known borrowers to increase their share in total takings. Most significant in this respect was the stepping-up of issues by the non-oil developing countries, which raised $3.1 billion, up from $1.7 billion in 1976. Two-thirds of this amount was accounted for by two countries — Mexico and Brazil — which despite their already high external indebtedness were increasingly accepted on these markets. A few OPEC countries likewise raised sizable amounts through bond issues.

However, the bulk of international issues were once again accounted for by the developed countries, even if their share in total issues declined slightly from 70 per cent. in 1976 to 68 per cent. There was a sharp decrease, from $9.1 to 5.2 billion, in recourse to international bond finance by Canadian entities, which nevertheless remained the most active group of borrowers. Similarly, issues by French entities, the second largest group of borrowers in 1976, contracted from $2.8 to 2 billion. However, both countries increased their borrowing from the international banking sector. On the other hand, certain countries with large balance-of-payments financing needs, notably Austria, Norway and Sweden, stepped up their recourse to the international issues market.

The lower volume of Canadian and French issues meant that the share of the public sector in total borrowing declined from 48 to 46 per cent. Private entities, on the other hand, made greater calls on the markets last year, accounting for 34 per cent. of the total volume of issues, against 28 per cent. in 1976, the gain being entirely in respect of Euro-bond issues. This was partly due to a revival in the demand for funds of some non-financial corporations which made a few large-scale borrowings. Multinational corporations based in the United Kingdom and the United States were particularly active, taking advantage of the attractive issue terms. In fact, issues by US companies jumped from $0.4 billion in 1976 to $1.6 billion. Japanese corporations, mainly non-banks, remained heavy borrowers, obtaining $1.9 billion, nearly as much as in 1976. Issues by financial institutions continued at about the same pace as in 1976, largely taking the form of floating-rate notes which, especially for non-dollar-based banks, are an alternative means of securing longer-term funds for their international operations.

In the early months of 1978 the continued ample availability of investible funds benefited primarily the sectors denominated in the stronger currencies. Sizable issues in the Euro-DM, the foreign Swiss franc and the yen sectors were easily absorbed, although the measures introduced by the Swiss authorities in February to restrict the purchase of Swiss franc securities issued by foreign borrowers had some impact on that sector's overall activity. On the other hand, Euro-dollar issues met with continuing resistance on the part of investors, who were reluctant to commit their funds in a weakening currency.

In the early spring, however, when the dollar regained some degree of stability in the exchange markets, the situation began to change. With investors' euphoria about the Deutsche Mark fading, the yield differential between dollar bonds and Euro-DM bonds began to look too large, and the volume of Euro-DM issues started to exceed the new demand for such bonds. In May, in order to avoid congestion of the market, the German Capital Market Sub-Committee decided to suspend temporarily DM issues by non-resident borrowers.

VI. THE INTERNATIONAL MONETARY SCENE.

This chapter reviews the major international monetary developments of the past year and a half. The first section traces the evolution of the exchange rates of the principal currencies during that period, with particular reference to the weakness of the dollar between mid-1977 and March 1978. The second section discusses, for the currencies of the Group of Ten countries and Switzerland, the contribution of exchange rate changes to the adjustment process both during the past year and a half and since the end of 1970. The third section gives an account of gold production and gold-market developments, the highlights of which were a further increase in non-monetary absorption and in the dollar price of the metal. The fourth section describes the very rapid growth of global reserves last year, which was largely the outcome of the US current payments deficit, and discusses the future provision of reserves to meet the needs of the monetary system as a whole.

Exchange rate developments.

The substantial depreciation of the dollar between late June 1977 and March 1978 was the dominating feature of exchange-market developments during the period under review, with the opposite side of the medal being the appreciation of the currencies of the main surplus countries — the yen, the Swiss franc and the Deutsche Mark. In addition the weakness of the dollar reinforced the effect of vigorous domestic adjustment policies in reversing the fortunes of the three major currencies — sterling, the French franc and the Italian lira — which during most or all of 1976 had been particularly weak. In 1977 and early 1978 the Canadian dollar and the Swedish krona were the only currencies of major industrial countries which declined in external value not only on the trade-weighted basis but also against the US dollar. Since March 1978 the dollar has strengthened quite markedly and in late May it was standing well above the earlier low points against the currencies of the main surplus countries, and in particular against the Swiss franc.

The basic cause of the *US dollar's* weakness was the persistence, throughout the period under review, of a very substantial deficit on the current account of the US balance of payments, coupled with some acceleration of the rate of increase of domestic consumer prices. During the first five and a half months of 1977, however, the dollar was remarkably stable overall, owing in large measure to substantial market interventions by the Bank of England and the Bank of Italy, both of which were rebuilding their monetary reserves. It is true that the dollar depreciated by 6.7 per cent. against the yen during this period, but at the same time it appreciated by 4.5 per cent. against the Canadian dollar, so that in late June the trade-weighted exchange rate was less than 1 per cent. lower than it had been at the beginning of the year.

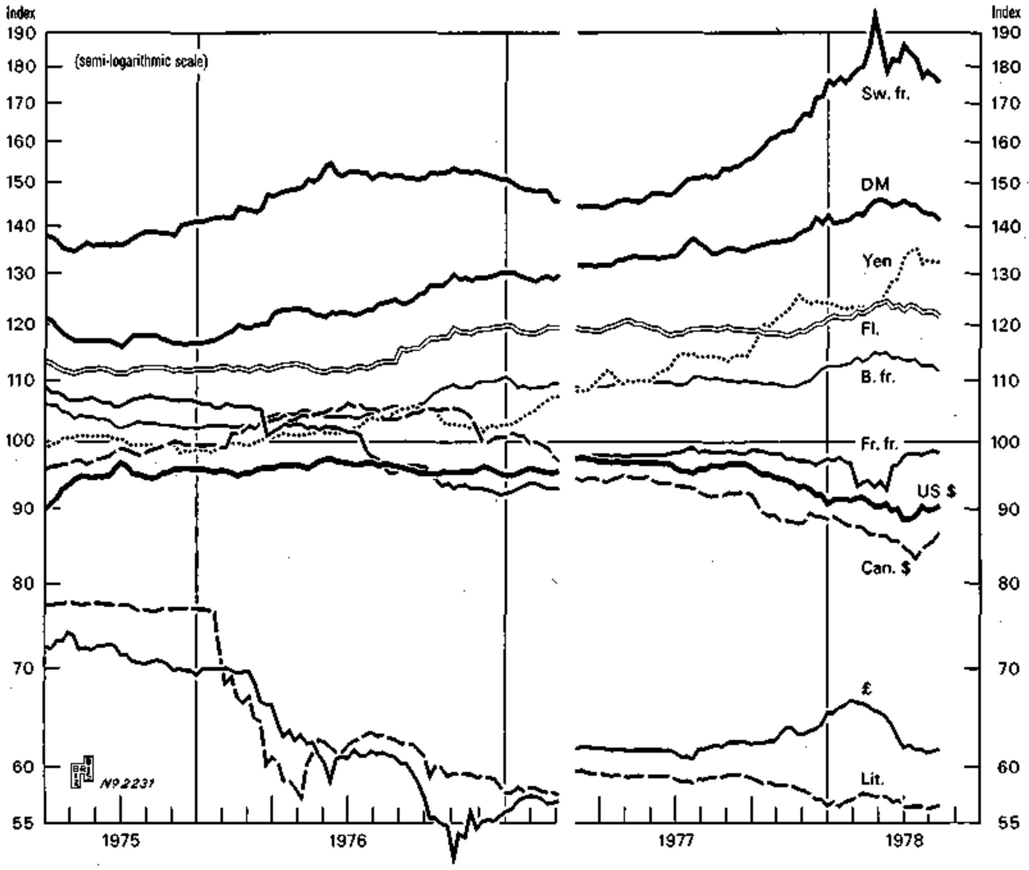
Events took a new turn after 24th June, when the communiqué issued by the Finance Ministers of the OECD countries following a meeting in Paris indicated that member countries in a strong external position were "ready to see a weakening in their current-account positions and an appreciation of their currencies in response to underlying market forces". Large-scale selling of the dollar then took place, with the result that in the four weeks to 22nd July the US currency fell by about 4 per cent. against the Deutsche Mark and the Swiss franc, by nearly a further 3 per cent. against the yen and by 1½ per cent. on the trade-weighted basis. In late July a rise in domestic short-term interest rates, together with some official US statements emphasising the importance of a strong dollar, brought about a recovery of the exchange rate. Indeed, by late September it was back to the level of three months earlier on the trade-weighted basis, although still somewhat lower against the Deutsche Mark, the Swiss franc and the yen.

Towards the end of September the dollar came under pressure again, this time more strongly than before. At the Annual Meeting of the International Monetary Fund the US Secretary of the Treasury had said that the current payments deficit for 1977 was likely to be within a range of $16–20 billion and at the same time private US forecasts of a further deterioration in 1978 appeared. Against this background, with the President's energy bill held up in Congress and the Bank of England withdrawing from substantial intervention in the exchange market towards the end of October, the decline of the dollar began to feed on itself, despite a variety of measures aimed at bringing the situation under control. These included a significant further widening of short-term interest rate differentials in favour of the dollar, various administrative measures against capital inflows taken by Germany, Japan and Switzerland, large-scale official intervention in the exchange markets by the main surplus countries and drawings totalling $0.8 billion by the Federal Reserve System on its swap line with the Deutsche Bundesbank. Between late September and the end of the year the dollar declined by a further 7 per cent. on the trade-weighted basis, by about 10 per cent. against the Deutsche Mark and the yen, and by 15 per cent. against the Swiss franc.

On 21st December the intention of the US Administration to counter the disorderly exchange-market conditions that had developed was, for the first time, publicly emphasised at the highest level, by the President himself. Shortly afterwards, on 4th January 1978, it was announced that the US Treasury had arranged a special swap line with the Deutsche Bundesbank, the amount of which was not disclosed, in order to enable it to join with the Federal Reserve System and foreign central banks in checking speculation and restoring order in the exchange markets. This decision was followed, on 9th January, by a ½ per cent. increase in the US official discount rate for purely external reasons — the first such move for many years. For a while the dollar then stabilised. But as markets came to view the various US measures as no more than a change in tactics, a new selling wave began in February which, despite further substantial interventions by the Japanese, German, Swiss and US authorities, had by the beginning of March extended the decline of the dollar since late September 1977 to 14.6, 24.7 and 12.5 per cent. against the Deutsche Mark, the Swiss franc and the yen respectively.

In the European exchange markets that proved to be the low point for the dollar. By 13th March, when the US and German authorities announced further

Effective post-Smithsonian exchange rates.*
Friday figures, Indices: 21st December 1971 = 100.



Source: Bank of England. * In March 1977 the series was put on a new basis by extending the coverage from eleven to twenty-one currencies and updating the trade weights from 1969 to 1972.

measures — including the doubling to $4 billion of the swap line between the Federal Reserve System and the Deutsche Bundesbank, the sale by the United States to Germany of SDR 600 million to procure Deutsche Mark for intervention and an indication by the US authorities of their readiness, if necessary, to draw on their reserve position at the IMF — the dollar had already begun to strengthen against both the Deutsche Mark and the Swiss franc and the atmosphere in the exchange market had improved. Pressure on the yen, however, increased very sharply in March, with the Bank of Japan taking in more than $5 billion from the market during the month and the dollar falling to Yen 218 in early April. Later that month, however, conditions in the Tokyo market too became calmer and the dollar began to strengthen against the yen. By late May, with the aid of a further tightening of US monetary policy, the dollar had recovered to stand about 11, 6 and 4 per cent. above its earlier low points against the Swiss franc, the Deutsche Mark and the yen respectively.

Among the currencies which were strongest in the exchange market during the period under review the *Japanese yen* had been the first to start rising, when Japan's current payments surplus increased strongly at the end of 1976. During the first quarter of 1977 the yen appreciated against the dollar by 5.9 per cent., from Yen 293 to Yen 276.70 and by 6.3 per cent. on the trade-weighted basis. The exchange rate then stabilised until near the middle of the year, when the general weakness of the dollar produced a further rise to Yen 263.25 by mid-July. Intervention by the Japanese authorities in the exchange market was relatively moderate and indeed at the end of September Japan's reserves were only $1.7 billion higher than at the end of 1976, with a significant part of this increase representing income from official holdings of dollars.

When the second, and more intense, phase of dollar weakness began towards the end of September, however, the Japanese authorities stepped up the level of their exchange-market interventions, so that the reserves increased by $4.3 billion in October and November. In addition various measures were announced to stimulate domestic demand, to raise the level of imports and to counter speculative inflows of funds: a $7.5 billion government expenditure package was introduced in September, together with a lowering of the official discount rate from 5 to 4¼ per cent., and a reduction in banks' reserve requirements; these were followed in November by a $3 billion import promotion scheme, a ban on non-resident purchases of Treasury bills and the imposition of a 50 per cent. reserve requirement on increases in non-residents' free yen deposits. Nevertheless, by mid-December the Japanese currency had appreciated to Yen 238 against the dollar, while on the trade-weighted basis its rise since the end of 1976 came to 20.5 per cent.

The exchange rate was then relatively stable until late February 1978, when the renewed weakness of the dollar brought the yen under further pressure. This intensified in mid-March as conditions in the European exchange markets became calmer. The Bank of Japan intervened in the exchange market on a still larger scale than in late 1977, and the reserves rose by over $5 billion in March. On the 16th of that month the official discount rate was further lowered, to 3½ per cent., the reserve requirement on further increases in non-resident free yen deposits was put up to 100 per cent. and non-residents were prohibited from buying any Japanese fixed-interest securities with maturities of less than five years and one month. After reaching a peak of Yen 218 against the dollar in early April, the yen subsequently eased somewhat. By late May the dollar rate was Yen 227.40 and the cumulative trade-weighted appreciation since end-1976 was about 27 per cent.

The *Swiss franc,* while showing a cumulative appreciation second only to that of the yen during the period under review, was on balance very stable during the first half of 1977. From around Sw.fr. 2.45 against the dollar at the beginning of the year it had in fact eased by early March to about Sw.fr. 2.56 before rising to around Sw.fr. 2.50 just before the general weakness of the dollar set in towards the middle of the year. On the trade-weighted basis, too, the franc was a little lower in late June than at the beginning of the year.

As the dollar weakened, the franc appreciated more than any other currency. During the remainder of 1977 it not only rose by about 24 per cent., to Sw.fr. 2.01, against the dollar but its trade-weighted appreciation came to almost 20 per cent. This included appreciations against the yen and the Deutsche Mark amounting to 9.6 and 11.6 per cent. respectively. The Swiss National Bank's total purchases of dollars in the exchange market during that period amounted to the equivalent of Sw.fr. 12.7 billion. In addition, the official discount rate was lowered from 2 to 1½ per cent. in July 1977, a ban on non-resident purchases of forward francs for periods of less than one month was introduced in late September, and in November the inclusion of early redemption clauses in new foreign issues of medium-term Swiss franc notes was prohibited.

After only a slight further rise in January 1978, the franc appreciated again very strongly in February, reaching a record high of Sw.fr. 1.77 against the dollar towards the end of that month. At their peaks, the cumulative appreciations since late June 1977 on the trade-weighted basis and against the dollar amounted to 32.4 and 41.3 per cent. respectively. Further measures to moderate the rise of the exchange rate were taken at the end of February 1978. They included the extension, with effect from 1st April, of the 10 per cent. per quarter negative interest charge on non-resident Swiss franc deposits to the accounts of central banks, as well as a 20 per cent. reduction of the limit below which the charge does not apply; an immediate ban on the sale of Swiss franc securities to non-residents, the only partial exception to which was in respect of foreign issues on the Swiss market; and the reimposition of limits on the import of foreign bank-notes. In addition, the official discount rate was lowered to 1 per cent. These measures effectively reversed the previous trend and by 13th March the dollar had risen as far as Sw.fr. 1.98. Although that level was not maintained subsequently, in late May the spot rate was about Sw.fr. 1.97 to the dollar, while on the trade-weighted basis it had declined by over 9 per cent. from the earlier peak.

The *Deutsche Mark,* too, was rather stable during the first half of 1977, its fluctuations being limited on the trade-weighted basis to 1¾ per cent. and against the dollar to 3½ per cent. When the dollar weakened, the movements of the Deutsche Mark were in the same direction as those of the Swiss franc, although much less pronounced. During the first phase of pressure on the dollar, between late June and late July, the Mark appreciated against that currency by nearly 5 per cent., almost to DM 2.25, while the trade-weighted rate put on 3 per cent. The Bundesbank lowered its lombard rate from 4½ to 4 per cent. in mid-July, as well as intervening in the exchange market for $0.6 billion.

During the final quarter of the year the Deutsche Mark appreciated by a further 10½ per cent. against the dollar, from just over DM 2.32 on 29th September to around DM 2.10 on 30th December. Over the same period the trade-weighted rate went up by 5 per cent. Among the measures taken by the German authorities at that time to moderate the rise in the exchange rate were further reductions of the official discount rate and the lombard rate, an extension from two to four years of the minimum maturity of domestic securities eligible for purchase by non-residents, increases in the reserve ratios on non-resident bank deposits and the imposition of an 80 per cent. reserve ratio on any increase in such deposits after the end of 1977. The most striking of the German authorities' actions, however, was the scale of their intervention in the exchange market. For the first time since early 1973 this included very substantial purchases of dollars, which were the main reason for the increase of $5.2 billion in the Bundesbank's reserves during the final quarter of the year.

After easing a little in January 1978, the Deutsche Mark, too, was caught up in the renewed weakness of the dollar that developed in February. On 1st March it reached a high point of DM 1.99¼ against the dollar, to bring its cumulative rise against that currency since late June 1977 to 18.2 per cent. Over the same period the trade-weighted exchange rate had put on 9½ per cent. Subsequently, the DM rate had already begun to ease before the joint announcement by the US and German authorities on 13th March (see pages 112–113) and in late May the Deutsche Mark was nearly 6 per cent. below the earlier high point against the dollar and over 3 per cent. lower on the trade-weighted basis. With effect from 1st June the 80 per cent. marginal reserve ratio on non-resident bank deposits was abolished and the ratios applicable to the outstanding amounts of such deposits were reduced.

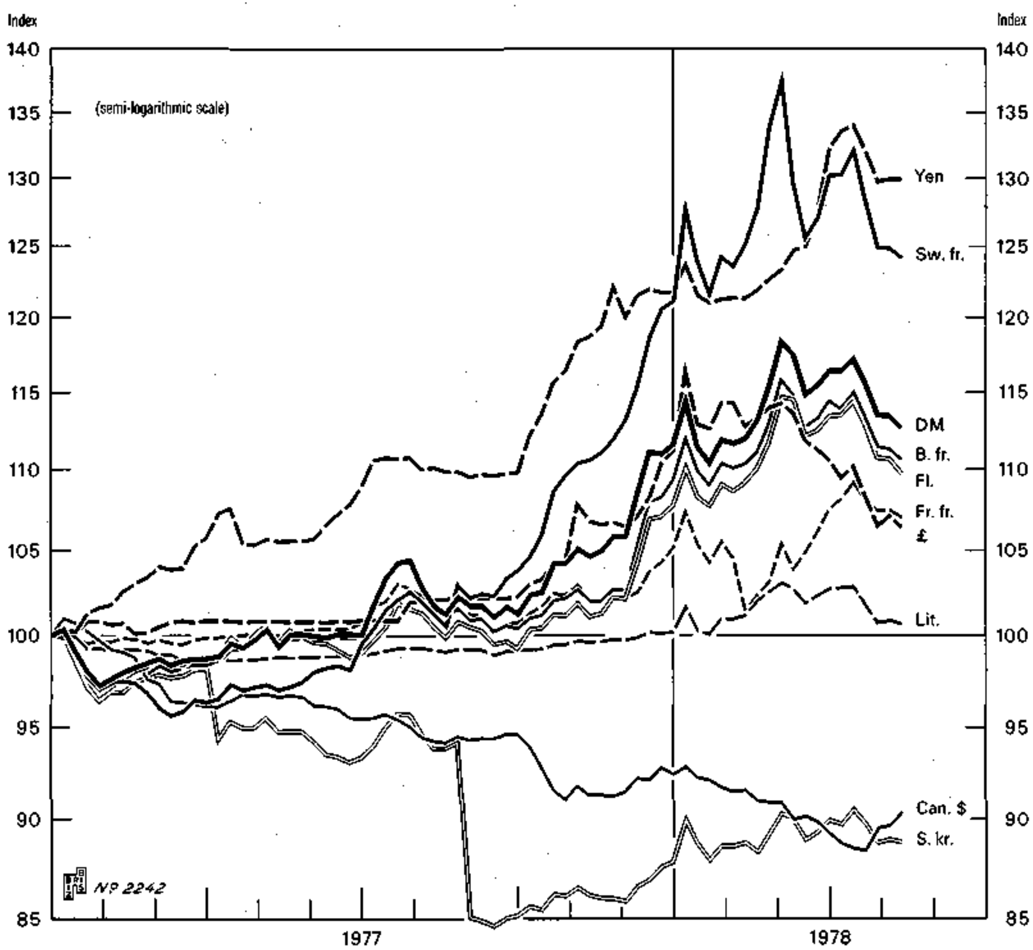
The recovery of the *pound sterling*, which had begun late in 1976, continued strongly throughout most of 1977. In the early part of the year growing confidence in sterling had been reinforced by the successful conclusion in January of the negotiations for the $3.9 billion IMF stand-by credit and in February of the $3 billion sterling balances facility. Rather than let the exchange rate rise any further — against the dollar it had come up from $1.55½ in late October to nearly $1.72 in mid-January 1977 — the authorities preferred to recoup their earlier exchange losses. During the first six months of 1977 nearly $5 billion was repurchased from the exchange market while over the same period the Bank of England's minimum lending rate was brought down from 14¼ to 8 per cent.

From late June onwards the policy of maintaining a stable exchange rate against the dollar meant that, as that currency weakened against those of nearly all the United Kingdom's other major trading partners, the trade-weighted exchange rate for sterling depreciated. Consequently, on 27th July the British authorities shifted the focus of their exchange rate policy and allowed the dollar rate to rise sufficiently above $1.72 — in fact to around $1.74 — to reverse the slight fall that had been recorded in the trade-weighted exchange rate.

When the dollar came under heavy pressure again in October the demand for sterling strengthened, despite the fact that by mid-October the Bank of England's minimum lending rate had come down to 5 per cent. During October the United Kingdom's reserves rose by a further $3 billion as a result of intervention by the Bank of England and as the month went on it became increasingly clear that stability of the exchange rate, even on the trade-weighted basis, was no longer compatible with the money supply targets which the British authorities had set themselves. Accordingly, from 31st October attempts to stabilise the trade-weighted exchange rate were abandoned. The dollar rate quickly jumped from around $1.77½ to 1.85 and the effective rate rose by over 3 per cent. After some reaction from that level, sterling began to appreciate again and this trend continued until the end of January 1978, by which time sterling had appreciated since end-1976 by over 8½ per cent. on the trade-weighted basis and by 14½ per cent. against the dollar, to $1.95. More recently, the recovery of the dollar and the accompanying rise in US interest rates have contributed to reversing the earlier inflows of funds. During April the Bank of England supported sterling in the exchange market to the tune of over $2 billion and by late May the trade-weighted exchange rate had fallen slightly below its end-July 1977 levels, while against the dollar sterling had eased to about $1.81.

The *French franc* showed remarkable stability on the trade-weighted basis in 1977, after having fallen by 13.3 per cent. in the previous year. This stability was mainly the result of the domestic stabilisation programme adopted in September 1976, which brought about some reduction in the rate of price increase as well as a sharp improvement in the foreign trade balance.

Nominal exchange rates: Indices of spot quotations for selected currencies vis-à-vis the US dollar.
Wednesday figures, end-1976 = 100.



As with other currencies, however, there was a marked difference between the two halves of the year, reflecting the fortunes of the US dollar. In the first half the franc had been stable both against the dollar and against most other major currencies, with the dollar rate remaining within a Fr.fr. 4.92–5.00 range and fluctuations in the effective rate mostly within a band of 1 per cent. In the latter half of the year, on the other hand, the dollar rate went up to Fr.fr. 4.71 at the end of December, while the franc lost 5.8 per cent. and 14.1 per cent. respectively against the Deutsche Mark and the Swiss franc, as these currencies were subjected to much heavier buying pressures. However, the effective rate continued to show little change and, at 97.2 per cent. of its post-Smithsonian level, closed the year virtually at its end-1976 level.

In February 1978 the course of events took a different turn, as fears of a victory for the opposition parties in the March parliamentary elections brought the franc under strong selling pressure. The exchange rate fell by about 3½ per cent. on the trade-weighted basis in the first week of February, while the dollar strengthened to nearly Fr.fr. 4.94. A further decline was prevented only by vigorous action on the part of the Bank of France, which intervened in the exchange market and also tightened money-market conditions. After the election victory of the previous majority parties the franc recovered strongly. By late March the trade-weighted rate had regained its former level and at the beginning of April the dollar had eased to under Fr.fr. 4.54. Since then the franc, while falling a little against the dollar, has continued to strengthen on the trade-weighted basis.

Like the French franc, although to a lesser extent, the *Italian lira* has been much more stable over the period under review than it had been in 1976. Whereas in that year it had fallen by 25 per cent. on the trade-weighted basis, last year's decline was limited to 6 per cent., virtually all of which took place during the latter part of the year when other major currencies were appreciating against the dollar but the Italian authorities only allowed the lira to rise against that currency from just under Lit. 885 to about Lit. 871.50, very close to its end-1976 level. The balance of payments improved from deficit to surplus and in addition there were substantial inflows of funds through the banking system, so that the stability of the dollar rate, as in the United Kingdom for much of the year, was maintained by large-scale official purchases of dollars from the market. During January and February 1978 the lira strengthened, both against the dollar and on the trade-weighted basis, but in late May it was back at about end-1977 levels.

The *Canadian dollar* depreciated during the period under review both on the trade-weighted basis and against the US dollar. It had already begun to weaken towards the end of 1976, following the victory of the separatist party in the Quebec elections. Within a month of that event the trade-weighted exchange rate had fallen by about 4½ per cent., to a large extent on fears that Canada's ability to raise abroad the funds necessary to cover its large current payments deficit might be seriously impaired, while against the US dollar it had declined from over US$1.02 to below $0.97½. In the event, by April 1977 Canada's credit rating in the US capital market, its chief source of funds, proved to have been unaffected; nevertheless, by the end of 1977 the Canadian dollar had declined to about US$ 0.91½. This occurred largely because of a narrowing of short-term interest rate differentials between Canada and the United States, from 3½ to only ½ per cent. Official intervention in the exchange market during 1977 by the Canadian authorities led to a reserve loss of US$ 1.2 billion. On the trade-weighted basis the Canadian dollar fell by 10 per cent. in 1977.

During the early part of 1978 the Canadian dollar depreciated further to a low point of just under US$ 0.87 in April, the trade-weighted exchange rate losing a further 6 per cent. The underlying reserve loss during the first quarter came to US$ 1.4 billion, including $750 million drawn on a $1.5 billion revolving credit facility arranged with the Canadian chartered banks in October 1977, and subsequently increased to $2.5 billion in April 1978. The official discount rate was raised twice, in March and April 1978, by ½ per cent. each time, and by late May the Canadian dollar had strengthened to just under US$ 0.90.

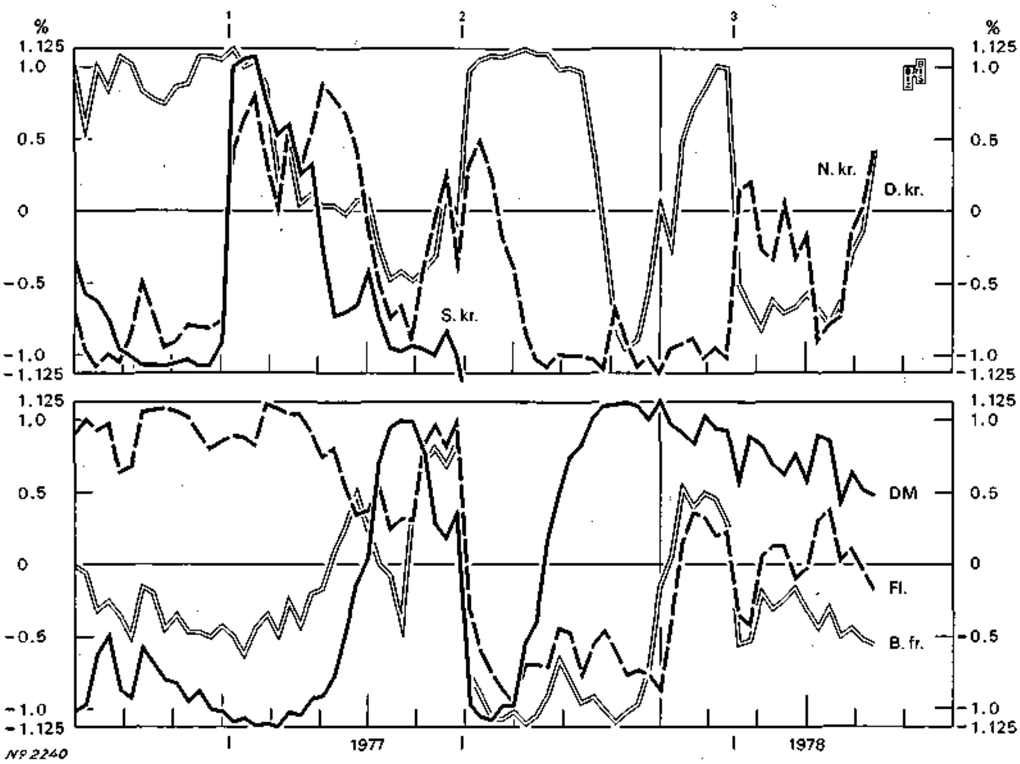
Under the influence of a weak balance of payments and high domestic inflation the *Swedish krona,* too, depreciated during the period under review not only on the trade-weighted basis but against the dollar as well. In addition, the krona was withdrawn from the European joint float at the end of August 1977. During the first quarter of 1977 the krona had eased against the dollar from S.kr. 4.11 to almost S.kr. 4.21, while throughout February and until the final days of March it had been the weakest currency in the "snake", although not requiring large-scale support from the Bank of Sweden. On 4th April, with the exchange-market situation relatively calm, the central rates of the krona were devalued by 6 per cent. against the Deutsche Mark, the Belgian franc and the guilder, and by approximately 3 per cent. against the Norwegian krone and the Danish krone. On 5th April Finland followed with a 5.7 per cent. trade-weighted devaluation of the markka.

After a brief period of strength, the krona soon began to decline again in the "snake". From mid-June onwards it was again the weakest currency in the "snake" and very large-scale official support, amounting in all to about $2 billion, was required to keep it there until on 29th August it was withdrawn from the joint float. At the same time it was decided to devalue the krona by 10 per cent. against a basket of the currencies of Sweden's fifteen major trading partners — this brought the cumulative trade-weighted depreciation of the krona since end-1976 to about 15 per cent. — and thereafter to regulate its exchange rate in terms of that basket. Since then, the effective exchange rate of the krona has been kept remarkably stable, mostly within a band of 1 per cent., while against the dollar the krona has strengthened from S.kr. 4.85½ to S.kr. 4.65 in late May 1978.

Inside the *European joint float* there were three realignments of participants' exchange rates during the period under review, two of which involved the Swedish krona, as described above. The need for these realignments arose basically out of the much higher inflation rates recorded in the Scandinavian participating countries — the effects of which inside the "snake" were aggravated in late 1977 and early 1978 by the movement out of the dollar into the Deutsche Mark.

The first of these realignments was initiated by Sweden in early April and involved, in addition to the larger devaluation of the Swedish krona, the central rates of the Norwegian krone and the Danish krone being devalued by 3 per cent. against the Deutsche Mark, the Belgian franc and the guilder. The second realignment, which took place when the Swedish krona withdrew from the "snake", involved further downward adjustments of the Danish and Norwegian currencies by 5 per cent. against the other three remaining participants.

Movements of spot exchange rates within the joint float of European currencies.
Weekly averages, in percentages.



¹ Adjustments of central rates on 4th April 1977. ² Adjustments of central rates on 29th August 1977. The Swedish krona withdrew from the "snake" arrangements on the same day. ³ Adjustments of central rates on 13th February 1978.

Despite these realignments the "snake" came under renewed pressure in the final quarter of 1977. As funds flowed into Deutsche Mark out of dollars, the German currency again rose to the top of the "snake" in November and all the other participating central banks had to sell Deutsche Mark, the National Bank of Belgium and the Bank of Norway particularly heavily, in order to maintain their currencies within the 2¼ per cent. band. At the same time official discount rates were raised in the Netherlands from 3½ to 4½ per cent. in November, and in Belgium from 6 to 9 per cent. in December. After a temporary respite in January 1978 the renewed appreciation of the Deutsche Mark against the dollar led to a further 8 per cent. devaluation of the Norwegian krone against all other participating currencies on 13th February. Since then, the "snake" band has no longer been fully stretched, the Netherlands and Belgian authorities have been able to reduce their official discount rates again and all of the indebtedness that had arisen out of earlier support operations has been repaid.

Exchange rates and international competitiveness.

The size of the exchange rate movements described in the preceding section, together with the persistence of large current payments imbalances in a number of the countries whose currencies were principally involved, has once again cast doubt, in the minds of some observers, on the efficacy of the rôle of exchange rate changes in the international adjustment process. Why, despite very drastic nominal realignments of currencies, has it been on the whole so difficult to bring about real changes in exchange rates? And why, in those instances where real changes in competitive positions did occur, have their balance-of-payments effects not been greater?

The graphs on the following pages attempt to throw some light on these questions, at any rate so far as the currencies of the Group of Ten countries and Switzerland are concerned, not only in the past year and a half but over the whole period since 1971. For each of the countries chosen, the upper graph shows the development of its effective exchange rate and its domestic cost and price performance in relation to the weighted average in the other countries of the group. Upward movements of the lines depicting a country's chosen cost and price indices indicate the extent to which that aspect of its position improved in relation to that of the rest of the group, and vice versa. Parallel movements of a country's effective exchange rate and its relative cost and price indices tend to indicate that its competitive position has not changed, while divergences between the two suggest a deterioration or improvement, as the case may be, in the real exchange rate position.

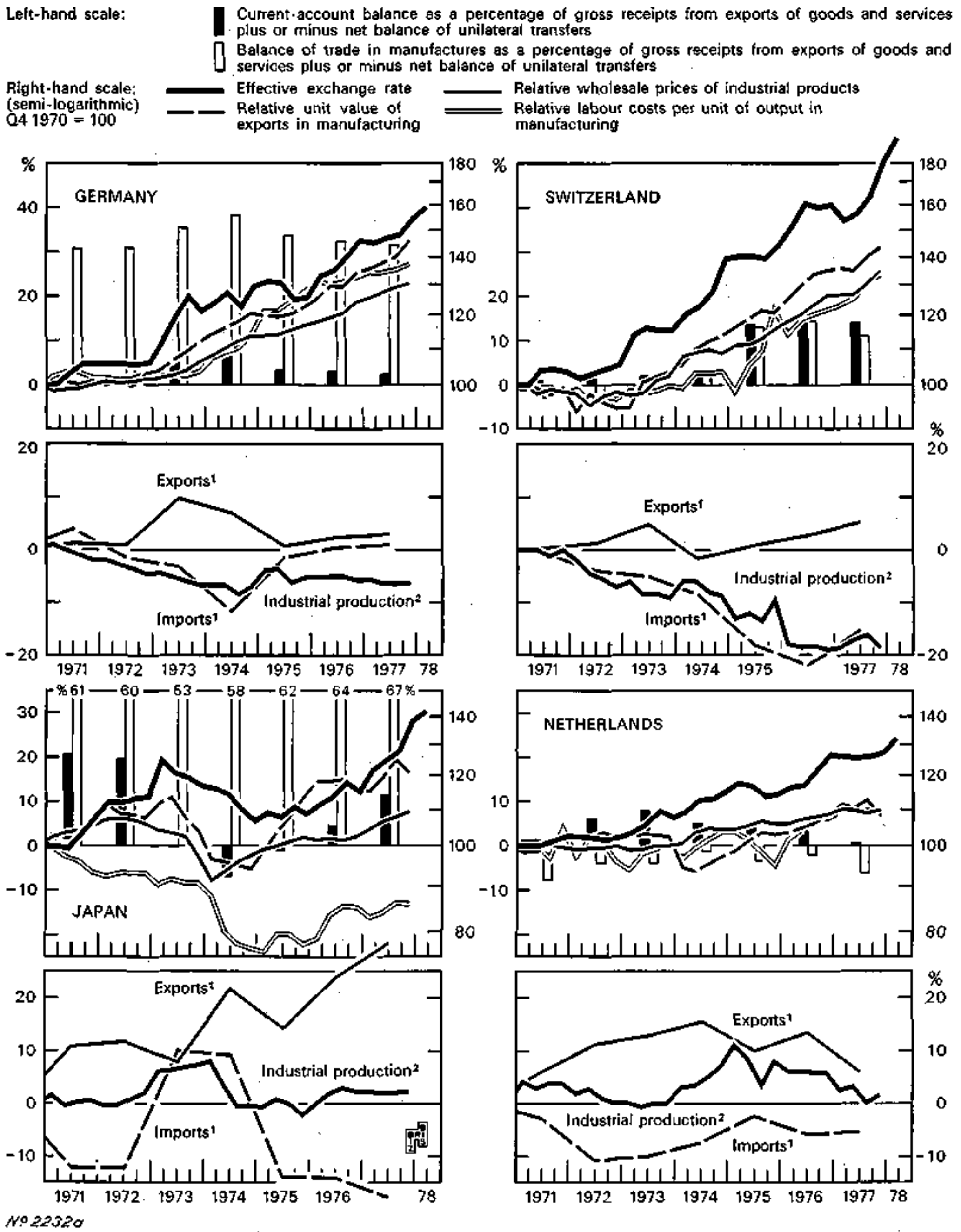
In a number of countries the movements of the various price and cost indices shown in the graphs have by no means been uniform. In particular, there are a number of instances in which the development of a country's unit labour costs, which in combination with that of the effective exchange rate is taken as the principal indicator of the competitive position, has diverged from that of export unit values. Such divergences mean that there has been a change in domestic profit margins relative to those in the other countries shown.

The weights used for the computation of exchange rate, price and cost indices are based on the shares of the countries concerned in international trade in manufactures and take into account competition both in one another's markets and elsewhere.

The lower graphs show the development of individual countries' manufacturing exports and imports in value terms relative to the OECD total. It is trade in these types of goods which can be expected to respond most readily to changes in competitive positions, although the other items of the current-account balance will also tend to be affected. In order to provide some indication of the importance of cyclical influences and of differences in longer-term growth trends, a third index line traces the development of the individual countries' industrial production in relation to the OECD total.

Such inter-country comparisons need, of course, to be evaluated with care. The cost and price statistics used, especially those on unit labour costs, are both imperfect in themselves and less than perfectly comparable internationally. Only substantial divergences between a country's exchange rate and its domestic cost and price performance can therefore be interpreted with any degree of confidence as indicating a genuine change in competitive position. Moreover, relative price

Group of Ten countries and Switzerland: Changes in effective exchange rates, relative prices and costs, and relative trade performances, 1971–78.



Note: The relative price and cost indices for the individual countries are arrived at by dividing the movement of their prices and costs into the sum of the trade-weighted price and cost movements of the other countries in the group. Thus, an upward movement of a country's indices reflects an improvement in its relative price and cost position.

[1] Development of exports and imports in relation to the OECD total (annual value figures, 1970 = 100). [2] Development of industrial production in relation to the OECD total (seasonally adjusted quarterly figures, 1970 average = 100).

is not the only element in competitiveness; nor, by a long way, are exports and imports of manufactured goods the only transactions that affect exchange rates. Nevertheless, the graphs do illustrate rather clearly a number of important features of the experience with exchange rates, both since the breakdown of the old exchange rate structure in 1971 and during the past year and a half.

As regards the first of the questions raised at the beginning of the section, the best examples of countries in which large movements in effective exchange rates have been accompanied by little change in relative competitive positions are Italy and the United Kingdom. Their experience shows clearly that in open economies currency depreciation on its own, in the absence of domestic stabilisation policies, not only fails to improve the international competitive position but, through its effects on domestic costs and prices, sets in motion (and tends to perpetuate) a cumulative adverse interaction between the external and the internal value of a currency, with periods of exchange rate depreciation being rather quickly followed by increased inflationary pressures which in turn lead to a further decline in the exchange rate. The United Kingdom did succeed in breaking out of this vicious circle in 1976–77, by slowing down the increase in unit labour costs through policies of wage restraint, assisted by restriction of domestic demand; by the end of 1977, however, the competitive advantage thus gained was already being eroded by the need to rebuild profit margins. It is true that in 1977 both Italy and the United Kingdom succeeded in greatly improving the current account of their balances of payments; however, this was achieved mainly through bringing the growth of their domestic demand to a standstill and, in the United Kingdom, through the coming into production of the North Sea oilfields.

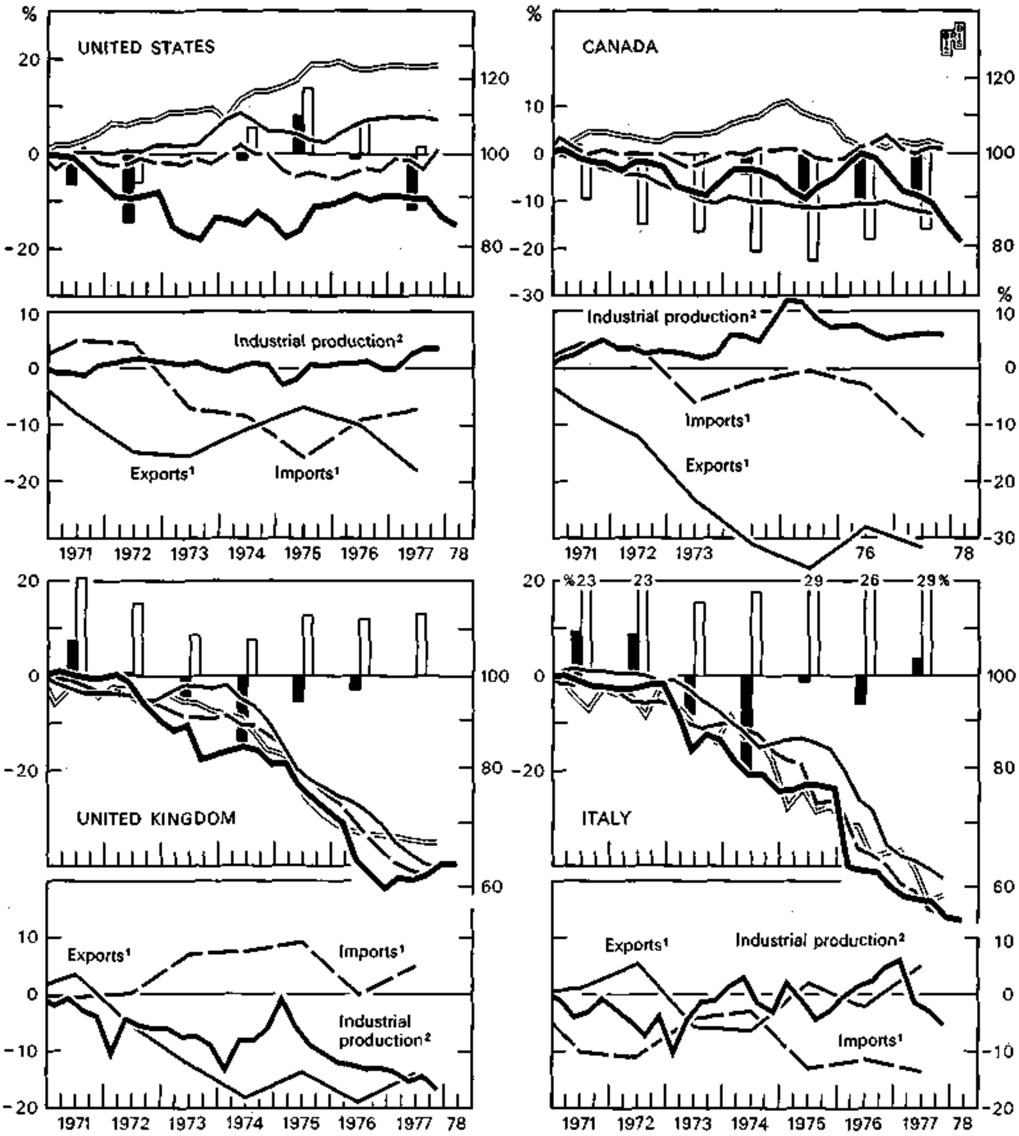
Germany's experience since 1970 has been to a considerable extent the same as that of Italy and the United Kingdom but in the opposite direction, with a "virtuous" circle of currency appreciation and relatively moderate domestic inflation. However, taking the period under review as a whole, Germany's international competitive position has certainly deteriorated, although it can safely be assumed that in 1971–72 the Deutsche Mark was undervalued. The worsening of the competitive position that had occurred in 1973 appears, by the end of 1975, to have been fully offset by the relative stability of domestic unit labour costs. Subsequently, the further appreciation of the Deutsche Mark in 1976 and again from late 1977 onwards brought about a renewed deterioration of the competitive position but, as German exporters attempted to maintain their market shares at the price of accepting lower profit margins, export values performed more favourably than unit labour costs. Nevertheless, the graph shows that Germany's share in the total value of OECD countries' exports is now lower than it was in 1973–74 while its share in their total imports has risen. Despite this, however, the current balance of payments is still in surplus and seems likely to remain so for some time under the combined influence of the relatively low rate of growth of domestic demand and the J-curve effects of the recent further appreciation of the Deutsche Mark.

If, in some countries, very large movements in exchange rates have not led to lasting or major changes in competitive positions, in others major shifts in competitiveness have failed to produce corresponding and lasting balance-of-

Group of Ten countries and Switzerland: Changes in effective exchange rates, relative prices and costs, and relative trade performances, 1971–78.

Left-hand scale:
- Current-account balance as a percentage of gross receipts from exports of goods and services plus or minus net balance of unilateral transfers
- Balance of trade in manufactures as a percentage of gross receipts from exports of goods and services plus or minus net balance of unilateral transfers

Right-hand scale: (semi-logarithmic) Q4 1970 = 100
- Effective exchange rate
- Relative unit value of exports in manufacturing
- Relative wholesale prices of industrial products
- Relative labour costs per unit of output in manufacturing



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Note: The relative price and cost indices for the individual countries are arrived at by dividing the movement of their prices and costs into the sum of the trade-weighted price and cost movements of the other countries in the group. Thus, an upward movement of a country's indices reflects an improvement in its relative price and cost position.

[1] Development of exports and imports in relation to the OECD total (annual value figures, 1970 = 100). [2] Development of industrial production in relation to the OECD total (seasonally adjusted quarterly figures, 1970 average = 100).

payments effects. This is most notably true of the United States and Japan, where exchange rates and domestic costs actually moved on balance in opposite directions on the graphs, producing very substantial competitive adjustments.

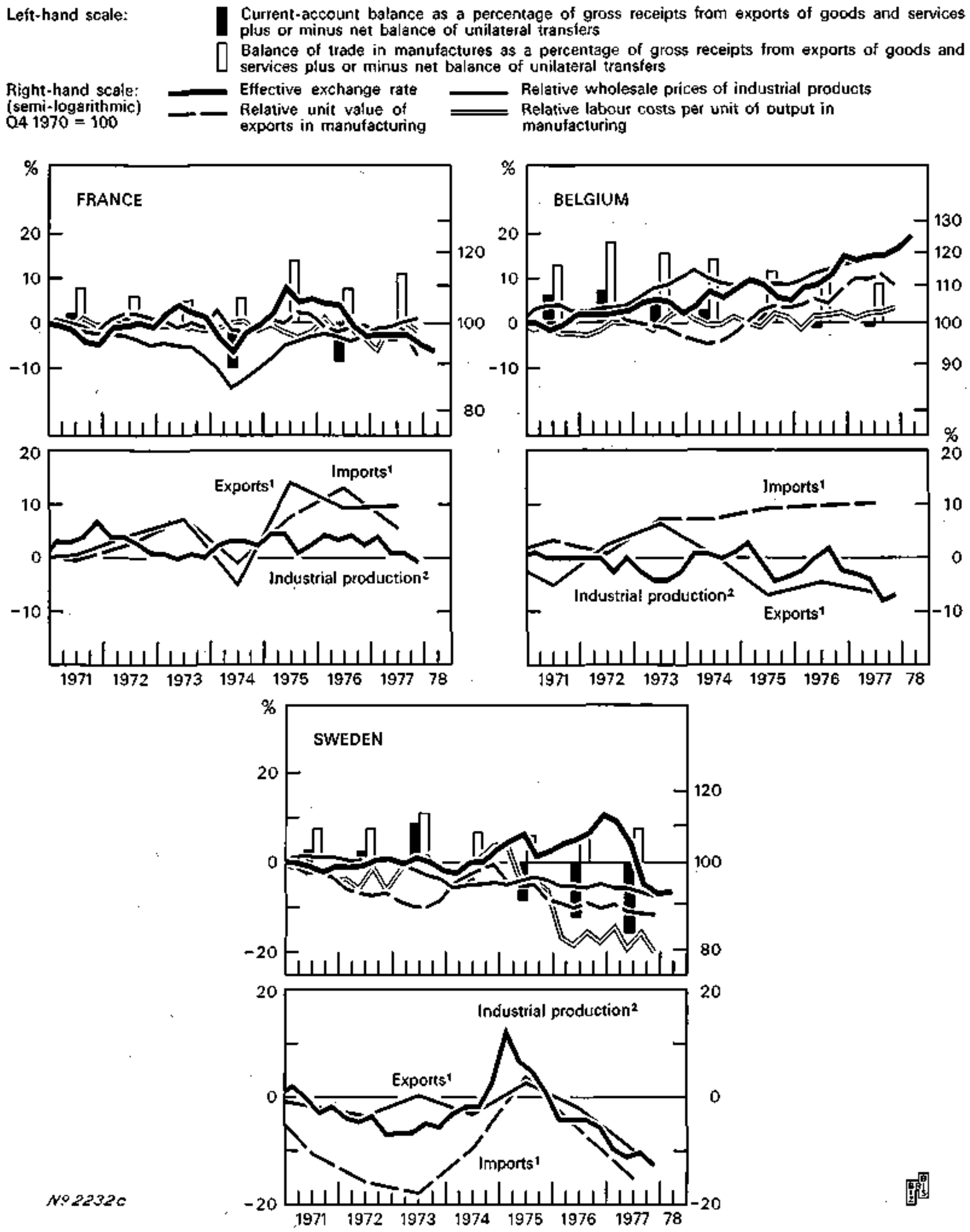
In the United States a spectacular improvement of the international competitive position occurred as a result of the 1971–73 depreciation of the dollar, and this was no doubt one of the main reasons, although not the only one, for the large swing in the US current account from deficit into surplus between 1972 and 1975. Yet the subsequent maintenance of the competitive advantage gained in the early 1970s did not prevent the surplus from disappearing in 1976 and from being replaced by a $20 billion deficit last year, which in turn led to a further depreciation of the dollar and strengthening of the US competitive position from late 1977 onwards.

Japan's experience has, in a number of respects, been the opposite of that of the United States. By early 1973 the appreciation of the yen, combined with the relative increase in unit labour costs, had produced a marked deterioration in the country's competitive position. However, the emergence of a large deficit on the current balance of payments in 1974 resulted not so much from this as from the $14 billion increase in Japan's oil import bill between 1973 and 1974. After 1974, despite little further change in Japan's relative competitive situation, the current external balance began to improve again, and by the end of 1976 a substantial surplus had re-emerged which led last year — chiefly through the appreciation of the yen — to a considerable further deterioration of Japan's relative cost position.

In both the United States and Japan the changes in competitive positions were considerably less if measured by the movements of industrial wholesale prices and export unit values than in terms of unit labour costs, which means that profit margins fared better in the United States than on average in the other countries while in Japan they fared worse. One reason for this difference in profit performance is to be found in the difference between the rates of growth of domestic demand and the degrees of capacity utilisation in the two countries. Moreover, in Japan profit margins have also come under pressure from the reluctance of business firms to release labour in periods of slack demand.

The difference between the rates of growth of domestic demand in the two countries, besides helping to explain their contrasting profit performances, is of course one of the principal reasons why, despite the shifts that have taken place in both countries' international competitive positions, the current balance of payments of the United States has been, and remains, in substantial deficit and that of Japan in substantial surplus. This, however, is by no means the whole explanation. Structural factors have also played an important part in offsetting the effects of changes in these countries' real exchange rates. One such factor is the difference in business attitudes towards exports, a difference which is reflected in the very striking contrast between the development of export unit values in the two countries. For many Japanese firms exports are so important that strenuous efforts are made to maintain their level even in the face of low profit margins; for most US firms, on the other hand, the size of the home market is such that profit margins on exports have to be significantly larger than those on domestic sales to make an added

Group of Ten countries and Switzerland: Changes in effective exchange rates, relative prices and costs, and relative trade performances, 1971–78.



Note: The relative price and cost indices for the individual countries are arrived at by dividing the movement of their prices and costs into the sum of the trade-weighted price and cost movements of the other countries in the group. Thus, an upward movement of a country's indices reflects an improvement in its relative price and cost position.

¹ Development of exports and imports in relation to the OECD total (annual value figures, 1970 = 100). ² Development of industrial production in relation to the OECD total (seasonally adjusted quarterly figures, 1970 average = 100).

export effort worthwhile. The other major structural factor, which concerns the United States only, has been that country's increased dependence on imported oil.

The other country shown in the graphs whose competitive position has substantially deteriorated without its current balance-of-payments surplus having been reduced is Switzerland. The upward movement of the franc has been the largest experienced by any country since the beginning of the 1970s and the improvement in relative costs and prices, although in itself quite considerable, has never caught up with it. Indeed, at the present time the decline in Switzerland's international competitive position is probably almost as great as that of Japan. Moreover, the factors that have maintained the current balance of payments in large surplus are, to some extent, the same as in Japan; they include determined efforts to maintain foreign sales in the face of declining profit margins and, more recently, J-curve effects which have offset the further deterioration in the country's international competitive position. Most important for Switzerland, however, has been the move to a lower growth path produced by the shrinkage of the labour force and which has, in turn, led to a relative decline in imports almost as striking as that which occurred in Japan.

What are the main lessons to be drawn from these experiences? The first surely is that if before 1971 too little use was made of the exchange rate as an instrument of adjustment by some major countries, or in certain instances no use at all, too much has sometimes been expected of it since then. This applies as much to those cases in which there have been large movements in exchange rates but little or no change in competitive positions as to those where payments imbalances have persisted in the face of substantial shifts in competitive advantage. In both types of case the effects of exchange rate movements have been overlaid by other factors: where no change in competitive position has come about, by the absence of adequate domestic adjustment policies; and where the competitive position has improved but the balance of payments remains in substantial disequilibrium, by a number of factors the most important of which have been differences between countries in the levels of domestic demand, structural factors such as the degree of export orientation and lagged responses to relative price changes, i.e. the so-called J-curve effects.

In theory, even in the absence of an adequate response of the current-account balance of payments to exchange rate adjustments (whether or not the latter are accompanied by changes in competitive conditions), destabilising movements of exchange rates of the kind seen in recent years may be avoided by offsetting autonomous capital movements. Such movements, however, can only take place if market operators are able to form a reasonably confident and realistic idea of what the longer-term equilibrium level of a country's exchange rate is likely to be. In recent years such judgements have often been very difficult to make. This has been partly due to the various factors mentioned above which have tended to offset the effects of nominal or real exchange rate movements; but in addition there has been the absence of clear exchange rate commitments and, in some cases, the unwillingness of the authorities to evince, even at times of seriously diminished market confidence, any active interest whatever in the external value of their currencies. As a result, capital movements, instead of stabilising the exchange markets, have often added to the exchange-market effects of current-account imbalances. In this way they have acted as an extra obstacle to the working of the adjustment process, with very rapid exchange rate depreciation reinforcing domestic cost inflation in countries with payments deficits and exchange rate appreciation adding to the recessionary forces in the countries with payments surpluses.

Of course there have been exceptions to this general pattern, notably on the part of those members of the European joint float that have on several occasions demonstrated, by a combination of vigorous domestic measures and exchange-market intervention, the importance they attach to exchange rate stability — and in doing so have fairly rapidly turned the markets in their favour.

But by and large the experience of recent years appears to have caused some observers to doubt the usefulness of exchange rate adjustments. Surely, however, the true lesson of recent experience is rather that exchange rate adjustments do indeed have a rôle to play, but that they can only play it if other forces, and in particular domestic policies, both of individual countries and of the major countries taken together, are acting in the same direction. That truth was recognised in the Bretton Woods rules, which provided for exchange rate adjustments only in those cases of fundamental disequilibrium where the economic and social costs of exclusive reliance on domestic policies to correct external imbalances would have been too great. The amended Articles of Agreement of the International Monetary Fund put the matter rather differently, with the emphasis on domestic policies, rather than the discipline of par values, as the source of exchange rate stability. Under these new arrangements, just because countries' exchange rate obligations to the Fund are looser than in the Bretton Woods system, their domestic policies will need to be that much stronger if they are to produce the same sense of commitment to exchange rate stability.

There is, in fact, an inherent difficulty in the present exchange rate arrangements, which can be put in the following way: exchange rate changes are a necessary part of the international adjustment process but exchange rate instability is not; most countries' direct commitments to exchange rate stability are now limited to the generalities contained in the amended Articles of Agreement of the International Monetary Fund; and it is hard for domestic policies alone to convey firmly and clearly that sense of commitment. In a sense, therefore, floating rates put more of a burden on domestic policies for the maintenance of reasonable exchange rate stability than did the par value system.

Gold production and the gold market.

In 1977 world gold production (excluding that of the USSR and other eastern European countries, mainland China and North Korea) amounted to 965 metric tons, the same as in 1976. South African production declined by a further 13½ tons to 700 tons, 30 per cent. below its 1970 peak, and its share in total western output of gold came down to just under 73 per cent. Elsewhere, there were offsetting increases in output in a number of the smaller producing countries, notably in Australia, Papua-New Guinea and the Philippines.

World gold production.

Countries	1929	1940	1946	1953	1970	1974	1975	1976	1977
	in metric tons								
South Africa . . .	323.9	436.9	371.0	371.4	1,000.4	758.6	713.4	713.4	699.9
Canada	60.0	165.9	88.5	126.1	74.9	52.8	51.4	52.6	53.1
United States . . .	64.0	151.4	49.0	60.9	54.2	35.1	32.7	32.6	32.5
Papua-New Guinea	.	.	.	.	0.7	21.5	18.4	19.2	22.1
Rhodesia	17.4	25.7	16.9	15.6	15.6	20.0	20.0	20.0	20.0
Australia	13.3	51.1	25.6	33.4	19.3	16.2	16.4	15.7	19.3
Philippines	5.1	34.9	—	14.9	18.7	16.7	15.6	15.6	17.4
Ghana	6.4	27.6	18.2	22.7	22.0	19.1	16.3	16.6	16.9
Colombia	4.3	19.7	13.6	13.6	6.3	8.3	9.7	9.4	9.3
Brazil.	3.3	4.7	4.4	3.6	5.3	7.6	7.8	8.2	8.2
Japan	9.3	12.6	1.3	7.1	7.9	4.3	4.5	4.3	4.4
Zaire	4.9	17.4	10.3	11.5	5.6	4.1	3.2	2.7	2.4
Total listed .	511.9	947.9	598.8	680.8	1,230.9	964.3	909.4	910.3	905.5
Other countries . .	*58.6*	*217.1*	*67.7*	*73.4*	*36.6*	*39.4*	*43.9*	*54.7*	*58.0*
Estimated world total*	570.5	1,165.0	666.5	754.2	1,267.5	1,003.7	953.3	965.0	963.5

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

The lower level of South African gold output last year reflected a 2.2 per cent. decline in the quantity of ore milled, with the average gold content of the ore — which in preceding years had gone down — virtually unchanged from 1976. Average production costs, which had gone up by 26.8 and 15.5 per cent. respectively in 1975 and 1976, rose by a further 23.7 per cent. as a result of further large increases in wages and material costs. Nevertheless the increase in the dollar price received by the mines for their output meant that average profits from gold mining, which in dollar terms had fallen by 31 per cent. in 1976, recovered by 20 per cent. last year.

On top of western production, market supplies of gold were substantially augmented in 1977 by communist countries' sales, which may be estimated at 450 tons — their highest level since 1965 — and by a further decline in western official gold stocks. This decline is reported to have amounted to 280 tons, including a decline of 90 tons in South Africa's gold reserve which is believed to have been essentially due to gold swaps concluded between the South African Reserve Bank and a group of commercial banks. Excluding this change in South Africa's gold reserve, which did not have the effect of increasing market gold supplies, western official gold stocks show an identified fall of 190 tons for 1977, of which 187½ tons is accounted for by gold sold to the market at eleven auctions during the year by the International Monetary Fund. All in all, the identifiable amount of gold available in 1977 for meeting non-monetary demand may be put at 1,605 tons, significantly more than the year before. Last year's non-monetary demand included a strong renewal of interest in gold by investors, in response partly to the disappointing performance of stock markets in most major countries and partly to the weakness of the dollar. Industrial demand, on the other hand, tended to fall off later in the year, as the market price increased. Heavy buying was reported from the Middle

East, and in addition there was an increase in demand, both for bars and coins, in the United States. The volume of gold traded in the futures markets of the New York and Chicago commodity exchanges rose sharply.

Estimated sources and uses of gold.

Items	1974	1975	1976	1977
	in metric tons			
Production	1,005	955	965	965
Estimated sales by communist countries	150	150	350	450
Decline in western official gold stocks (net)	35	35	155*	190*
Total (= estimated non-monetary absorption)	1,190	1,140	1,470	1,605

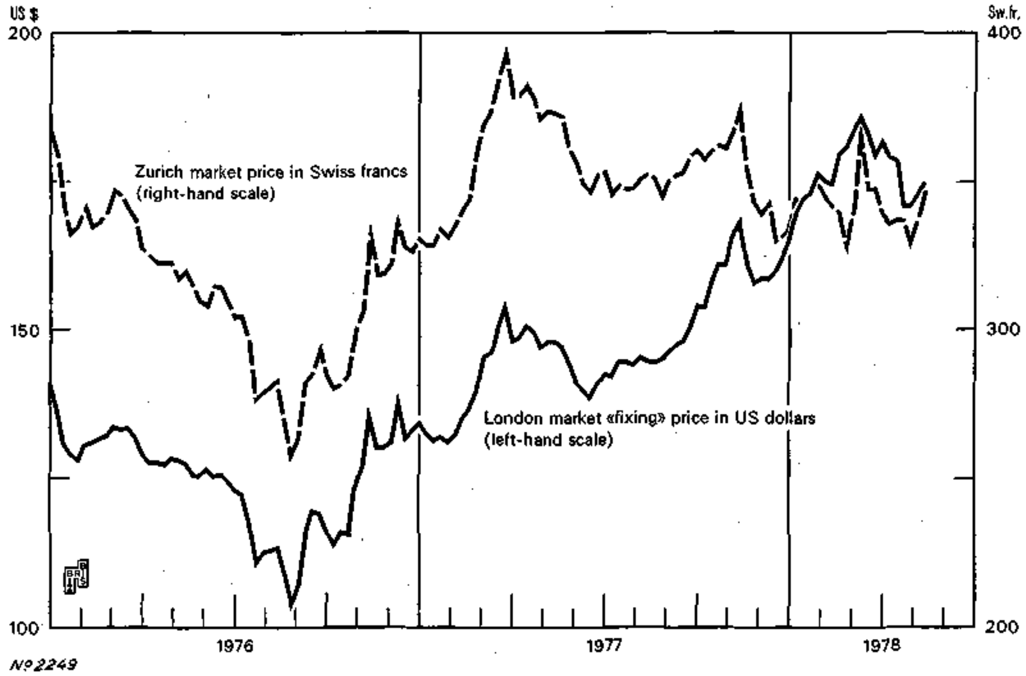
* Excluding the declines in South Africa's gold reserve of 160 tons in 1976 and 90 tons in 1977.

The strength of non-monetary demand for gold in 1977 and the early months of 1978 is shown by the larger quantity of metal absorbed by non-official users. The rise in the dollar price of gold over the period under review appears to point in the same direction. However, a substantial part, though not all, of this increase was simply due to the weakening of the dollar against other major currencies during the period. Thus, as the graph shows, the Swiss franc price of gold, after rising sharply in the first part of 1977, was in late May 1978 less than 10 per cent. higher than it had been at the end of 1976.

The upward movement of the dollar price of gold during the period under review occurred in two main phases, during February and March 1977 and again from September 1977 to March 1978. After starting 1977 at $136.10 per fine ounce, the London market "fixing" price actually declined to $129.40 on 11th January. This was a temporary reaction to the very rapid run-up of prices during the preceding four months, from the $103 low point recorded at the end of August 1976. Towards mid-February the upward price trend was resumed and by late March a level of $153.60 had been reached. This was followed by a dip to below $140 in mid-June. Although quotations subsequently firmed a little, the price remained in a fairly narrow range on either side of $145 from mid-July until early September. At that point, as the weakness of the dollar against other major currencies began to be more pronounced, a new upward movement began which by 11th November had carried the London market price to over $168, its highest level since May 1975.

A temporary reaction then followed, with the London market "fixing" price falling by more than $10 in little over a week. Profit-taking was in evidence, and in addition the volume of sales by the Soviet Union had increased. Before long, however, the persistent weakness of the dollar caused the gold price to start rising again and by the end of the year the London market price had recovered to $165. The renewed upward movement of the dollar price of gold continued, with only minor interruptions, until early March 1978. The announcement on 23rd January that the August 1975 agreement between the Group of Ten countries, Switzerland and Portugal not to increase their combined gold stocks and that of the IMF was being

Market prices of gold bars in US dollars and Swiss francs, 1976–78.
Friday figures, per fine ounce.



allowed to expire at the end of that month had no noticeable effect on the upward movement of quotations. On 8th March 1978 quotations reached \$190, their highest level for three years.

There then followed a fairly sharp reaction to \$177 on 21st March, resulting partly from the improved performance of the dollar in the exchange markets and partly from rumours of impending market sales by the US Treasury. Four weeks later, on 19th April, the market price had eased a little further, to just below \$175. On that day the US Treasury Department announced that it planned to hold at least six monthly auctions of 300,000 ounces each, beginning on 23rd May. Following that announcement the gold price fell at one point to around \$168; by late May, however, it was again nearly at \$180 per fine ounce.

Reserves and international liquidity.

In 1977 the growth of global reserves, measured in current dollars, was the highest recorded in any year. Countries' total official holdings of gold, foreign exchange, special drawing rights and IMF reserve positions rose by \$58.7 billion, to a total of \$317.7 billion at the end of the year. In relative terms, however, last year's reserve growth rate of 23 per cent. was little more than half that of 43 per cent. recorded in 1971.

About 12 per cent., or \$6.8 billion, of last year's global expansion of reserves can be accounted for by the effects of exchange rate movements on the dollar value of other types of reserve assets. These valuation changes are estimated to have added about \$3.5 billion to the dollar value of total foreign exchange reserves, Changes in global reserves, 1975–77.*

Areas and periods	Gold	Foreign exchange	IMF reserve positions	SDRs	Total
	in millions of US dollars				
Group of Ten + Switzerland					
1975	− 1,605	+ 935	+ 1,620	− 235	+ 715
1976	− 260	+ 5,870	+ 4,345	+ 15	+ 9,970
1977	+ 1,840	+34,255	+ 1,100	− 265	+36,930
Amounts outstanding at end-1977	*35,395*	*105,125*	*13,815*	*7,510*	*161,845*
Other developed countries					
1975	− 220	− 1,360	− 355	− 85	− 2,020
1976	− 240	+ 550	+ 400	− 125	+ 585
1977	− 25	+ 1,635	+ 15	− 25	+ 1,600
Amounts outstanding at end-1977	*3,940*	*23,165*	*1,075*	*720*	*28,900*
Developing countries other than oil-exporting countries					
1975	− 80	− 1,270	− 100	− 215	− 1,665
1976	− 90	+11,110	− 135	− 110	+10,775
1977	+ 180	+ 9,145	+ 55	+ 25	+ 9,405
Amounts outstanding at end-1977	*2,200*	*44,915*	*535*	*1,165*	*48,815*
Total oil-importing countries					
1975	− 1,905	− 1,695	+ 1,165	− 535	− 2,970
1976	− 590	+17,530	+ 4,610	− 220	+21,330
1977	+ 1,995	+45,035	+ 1,170	− 265	+47,935
Amounts outstanding at end-1977	*41,535*	*173,205*	*15,425*	*9,395*	*239,560*
Oil-exporting countries					
1975	− 50	+ 7,340	+ 2,785	− 50	+10,025
1976	+ 75	+ 8,005	+ 1,220	+ 15	+ 9,315
1977	− 40	+10,535	+ 205	+ 85	+10,785
Amounts outstanding at end-1977	*1,485*	*69,580*	*6,555*	*485*	*78,105*
All countries					
1975	− 1,955	+ 5,645	+ 3,950	− 585	+ 7,055
1976	− 515	+25,535	+ 5,830	− 205	+30,645
1977	+ 1,955	+55,570	+ 1,375	− 180	+58,720
Amounts outstanding at end-1977	*43,020*	*242,785*	*21,980*	*9,880*	*317,665*

* Including valuation changes.

$1.9 billion to gold reserves, almost $1 billion to Fund reserve positions and $0.4 billion to countries' total SDR holdings.

By types of asset, reserve growth continued to be concentrated on official holdings of foreign exchange, which went up by $55.6 billion. Of that amount, $34.1 billion was accounted for by additions to dollar reserves held in the United States. Of the remaining $21.5 billion, nearly $10 billion can be identified as having been deposited by monetary authorities with banks in the narrowly defined Euro-currency market, in Canada and Japan and with the branches of US banks in the Bahamas and the Cayman Islands in foreign currencies. A further $2½ billion can be identified as having been deposited by monetary authorities in currencies other than the dollar, mainly Deutsche Mark and yen, in the national financial markets of the currencies concerned. Of this identified total increase of \$12½ billion in exchange reserves held outside the United States, about \$5 billion was in US dollars and the remainder in other currencies, including a \$3½ billion appreciation in dollar terms resulting from the decline of the dollar against other currencies held in reserves.

Turning to changes in other types of reserve asset last year, the rise in the current dollar value of countries' gold reserves resulted almost entirely from valuation changes. Despite receiving \$0.5 billion worth of gold from the IMF under the restitution programme the volume of countries' gold reserves increased by only \$0.1 billion worth in 1977.

Excluding valuation changes, the growth of total IMF reserve positions during 1977 was only \$0.4 billion, as against \$6 billion the year before. On the demand side, developed countries' net drawings were down from \$4½ to 1 billion while the developing countries, which had drawn over \$2 billion net in 1976, made net repayments of \$0.4 billion. On the supply side, the Fund's oil facility had come to an end and the sixth general increase in members' quotas did not come into effect until April 1978. In August 1977 it was decided to establish a temporary supplementary financing facility in the Fund, for the benefit of member countries with payments imbalances that are large in relation to their quotas and that require relatively long periods for their correction. So far fourteen Fund members, together with the Swiss National Bank, have expressed their readiness to make available to this facility a total equivalent to \$11 billion. It is hoped that the facility will come into operation later this year.

Last year's acceleration of global reserve growth owed little to the oil-exporting countries. At \$10.8 billion, the reported additions to their reserves were not much greater than in 1976, when they had amounted to \$9.3 billion. For the first time since the oil price increase, the largest individual reserve gain was recorded by Iran, with \$3.4 billion. Saudi Arabia's reserves rose by a further \$3 billion, while four other OPEC countries showed substantial gains — Iraq (\$2.4 billion), Libya (\$1.7 billion), Kuwait (\$1.1 billion) and Indonesia (\$1 billion). On the other hand, the reserves of the United Arab Emirates declined by \$1.1 billion and those of Nigeria by a further \$1 billion, after a \$0.4 billion fall the year before.

The essential difference between last year's reserve growth and that of 1976 was in the oil-importing world, where total reserves, after a substantial increase of \$21.3 billion in 1976, went up by \$47.9 billion last year. Within the oil-importing world, the much faster growth of reserves last year was concentrated in the Group of Ten countries and Switzerland, whose combined reserves increased by \$37 billion, as against a \$10 billion gain in 1976.

Last year's reserve increase in the Group of Ten countries and Switzerland fell broadly into two phases. During the first of these, which covered the nine months to end-September, their total reserves increased by \$16.9 billion, almost all of which was accounted for by the rebuilding of the reserves of the United Kingdom and Italy, by \$13 and 3.4 billion respectively. During the second phase, which covered the final quarter of the year, the Group of Ten countries' total reserves increased by \$20 billion. While the United Kingdom's reserves rose by a further \$3 billion in October before the British authorities allowed the pound to float rather freely, and Italy's by $1.5 billion, the predominant features of the second phase were additions of $5.2 and 5 billion respectively to the reserves of Germany and Japan and of $3.3 billion (of which nearly one-quarter reflected end-year swaps with the banks) to those of Switzerland, all of them resulting from official intervention aimed at moderating the rise in those countries' currencies against the US dollar.

The same pattern was evident, although on a smaller scale, in the first quarter of 1978. The Group of Ten countries and Switzerland added a further $7.1 billion to their combined reserves, with Japan gaining $6.4 billion and Germany $2.5 billion. The first-quarter increase would have been greater but for the reversal of end-year window-dressing operations by the Swiss commercial banks, which led to a small decline in the National Bank's reserves during the quarter.

In the remainder of the oil-importing world aggregate reserve changes by groups of countries were not greatly different in 1977 from what they had been the year before, with the other developed countries gaining $1.6 billion as against $0.6 billion and the non-oil developing countries $9.4 billion as against $10.8 billion.

In the group of "Other developed countries", the principal gains were those of Spain ($1.3 billion), Denmark ($0.8 billion) and Ireland ($0.5 billion). Australia's reserves declined by $0.8 billion and those of Turkey by $0.3 billion.

In the group of non-oil developing countries, three of the principal gainers in 1976 again added substantially to their reserves — India with $2.1 billion, Argentina with $1.7 billion and South Korea with $1.3 billion. Other sizable gains were registered by Colombia ($0.7 billion), Mexico and Singapore ($0.5 billion each) and Malaysia ($0.4 billion).

Despite its size, last year's overall expansion of international liquidity cannot be considered as constituting an immediate inflationary threat. In the case of those oil-importing countries which were rebuilding their reserves the increase in liquidity was, by and large, both desired and desirable, while the further additions to the official foreign exchange holdings of the OPEC countries and of the main surplus countries in the industrial world clearly present no danger of inflation for the system as a whole. Indeed, an increase in the level of those countries' imports would be greatly welcomed by the rest of the oil-importing world.

The most important difference between last year's growth of reserves and that which occurred in 1976 lies in the factors that gave rise to it outside the group of oil-exporting countries. During 1976 the increase in oil-importing countries' reserves had been accompanied by substantial external borrowing from commercial banks, including banks in the United States; this meant that on a net basis these countries' reserve gains had been relatively modest and, at the same time, that they were intended. In 1977, on the other hand, while a number of countries continued to add to their reserves in that way, the main source of international liquidity creation was the current payments deficit of the United States. This meant that the reserve gains of other oil-importing countries were no longer accompanied, to the same extent as before, by an increase in their external indebtedness. It also meant, for some countries which were not ready to accept a completely unrestricted appreciation of their currencies, that the size of their reserve gains went well beyond what they would have wished. The effects on the international monetary system of last year's reserve creation were, therefore, destabilising, either potentially or actually, in two ways. In the first place, it resulted in a much greater net creation of liquidity, although the possible future inflationary implications of this were lessened by the fact that a good part of it accrued to industrial countries with low rates of inflation and substantial surpluses on their current balances of payments. Secondly, the expansion of international liquidity in 1977 was accompanied by erratic movements of exchange rates which produced a substantial further reduction in the value of the US dollar against a number of other major currencies. The latter development has once more raised the question of the asset composition of global reserves.

This question concerns not only the present stock of reserves but, equally importantly, future additions to it. For it has been quite clear for some years now that the change from the Bretton Woods system of par values to the present situation of rather generally managed floating of exchange rates has not made as much difference to countries' demand for reserves as had been supposed at the time when the par value system came to an end in 1973.

One indicator of the strength of that demand in recent years can be seen in the behaviour of non-oil developing countries. In 1976 and 1977, both of them years in which that group of countries registered substantial aggregate current payments deficits, they replenished their reserves by $10.8 and 9.4 billion respectively. Another aspect of countries' continuing need for reserves is illustrated by the level of official intervention in the exchange markets. According to estimates published by the Federal Reserve Bank of New York, total gross exchange-market intervention by the monetary authorities of the Group of Ten countries and Switzerland came to $40 billion during the twelve months from February 1975 to January 1976, $73 billion in the corresponding period of 1976–77 and $101 billion in the corresponding period of 1977–78. These figures include, particularly during 1977–78, very substantial amounts of dollars reluctantly purchased by surplus countries whose "demand" for reserves resulted solely from the desire to moderate the upward movement of their currencies in the exchange market. However, they also include the very large sums spent by deficit countries, such as Italy and the United Kingdom, in 1976 to avoid excessive downward movements of their exchange rates, as well as these countries' very large repurchases of dollars to rebuild their reserves in 1977.

Given that there continues to be a strong demand for reserves in the system, last year's experience has reinforced earlier doubts as to whether this can, consistently with the maintenance of reasonable stability in the exchange markets, be met simply through additions to dollar reserves. It may be added that even during the Bretton Woods era the acceptability of the dollar as the major element in reserve growth depended on there being also an adequate growth over time in world monetary gold stocks, both as backing for the US dollar and to meet the demand of those other countries for which gold was a major reserve asset. With gold no longer an element in reserve growth, other sources may now have to be looked to as a supplement to the dollar in world reserves. Here, the choice would appear to lie between the SDR, or some other internationally created asset, and the use as reserves of currencies other than the dollar.

What contribution could be made by the SDR to future reserve growth? The amended Articles of Agreement of the International Monetary Fund enshrine the hope that in due course the SDR will be the system's principal reserve asset, and Fund members have accepted a general commitment to work towards that end. However, this aim is probably best seen as a long-term one and for the foreseeable future it does not seem likely that SDRs can do more than serve the purpose for which they were originally designed, namely to supplement other types of reserve growth. In such a supplementary rôle, however, the SDR should be able to provide useful additions to owned reserves, since it is now the only type of reserve asset which is not at the same time a liability of any individual country in the system.

Could some non-dollar currencies, too, contribute usefully to future reserve growth? And, if so, would this be desirable? The countries whose currencies are in question remain, understandably, anxious to avoid becoming major reserve centres and have taken strong measures to avoid that happening. Nevertheless, there has, equally understandably, been strong central-bank demand for their currencies in recent years with the result that, despite all obstacles, the amounts held in official reserves have increased significantly in absolute terms, even if not relative to the total of all types of reserve asset. Of course, to the extent that the use of other currencies as reserve assets continued to expand, even with the dollar remaining far and away the principal reserve currency of the system, the importance of maintaining stability between the various reserve currencies would become correspondingly greater, as would the dangers involved in shifts of holders' asset preferences between the different currencies.

Two conclusions would seem to follow from these considerations. The first is that since there is for the foreseeable future no alternative to the dollar as the principal reserve asset in the monetary system, appropriate steps should be taken to restore full confidence in it. This means, above all, reducing the current-account payments deficit of the United States from the present level, at which it has been giving rise to an unacceptably high rate of increase of net dollar reserves in the rest of the world. In addition confidence would be strengthened if the dollar were seen to be backed by reserve assets in the United States rather than simply by the present network of short-term swap facilities. As to the future provision of dollar reserves to the system, in the interests of the stability both of the dollar and the monetary system as a whole this should come only in part from a current payments deficit in the United States and for the rest from borrowing, so that the increase in other countries' gross dollar reserves is to that extent accompanied by a rise in their external indebtedness.

The second conclusion is that a strengthening of the dollar, while necessary and desirable, may not be enough to ensure that all future reserve needs will be adequately met. It may need to be supplemented in due course by an expansion of the reserve function of other assets, if countries' preferences as regards the composition of their reserves are to be satisfied. In other words, it may not be realistic to demand a strong dollar and at the same time to pursue policies aimed at keeping the dollar as virtually the only element in reserve growth.

VII. ACTIVITIES OF THE BANK.

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

During the past year the Bank has continued to play its traditional rôle in fostering international monetary co-operation. In addition to the regular meetings in Basle of the Governors of the central banks of the Group of Ten countries and Switzerland and to those of the Board of Directors, the Bank has 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 to study and exchange information on other economic, monetary, technical and legal questions of interest to central banks.

The Bank continued to participate as an observer in the work of the Interim Committee of the Board of Governors of the International Monetary Fund on the International Monetary System. In accordance with the agreement reached at the Committee's meeting on 31st August 1975 in Washington, the Bank acted as registrar in connection with the arrangements entered into between the Group of Ten countries concerning their gold transactions until the arrangements were terminated at the end of January 1978.

The Bank also continued to provide the Secretariat for the Committee of Governors of the Central Banks of the Member States of the European Economic Community and for the Board of Governors of the European Monetary Co-operation Fund — EEC organs which were established in May 1964 and April 1973 respectively — as well as for their sub-committees and groups of experts. The latter include in particular the Committee of Governors' Alternates, which systematically prepares the groundwork for meetings of the Governors; a group specialising in matters relating to foreign exchange markets and intervention policies on these markets (since the beginning of 1976 the composition of this group has on occasion been confined to the EEC countries and at other times been extended to include other industrialised countries, generally members of the Group of Ten); a group commissioned to carry out periodic examinations of the monetary situation in member countries and of the problems raised by the co-ordination, on a Community scale, of national monetary policies; and a group concerned with the harmonisation of monetary policy instruments applied by member countries (this group is responsible to both the Monetary Committee of the EEC and the Committee of Governors).

As in previous years, these committees and groups held a large number of regular or ad hoc meetings in 1977–78, mostly in Basle and generally in preparation for discussions among the Governors. On the basis of their work the Committee of Governors itself and the Board of Governors of the European Monetary Co-operation Fund, each within the framework of its competence and functions, which are closely related and complementary, are able to take various decisions or to prepare reports and opinions, on a regular or ad hoc basis, for the Commission of the European Communities or, more usually, for the Ministers of Finance of the EEC countries. In 1977 this work centred primarily around intra-Community exchange rate relationships and Community facilities for mutual assistance, the co-ordination of the domestic monetary policies pursued by EEC member countries and the monetary aspects of the new initiatives with respect to monetary and economic union proposed by the Commission of the European Communities in the second half of the year.

The Bank continued to participate as an observer at meetings of the Finance Ministers and central-bank Governors of the Group of Ten countries and Switzerland, and of their Deputies. Furthermore, the Bank continued to perform the functions entrusted to it in August 1964 by the Ministers and Governors of the Group of Ten countries and Switzerland of collecting and distributing to all the participants in 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 and Switzerland. 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, in particular providing the Secretariat for the Committee on Banking Regulations and Supervisory Practices established by the central-bank Governors of the Group of Ten countries in December 1974.

Finally, the Bank has continued to provide the Secretariat for the Group of Computer Experts of the central banks of the Group of Ten countries and Switzerland, thereby facilitating discussions and the exchange of information between senior officials from the data-processing and organisation departments of the central banks concerned. Particular attention has been paid to the rapidly changing fields of message switching and electronic systems for international payments. The experts have further studied the question of security and reliability in this context, and at present they are examining payment systems and ways in which they may be automated. The Secretariat still participates as a liaison observer in the work of the International Standards Organisation relating to standards for international payments, and it follows closely all developments in this field. During the year the central banks completed their evaluation of the technical functioning of a centralised macro-economic data bank and the services it might provide for them. They reached the conclusion that the project was definitely worth developing further, and it was agreed that the experimental data bank operated by the BIS should be put on a permanent footing as from the beginning of this year. It will not, however, be possible to develop the full potential of this data bank until the BIS has installed a computer on its own premises, which it expects to do at the end of 1978.

* * *

2. Operations of the Banking Department.

The Balance Sheet of the Bank and the Profit and Loss Account at 31st March 1978, certified by the auditors, are reproduced at the end of this Report; both are expressed in gold francs.*

* * *

The balance-sheet total at 31st March 1978 stood at	F 59,334,066,542
against, on 31st March 1977,	F 48,846,308,213
It thus registered an increase of	F 10,487,758,329

or 21.5 per cent., which is very much larger, in both absolute and relative terms, than that recorded in the previous financial year (5,420 million and 12.5 per cent).

It may, however, be noted that approximately one-eighth of the increase in the balance-sheet total was due to the appreciation of certain currencies, most particularly the Swiss franc.

In the course of the financial year the total of the monthly statement of account progressed on the whole fairly steadily; its highest level was recorded at the end of February, when, at 60,192 million, it exceeded the 60 billion mark for the first time.

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
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
1974	31,615	+ 6,365	+ 25
1975	41,940	+ 10,325	+ 33
1976	43,426	+ 1,486	+ 4
1977	48,846	+ 5,420	+ 13
1978	59,334	+ 10,488	+ 22

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) assets held by virtue of the functions performed by the Bank (as Depositary, Trustee or Paying Agent) in connection with international loans;

(iii) assets and liabilities arising from the Bank's functions as Agent for the European Monetary Co-operation Fund in connection with Community borrowing and lending operations;

(iv) gold under earmark held by the BIS for the account of depositors; this item amounted to 1,018 million francs on 31st March 1978, against 1,311 million on 31st March 1977.

* In this chapter the term "francs" (abbreviated to F) signifies *gold* francs, except where otherwise indicated. The gold franc is the equivalent of 0.290 322 58... grammes fine gold — Article 4 of the Statutes. Assets and liabilities in US dollars are converted on the basis of 1 gold franc = US $ 0.394 1...; all other items in currencies are converted at central or market rates against the US dollar.

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			
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
1974*	967	30,378	270	31,615
1975*	1,122	40,435	383	41,940
1976*	1,253	41,617	556	43,426
1977*	1,373	46,934	539	48,846
1978*	1,493	57,150	691	59,334

* After allocation of the net profit for the year as proposed to the Annual General Meeting.

A. Capital, reserves, provisions and miscellaneous liabilities.

(a) Paid-up capital F 300,703,125

The Bank's authorised capital remained unchanged; so also did the issued capital, which is made up of 481,125 shares paid up to the extent of 25 per cent. The 1,000 shares of the Albanian issue, which had hitherto been held by the State Bank of Albania, Tirana, were sold by the latter institution to a group of member central banks; at the same time the State Bank of Albania renounced all the rights it had held as a result of its participation in the BIS; the operation in question did not alter the distribution of the rights of voting and of representation as between the other member institutions.

(b) Reserves

(1) *Legal Reserve Fund* F 30,070,313

This amount showed no change; it has in fact remained unchanged since 1971, when it reached 10 per cent. of the paid-up capital, which is the maximum laid down in Article 51(1) of the Statutes.

(2) *General Reserve Fund*

after allocation of the net profit for 1977–78 F 519,847,193

This compares with 471.8 million francs on 31st March 1977; the difference of 48 million francs represents the amount it is proposed to transfer to the Fund from the net profit; the proposed increase in this Reserve Fund is in conformity with the provisions of Article 51(3) of the Statutes.

(3) *Special Dividend Reserve Fund* F 75,175,781

This Reserve Fund has remained unchanged since 1973.

(4) *Free Reserve Fund*

after allocation of the net profit for 1977–78 F 567,118,200

This compares with 495.1 million francs on 31st March 1977, the amount it is proposed to transfer to this Fund from the net profit being 72 million francs.

The Bank's overall reserves after allocation of the net profit for 1977–78 thus stand at F 1,192,211,487
against 1,072.2 million francs at the beginning of the financial year, giving an increase of 120 million; it may be recalled that the rise in the overall reserves amounted to 131 million in the financial year 1975–76 and, as in the year under review, to 120 million in 1976–77.

(c) The item "Miscellaneous" rose to F 595,442,887

from 456.9 million francs on 31st March 1977, an increase of 138.5 million.

(d) Provision for Building Purposes F 24,932,478

The comparable amount on 31st March 1977 was 34.4 million francs; the decrease of 9.5 million francs is the result of incurred expenditure of 28.6 million francs, partially offset by an additional amount of 13 million francs which the Board of Directors decided to allocate to this Provision and by an exchange difference of 6.1 million.

(e) Profit and Loss Account, *before* allocation F 191,050,134

This figure represents the net profit for the financial year 1977–78; it is 23.2 million francs higher than the net profit for the preceding financial year, which — at 167.9 million — had been 11 million lower than that for the financial year 1975–76. Details of the proposed allocation of the profit for 1977–78, in accordance with the provisions of Article 51 of the Statutes, are given in Section 6 below; these proposals, to which reference has already been made in connection with the development of the reserves, provide in particular for a sum of 71,050,134 francs — against 47,920,050 francs in the preceding financial year — to be set aside in respect of the dividend of 110 Swiss francs per share (as compared with 100 Swiss francs per share last year) to be paid on 1st July 1978; *the increase in the amount* of the dividend is thus much greater in terms of gold francs (+ 48 per cent.) than in terms of Swiss francs (+ 10 per cent.); the divergence is due to the very appreciable rise in the gold franc value of the Swiss franc, to which reference has been made above.

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 1977	1978	Movement
	in millions of francs		
Deposits of central banks	45,894	56,360	+ 10,466
Deposits of other depositors	1,040	790	— 250
Total	46,934	57,150	+ 10,216

The increase in "Deposits of central banks" was very marked, also in relative terms (+22.8 per cent., against 14.8 per cent. in the previous financial year); it again accrued chiefly in US dollars, although there were also fairly substantial rises in most of the other currencies, particularly Deutsche Mark; deposits in Swiss francs were a special case in that the growth recorded was due to the fact that the rise in their gold franc value was greater than the net amount of repayments effected.

"Deposits of other depositors" continued to decline, although less sharply than in the previous financial year, when they had fallen by slightly more than one-third.

As a result of the divergent movements recorded in the two items mentioned above, there was a further increase — from 97.8 to 98.6 per cent. — in the preponderant share of "Deposits of central banks" in the total of borrowed funds.

BIS: Borrowed funds, by nature and term to maturity.

Term	Deposits in gold			Deposits in currencies			Total		
	Financial years ended 31st March		Movement	Financial years ended 31st March		Movement	Financial years ended 31st March		Movement
	1977	1978		1977	1978		1977	1978	
	In millions of francs								
Sight	2,509	3,708	+1,199	753	1,235	+ 482	3,262	4,943	+ 1,681
Not exceeding 3 months . . .	1,032	159	− 873	35,523	37,918	+2,395	36,555	38,077	+ 1,522
Over 3 months .	24	91	+ 67	7,093	14,039	+6,946	7,117	14,130	+ 7,013
Total . .	3,565	3,958	+ 393	43,369	53,192	+9,823	46,934	57,150	+10,216

Although deposits in gold increased somewhat, their share in the total of borrowed resources declined further, dropping from 7.6 to 6.9 per cent., while the proportion of deposits in currencies rose, correlatively, from 92.4 to 93.1 per cent.

(a) Deposits in gold F 3,957,761,261

This figure compares with that of 3,565 million francs at 31st March 1977, representing an increase of 393 million, quite appreciably higher than that of 45 million recorded during the previous financial year; sight deposits increased by approximately one-half, partly as a result of the receipt of additional deposits, but more particularly owing to the reversion to sight accounts of gold which had previously been held on fixed-term deposits not exceeding three months; the level of the latter consequently declined by five-sixths. The reason why the fixed-term deposits were not renewed in the same form was that during the financial year the possibilities open to the Bank for using gold on time deposit were gradually reduced; the increase in deposits at over three months was accounted for by a new deposit placed with the Bank for a fairly long period.

(b) Deposits in currencies F 53,191,965,170

This figure compares with that of 43,369 million francs at 31st March 1977; the increase of 9,823 million (+ 22.7 per cent.) was particularly marked and appreciably larger than that recorded in the previous financial year (5,272 million and + 13.8 per cent.); it was principally attributable to a rise in funds with maturities of over three months, the amount of which virtually doubled; the remainder was accounted for by sight deposits, which increased by almost two-thirds, and liabilities with maturities of not more than three months, the expansion in which was large in absolute terms but relatively small in percentage terms.

ASSETS (EMPLOYMENT OF RESOURCES).

The following table gives a breakdown 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 1977		1978		Movement	
	in millions of francs					
Sight assets						
Gold	4,046		5,069		+ 1,023	
Currencies	81	4,127	329	5,398	+ 248	+ 1,271
Treasury bills						
Currencies		133		288		+ 155
Time deposits and advances						
Gold	76		—		— 76	
Currencies	40,720	40,796	50,253	50,253	+ 9,533	+ 9,457
Securities at term						
Currencies		3,551		2,456		— 1,095
Total						
Gold	4,122		5,069		+ 947	
Currencies	44,485	48,607	53,326	58,395	+ 8,841	+ 9,788

(a) Gold F 5,069,414,415

This item had amounted to 4,046 million francs at the beginning of the financial year; the fairly marked increase of 1,023 million was the result of various operations: the receipt of new deposits, the maturing of swaps of gold — sold spot — against currencies and, finally, the maturing of deposits of gold that had been placed on the market.

On the other hand, it should be mentioned that, as indicated in note 3 to the Balance Sheet, the amount of gold pledged stood at 129 million francs, compared with 857 million at 31st March 1977.

(b) Cash on hand and on sight account with banks F 328,595,064

This figure compares with 81 million francs at 31st March 1977; the increase of 248 million was due to the fact that the Bank received funds at short notice which it had to keep in cash.

(c) Treasury bills F 287,962,424

This compares with a figure of 133 million francs at the end of the previous financial year; the increase of 155 million, which was greater than the amount outstanding at the beginning of the financial year, reflected the resumption by the Bank, as from July 1977, of purchases of Treasury bills denominated in US dollars.

(d) Time deposits and advances F 50,252,922,918

This figure compares with one of 40,796 million francs at 31st March 1977; the increase, of 9,457 million or 23.2 per cent., corresponds to the major part of the rise in total assets; it was accounted for entirely by currencies, the gold component having disappeared as a result of the maturing of time deposits mentioned under item (a) above.

The item in currencies rose from 40,720 million to 50,253 million, or by 9,533 million, thereby recording an increase even more marked than that of 6,190 million in the previous financial year; the rise primarily involved US dollars — placed on numerous markets — and, to a lesser extent, Deutsche Mark and the majority of other currencies in which assets are held; as in the case of borrowed funds, the expansion recorded in respect of Swiss francs was due to the fact that the rise in their gold franc value was greater than the effective reduction in investments in Swiss francs.

(e) Securities at term F 2,456,540,360

This figure compares with one of 3,551 million francs at 31st March 1977; the marked reduction, of 1,095 million or 30.8 per cent., essentially represents the difference between, on the one hand, the maturing of bank certificates of deposit, bankers' acceptances — all purchased on the US market and denominated in US dollars — and notes denominated in Swiss francs and, on the other, the purchase of various types of paper denominated in US dollars.

It may be noted that, whereas this item had at the beginning of the year still accounted for 7.3 per cent. of total assets, by the end of the year it represented no more than 4.1 per cent.; conversely, the share of the item "Time deposits and advances" increased from 83.5 to 84.7 per cent.

The increase in the total of the assets shown in the table below was principally attributable to investments with over three months to run; in fact,

BIS: Time deposits and advances and securities at term, by term to maturity.

Term	Financial years ended 31st March 1977	Financial years ended 31st March 1978	Movement
	in millions of francs		
Not exceeding 3 months	31,815	33,663	+ 1,848
Over 3 months	12,532	19,046	+ 6,514
Total	44,347	52,709	+ 8,362

the amount of such investments rose very sharply in both absolute and relative terms (by slightly more than one-half), which was connected with the lengthening of the terms of borrowed resources; on the other hand, the expansion of investments with not more than three months to run, while appreciable in absolute terms, was comparatively modest in percentage terms.

(f) Miscellaneous F 938,631,360

This figure compares with 239 million francs at 31st March 1977; as in the previous financial year, the very sharp increase — of 700 million — was virtually entirely a result of book-keeping adjustments; in fact, net weights of gold purchased under swaps against currencies were entered in the accounts on the basis of the statutory definition of the gold franc, whereas the operations in question had been concluded at market-related prices.

Forward gold operations.

These operations, which are referred to in note 2 to the Balance Sheet, resulted in a negative net balance (gold payable forward) of F 449,645,239 whereas at the beginning of the financial year there had been a positive net balance (gold receivable forward) of 105 million francs.

The turn-round in the net balance thus amounted to 554 million; it was the result of the maturing — referred to above under item (a) of the Assets — of swaps of gold (repurchased forward) against currencies and the net conclusion of swaps of gold (resold forward) against currencies; the latter swaps permitted a temporary mobilisation of central-bank gold reserves.

The Bank also pursued its traditional activity in the field of gold operations.

* * *

In general, the Bank's operations expanded further in the course of the financial year 1977–78 and reached an unprecedentedly high level.

3. The Bank as Trustee for international government loans.

In conformity with the agreements in force, the Bank continued to perform the functions of Trustee for the new bonds 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, in respect of the German External Loan 1924 (Dawes Loan) and of the German Government International Loan 1930 (Young Loan).

As regards the Dawes Loan, all outstanding conversion bonds matured in October 1969 and all outstanding funding bonds matured in October 1972. In accordance with Article 16 of the General Bond of the Dawes Loan dated 10th

October 1924, the Trustee repaid to the German Government in 1977 all amounts which remained unclaimed by holders of outstanding funding bonds and relevant coupons.

The financial year 1977–78 for the Young Loan ended on 1st June 1978. The interest in respect of the financial year 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 1977–78 was effected partly by purchases of bonds on the market and partly by drawings. All the outstanding funding bonds were redeemed on 1st December 1972, whereas the final maturity date for the conversion bonds is fixed at 1st June 1980.

German Government International Loan 1930 (Young Loan).
Conversion bonds.

Issue	Currency	Redemption value*			
		Bonds issued	Bonds purchased or drawn for redemption in respect of the financial years: 1958–59 to 1976–77	1977–78	Balance after redemption
American . . .	$	86,144,000	27,179,000	2,219,000	56,746,000
Belgian	B.fr.	202,872,000	61,695,000	4,803,000	136,374,000
British	£	42,091,000	12,709,000	992,000	28,390,000
Dutch.	Fl.	52,581,000	15,673,000	1,231,000	35,677,000
French	Fr.fr.	644,438,000	197,179,000	15,303,000	431,956,000
German . . .	DM	14,509,000	4,231,000	336,000	9,942,000
Swedish . . .	S.kr.	128,380,000	39,456,000	3,091,000	85,833,000
Swiss	Sw.fr.	58,393,000	17,355,000	1,364,000	39,674,000

* Provisional value on 1st May 1978 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 in 1961 and 1969 and the subsequent appreciation of some currencies of issue not involving a formal change in their par values.

The German Federal Debt Administration (Bundesschuldenverwaltung) informed the Trustee that following the entry into force on 1st April 1978 of the Second Amendment to the Articles of Agreement of the International Monetary Fund it had decided to apply the exchange guarantee clause attached to the Young Loan and thenceforth to calculate the amounts due to holders of conversion bonds and related coupons on the basis of Article 13(c) of the London Agreement on German External Debts of 27th February 1953. The amounts payable on conversion bonds and related coupons will thus be established, from case to case, on the basis of the exchange rates of the currencies of issue of the Young Loan ruling on the market on each maturity date. Prior to the above-mentioned Amendment the German Federal Debt Administration had maintained that only par values notified to the International Monetary Fund were applicable under the exchange guarantee clause. At the time when the new basis for calculation of the amounts payable was communicated to the Trustee, the Belgian franc was, in the opinion of the German Federal Debt Administration, the "least depreciated currency" within the meaning of Paragraph 2(e) of Section A of Annex I to the London Agreement.

The Trustee, while welcoming the decision of the Federal Debt Administration to recalculate the amounts due to bondholders, is nevertheless of the opinion that an adjustment should already have been made, so far as de facto depreciations of currencies are concerned, to compensate the bondholders of issues whose currency of payment has progressively depreciated in value since 1971. This question, as well as the wider one of whether de facto appreciations of currencies should similarly give rise to application of the exchange guarantee, has been brought to the attention of the governments of the countries in which issues of the Loan were made and the Trustee has requested them to take the matter up and do everything to ensure that an appropriate solution is reached.

The question whether the exchange guarantee is applicable in the case of the revaluations of the Deutsche Mark in 1961 and 1969 was submitted in May 1971 to the court of arbitration provided for in the London Agreement; the arbitral proceedings are in progress.

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 1959 to 1976	1977	Advance repayment 1978	Balance after redemption
American	$	1,667,000	1,503,000	21,000	143,000	—
Anglo-Dutch . .	£	856,600	745,700	56,000	—	54,900
Swiss	Sw.fr.	7,102,000	5,589,000	445,000	—	1,068,000

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

The following table 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 1977–78 the amounts received by the Bank for the service of the secured loans came to the equivalent of about 5 million francs in respect of interest and about 33 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 81 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 1978	Rates of interest %	Year of final maturity or redemption
1st	1954	United States	US Government	$	100,000,000	13,000,000	3⅞	1979
2nd	1955	Belgium	Caisse Générale d'Epargne et de Retraite, Brussels	B.fr.	200,000,000	56,000,000	3½	1982
3rd	1955	Germany	Westdeutsche Landesbank Girozentrale, Düsseldorf[1]	DM	50,000,000	6,965,000	3¾	1981
4th	1955	Luxembourg	Caisse d'Epargne de l'Etat, Luxembourg	B.fr.	20,000,000	5,600,000	3½	1982
				L.fr.	5,000,000	—	3½	1961
5th	1956	Saar	Landesbank Saar Girozentrale, Saarbrücken	DM	2,977,450[2]	—	4¼	1977
6th	1956	Switzerland	Public issue	Sw.fr.	50,000,000	—	4¼	1974
7th	1957	United States	Public issue	$	25,000,000	—	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	Luxembourg	Etablissement d'Assurance contre la Vieillesse et l'Invalidité, Luxembourg	L.fr.	100,000,000	34,532,882	5⅜	1982
11th	1958	United States	Public issue	$	35,000,000	2,800,000	5	1978
12th	1958	United States	Public issue	$	15,000,000	—	4½	1963
13th	1960	United States	Public issue	$	25,000,000	5,200,000	5¾	1980
14th	1960	United States	Public issue	$	3,300,000	—	4¾	1963
				$	3,300,000	—	4⅞	1964
				$	3,400,000	—	5	1965
15th	1961	Luxembourg	Etablissement d'Assurance contre la Vieillesse et l'Invalidité, Luxembourg	L.fr.	100,000,000	51,008,942	5¼	1986
16th	1961	Netherlands	Public issue	Fl.	50,000,000	13,150,000	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.

5. The Bank as Agent for the European Monetary Co-operation Fund.

The Bank continued to perform the functions of Agent for the European Monetary Co-operation Fund which it has been executing since 1st June 1973. This Community institution, which was set up on 6th April 1973 by the member states of the European Economic Community, is still only in the initial stage of its operation, but its activities have become more diversified since the conclusion in March and April 1976 of the first Community borrowing operations, the administration of which has been entrusted to the Fund.

As the Fund's technical Agent, the Bank thus performs two sets of functions: on the one hand, book-keeping operations in connection with the working of the exchange rate system introduced in the Community in April 1972 and, on the other, functions relating to the execution of financial operations connected with Community borrowing and lending.

In the first case, the Bank's rôle consists principally in keeping the Fund's accounts and recording therein:

- the debts and claims vis-à-vis the Fund of the EEC central banks participating in the "snake" arrangement which arise from interventions carried out by those banks in member countries' currencies in order to keep fluctuations between their exchange rates within a margin of no more than 2.25 per cent.;
- the periodic settlement of these very short-term debts and claims;
- operations carried out in the context of the short-term monetary support arrangements; operations of this kind were entered in the Fund's books in connection with the monetary support received by the Bank of Italy between March and December 1974; they subsequently disappeared from the accounts when this short-term credit was consolidated into medium-term financial assistance; a further monetary support facility of US $ 482.54 million which had been granted to the Bank of Italy in May 1976 was closed in June 1977 without ever having been drawn upon.

During the financial year 1977–78 the number of accounting operations varied considerably in line with the situation on the foreign exchange markets of the EEC countries participating in the "snake" and with the greater or lesser recourse by these countries to interventions in US dollars, which are not entered in the Fund's books.

In its function as Agent of the Fund for the administration of borrowing and lending operations concluded by the Community in accordance with the Regulations adopted by the Council of the European Communities in February 1975, the Bank is responsible principally for the following tasks:

- carrying out payments connected with these borrowing and lending operations;
- opening the necessary accounts in the Fund's books and recording such financial operations;
- keeping a check on the due dates laid down in the borrowing and lending contracts for the payment of interest and repayment of the principal;
- informing the Commission of the European Communities of the operations carried out for the account of the EEC.

The payments mentioned above are effected through the accounts which the Fund has opened in its name at the Bank; the accounts in question are, however, merely transit accounts, as the sums received by the Fund under borrowing arrangements entered into by the Community are transferred on the same value date to the account specified by the central bank of the country receiving the corresponding loan.

During the financial year 1977–78 the Bank in its capacity as Agent of the Fund has, on the one hand, seen to the payment of interest falling due on the loans contracted by the EEC since 1976 and, on the other hand, participated in the execution of two new operations. The first of these, for an amount of US$ 100 million, was undertaken with a view to converting the final tranche of the US$ 300 million variable-rate bank facility contracted by the EEC in April 1976 into a fixed-rate loan, the first two tranches having already been consolidated during the previous financial year. The second operation was a US$ 500 million public bond issue by the EEC in the Euro-dollar market, with the proceeds being on-lent to Italy.

Taking these two new transactions into account, a total of seven Community borrowing and lending operations were being administered by the Bank as Agent of the Fund at 31st March 1978, amounting to the equivalent of some US$ 1.8 billion, of which $1.5 billion was lent to Italy and $300 million to Ireland. All the borrowing and corresponding lending contracts carry a fixed rate of interest varying between 7¼ and 8¼ per cent. according to the term of the loan (over five years on average), the currency of issue and the date of conclusion of the contract.

6. Net profits and their distribution.

The accounts for the forty-eighth financial year ended 31st March 1978 show a net operating surplus of 204,477,506 francs, compared with 175,776,466 francs for the preceding financial year and 184,464,774 francs for the financial year 1975–76. The increase recorded in the year under review reflects the substantially greater volume of the Bank's operations during this period, offset to some extent by a rise in the level of the Bank's costs of administration as a consequence, in part, of the move to the new building.

The Board of Directors has decided to transfer 427,372 francs to the Provision for Exceptional Costs of Administration and 13,000,000 francs to the Provision for Building Purposes. As a result of these transfers the net profit amounts to 191,050,134 francs, against 167,920,050 francs for the previous financial year and 178,876,749 francs for the financial year 1975–76. The allocation of this amount is governed by Article 51 of the Statutes.

On the basis of this provision, the Board of Directors recommends that the net profit of 191,050,134 francs be applied by the General Meeting in the following manner:

(i) an amount of 71,050,134 francs in payment of a dividend of 110 Swiss francs per share;

(ii) an amount of 48,000,000 francs to be transferred to the General Reserve Fund; and finally

(iii) an amount of 72,000,000 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.

The higher amount of this year's dividend in gold francs as compared with last year reflects not only the recommended increase from 100 to 110 Swiss francs per share, but also the greater value of the Swiss franc in terms of gold francs.

If the above proposals are accepted, the dividend will be paid on 1st July 1978 to the shareholders whose names are contained in the Bank's share register on 20th June 1978.

The Balance Sheet, the Profit and Loss Account, and a summary statement showing 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, including the notes thereon, give a true and fair view of the state of the Bank's affairs at 31st March 1978 and of its profit for the year ended on that date. Messrs. Price Waterhouse & Co.'s report is appended at the foot of the Balance Sheet.

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

At the meeting of the Board held on 13th June 1977 the Chairman announced that Dr. Emminger had appointed Herr Karl Otto Pöhl as his Alternate.

The mandate of Mr. Carl-Henrik Nordlander as a member of the Board being due to expire on 31st March 1978, he was re-elected under Article 27(3) of the Statutes at the meeting of the Board on 14th March 1978 for a further period of three years ending on 31st March 1981.

Lord O'Brien of Lothbury, whose mandate as a member of the Board was due to expire on 6th May 1978, was re-appointed under Article 27(2) of the Statutes by Mr. Gordon Richardson, Governor of the Bank of England, in April 1978 for a further period of three years.

At the Board meeting on 13th September 1977 Dr. Günther Schleiminger, who had been the Bank's Secretary General since 1st January 1975, was appointed Assistant General Manager as from 1st January 1978, and Dr. Giampietro Morelli was appointed Secretary General with effect from 1st June 1978. In addition to his new functions as Assistant General Manager, Dr. Schleiminger continued to perform the functions of Secretary General until 31st May 1978. At the same meeting the Board appointed Dr. Antonio d'Aroma Special Counsellor for a period of one year as from 1st January 1978.

The Chairman announced at the Board meeting held on 14th March 1978 that it had been decided to promote M. André Bascoul and Herr P. Hauser to the rank of Assistant Manager as from 1st April 1978.

CONCLUSION.

The weakening of world economic activity last year was largely unanticipated. Is there a risk of a continued unsatisfactory development of trade and output? And if so, what can be done about it without rekindling inflation?

Undoubtedly, a number of depressive influences are still at work in the world economy. They are the same as those which last year tilted the balance, outside the United States at least, towards slower growth: the shrinking but still sizable oil surplus; the payments imbalances among industrial countries and the resulting currency unrest; persisting cost/price inflation; and structural problems in some of the highly developed, export-oriented, industrial countries.

On the other hand, the forces which could contribute to renewed growth seem to have strengthened. Many countries, both in western Europe and among developing nations, have gone far towards redressing their external balances and their reserve positions. The supply of funds for balance-of-payments financing shows no signs of becoming tighter. In Japan and Germany there is awareness that a steady, healthy expansion of domestic demand is as important for these countries as for the rest of the world. And in the United States the outlook is for continued expansion, though probably at a slower pace.

On balance, therefore, it appears unlikely that depressive influences could prove strong enough to push the world further into recession. But it seems equally unlikely that economic growth could resume a satisfactory upward course in the absence of further stimulatory measures, taken with due regard for relative payments imbalances and the continuing need to reduce inflation. The chances are that, with no change in policies, economic activity and trade would continue to grow at a very slow pace.

Even though such a development could hardly be described as a world crisis, or be compared to the depression of the 1930s, it would entail a number of potentially grave consequences for industrial and developing countries alike.

One obvious consequence would be the widespread persistence of high rates of unemployment, particularly if rises in real wages continue to support the strong labour-saving bias of investment policies. In this event, the growth of labour productivity could tend to equal, or even to exceed, that of output.

Secondly, the normal and continuous process by which resources — entrepreneurship, labour and capital — are transferred from declining to expanding industries might, far from accelerating, actually slow down. There are two complementary reasons why a slack world economy would in this way become an obstacle to solving structural problems, especially those which have emerged as a result of successful industrialisation in some of the developing countries. The first is that in a slowly growing economy it is hard to distinguish permanent shifts in comparative advantage from excess capacities that are simply the outcome of near-stagnation. This strengthens the temptation to grant trade protection and government assistance not only to those industries whose "early retirement" justifiably deserves to be carried out in an orderly way, but also to some genuine growth industries which should be able to take care of themselves. The second reason is that many industrialists, inhibited by the general uncertainties of hesitant growth, would shy away from undertaking major investment in the potentially promising sectors. Desirable structural changes would thus be delayed. Too much labour and capital would remain locked in declining industries carrying out defensive investment under the umbrella of spreading protectionism, with no sufficiently strong compensating development elsewhere.

Thirdly, one can probably discard the illusion that a semi-stagnating economy would help in efficiently fighting the cost/price spiral. It is true, of course, that persistent excess capacities and unemployment would rule out demand-pull inflation. It is also true that, with memories of a protracted period of over-full employment and high inflation still vivid, it would be a mistake to aim at degrees of resource utilisation comparable to those of the golden 'sixties. But it is also possible to argue that, after having participated in the benefits of several decades of fast and regular growth, economic groups are not likely to rest content with small increases in real income, let alone with stationary earnings. Competing pressure groups would try to appropriate ever-increasing shares of a cake that had ceased to grow. The outcome could be continued upward pressure of wages, costs and prices — and, with unemployment persisting, governments would find it very hard indeed not to validate such a spiral. Would governments not have a better chance of containing inflation, and even reducing it further, if they aimed at accommodating the desire for higher living standards by some reasonable rate of real growth?

Finally, the stagnation of output in the industrial world would have manifestly detrimental effects on developing countries. The success which the major debtor LDCs have had so far in cutting current-account deficits to manageable size would be subject to reversal, while other developing countries would find their chances of joining the development process seriously reduced. This, in turn, could have unfavourable repercussions on the western industrial world as a whole and, in particular, on its banking system through its heavy involvement in balance-of-payments financing.

From an international standpoint, the conclusion is that it would be wrong to accept with resignation the prospect of mediocre growth. The potential consequences of near-stagnation are sufficiently dangerous to warrant a concerted international effort to put the world economy back on a more satisfactory path of development. Admittedly, even with the best combination of luck and wise policies the western industrial world will not be able to return to the growth path that prevailed until 1973. Aiming at ambitious growth rates would be doomed to failure, since growth potential has been curtailed by low investment rates over many years; it would also be dangerous, since nothing could be easier than to revive demand-pull inflation. But surely there is a middle course between the probably very slow growth indicated by present trends and the dangers inherent in unrealistic growth targets.

The policy recommendations that follow are derived from an analysis of the depressive factors underlying the current slowdown in the expansion of world trade and output.

The first of these factors is the oil surplus. Although it has been shrinking quite rapidly over the last year, not all of this decline is the result of genuine adjustment; some of it is due to the sluggishness of the world economy. This means that, short of a further substantial real adjustment, any revival in economic activity would again be hampered by a rising oil imbalance. Experience has clearly shown that recycling the surplus, though necessary, is no more than a palliative; it is the imbalance itself that exerts a depressive influence on economic activity. One component of real adjustment — the absorption of goods and services by the oil-producing countries — will have to be spread over a fairly long time-span. The burden of further adjustment will therefore have to be borne by the oil consumers, who have little choice but to reduce the total oil import bill. Such a reduction need not be achieved primarily through measures designed to economise on overall energy consumption; it can result from the substitution of other forms of energy for oil or, in some countries, from an expansion of domestic oil production.

The second major constraining factor is the balance-of-payments disequilibrium among industrial countries — more specifically between the United States on the one hand and Japan, Germany and Switzerland on the other. This imbalance has brought about excessive exchange rate movements, which have accelerated price inflation in the United States and jeopardised investment and recovery in the countries with appreciating currencies. Moreover, the severity of these movements, and the disorderly market conditions in which they occurred, dealt a further blow to business confidence, which had already been badly shaken by other events.

The reduction of these imbalances requires adjustment measures both by the United States and by the surplus countries. However, it would seem unrealistic, and potentially dangerous for the world economy, to recommend strong overall domestic restriction in the United States and, conversely, strong overall domestic expansion in Germany and Japan. It would be unrealistic because none of these countries appears ready to subordinate its domestic policy targets to balance-of-payments considerations: the United States will not put a brake on growth unless there are compelling domestic reasons for doing so; nor will Germany and Japan take reflationary measures which in their own judgement would carry the risk of rekindling inflation. But such a recommendation would also be dangerous from the point of view of the world economy. The United States, alone among the major industrial economies, has been spontaneously expanding at a good pace, while both Japan and Germany have experienced substantial difficulties in initiating a self-sustaining recovery of domestic demand. The contrast in this respect is vividly demonstrated by the relatively much higher level of public-sector financial deficits in Japan and in Germany than in the United States.

The practical conclusion is that while an acceleration of domestic expansion in the surplus countries would undoubtedly be a welcome development, it remains uncertain to what extent it will actually take place. And so long as this uncertainty prevails, the rest of the world would hardly wish to see the United States seeking to restrain demand by more than is necessary in any case for the purpose of keeping prices and wages under control in the present advanced stage of the cyclical upswing. All the more reason why the US efforts should be heavily concentrated on measures leading to a cutback in oil imports. The fact that such a development is within the reach of the US economy has been clearly demonstrated by the sharp decline in oil consumption figures per unit of gross national product in some other major industrial countries.

That having been said, it appears fairly obvious that there can be no lasting upturn in world trade and output unless a number of countries gradually take over from the US economy as the driving force behind expansion. In principle, the major responsibility in this respect would seem to lie with Japan and Germany, since both countries have achieved considerable success in fighting inflation and since a stimulation of their domestic demand would best serve the international adjustment process. In practice, however, neither of these two countries is likely to be very successful in strengthening world demand unless a number of other countries take action as well. In a sluggish world economy the export-oriented structure of their industry precludes any satisfactory short-term revival of domestic demand through investment, and it would be unrealistic to expect a sufficiently quick adjustment through public investment and private consumption alone. It follows that, although more moderately than in these two countries, domestic expansion may have to be stimulated elsewhere as well — in countries where balance-of-payments constraints have been reduced and where inflation rates have been brought down substantially.

What can be done to stimulate domestic demand? Although generalisations regarding demand management are risky, two broad propositions can nevertheless be advanced. The first must be stated in negative terms: expansion should *not* be initiated through easier monetary policy. There are several reasons for this. One is that private-sector liquidity has improved in most countries in recent years, and the availability of finance appears to be adequate. Another is that expansive monetary policy may cause only a temporary reduction in interest rates — and, in any case, neither investment nor consumption seems to be strongly responsive to falls in interest rates. The real risk, however, is not that easier monetary policy will be ineffective — but that it will lead to renewed price increases. The growth of monetary aggregates has come to be linked in the eyes of the public to prospective changes in inflation rates; thus any lasting shift to faster monetary expansion would be liable to increase inflationary expectations.

The second broad proposition may be couched in more positive terms: compared with monetary policy, expansionary fiscal policies would be less likely, under present circumstances, to elicit countervailing market reactions. The risk would be even less if fiscal action were to rely on tax cuts rather than on additional government spending — except, perhaps, for various kinds of investment expenditure yielding a high, immediate return. Three considerations lend support to this view. The first is that in many western industrial countries the share of the public sector in the economy has reached a level which has in itself broadly discouraging effects on economic growth; and a further rise in public spending could foreshadow an increase in the tax burden that would make matters even worse. The second is that income-tax cuts seem to be the only way of raising personal disposable income, responding to the desire for a higher standard of living, and stimulating consumer expenditure without at the same time exacerbating the upward pressure of costs and further eroding profit margins. And, given the great reluctance of industrialists to expand investment in the current climate of uncertainty, there is little hope of inducing growth in domestic demand without additional spending by households. The third consideration is that cuts in corporate income tax would contribute to bringing about a much needed improvement in industry's profit situation and would thereby strengthen the propensity to invest.

The major question is, of course, whether such a policy is compatible with the need to bring down inflation rates further — and the mere fact of raising this question points to the obvious limitations of demand stimulation policies. Such limitations exist, as was mentioned above, in countries where stagnating investment has slowed down capacity growth. They are even more accentuated in countries which have only very recently managed to reduce inflation, and where an early reappearance of bottlenecks could quickly lead to accelerated price increases. Since most countries belong to this latter group, growth targets for the western industrial world must necessarily remain modest.

However, if fiscal expansion is pursued moderately, and with due regard to each country's external strength and inflation rate, it is unlikely to trigger a revival of demand-pull inflation in the current depressed state of western industrial economies other than the United States. Cuts in tax rates, if they are successful in raising consumer spending and thus stimulating activity, need not imply more than a transitional shortfall in tax receipts and a temporary rise in the public sector's deficit. Even if they did, the savings/investment balance of the private sector seems at present to have shifted to such an extent in all major countries — except the United States — that the increased financing need of the public sector could most probably be covered without much additional recourse to monetary financing. And this, after all, is the crux of the matter as far as inflationary expectations and demand management are concerned. It should be added, however, that once a strong revival of private-sector investment had got under way there would no longer be the same scope for financing public-sector deficits from the financial surpluses of the private sector. It would therefore be wise to look upon tax cuts made to counter the present situation of insufficient demand as potentially reversible once that situation had ceased to exist.

This still leaves open the question of how to tackle the cost/price spiral. It would be a grave mistake to ignore the underlying strength of such inflationary pressure, since its persistence would be likely to bring any revival in growth to an early halt. Unfortunately, there are no miracle remedies in this field, and clearly each individual country has to devise policies which correspond to its own political, social and institutional background. Experience has shown this to be especially true of incomes policies, whose feasibility and effectiveness have varied considerably from country to country. On the other hand, cuts in income taxes should be conducive to greater wage restraint since they provide a practical alternative to pre-tax wage increases. Similarly, publicly announced and broadly respected targets of growth for monetary aggregates create a propitious climate for moderating wage claims and price increases.

This set of policy proposals — a reduction in oil import bills, internationally concerted expansionary action featuring tax cuts, and a continuation of the fight against inflation — could help to reactivate growth. It could also reduce current-account imbalances to a manageable size — meaning that with appropriate policies regarding capital movements, the availability of short-term finance and the supply of international reserves, the remaining imbalances would cease to be a major source of currency unrest and would no longer produce asymmetrically depressive adjustment policies. Or to put it differently: balance-of-payments financing policies would resume their normal function of complementing and facilitating current-account adjustment instead of substituting for such adjustment. For the clear lesson to be drawn from the last few years is that, apart from the traditional transfer of real resources from highly developed countries to developing ones, long-lasting substantial current-account imbalances lead ultimately to a painful reckoning, whether for the deficit countries, for the surplus countries, or for both.

If it can be assumed that the world is moving towards an improved current-account situation, what can be said about the appropriate rôle for international monetary and financial policies?

First, a remark about the flow of aid and long-term capital to developing countries. For these countries, as mentioned above, moderate current-account deficits are a normal feature of the international pattern of trade and payments. What is less normal is that the deficits in question should be covered increasingly by medium-term bank loans, often at variable interest rates. Financing of this kind involves high and unpredictable annual debt service charges for the countries concerned and renders the lending banks themselves increasingly vulnerable to country risks. As a general rule, the greater part of the financing should consist of aid, long-term loans and direct investment.

A second preoccupation has to do with the external position of the United States. Last year's excessive current-account deficit was seriously aggravated by an outflow of capital, resulting in a precipitate fall of the dollar and widespread currency turmoil, despite substantial dollar acquisitions by foreign central banks. Of course, if appropriate corrective measures are now taken, both in the United States and abroad, the decline in the current-account deficit might alone shift the balance of private capital flows back towards the United States. Alternatively, private capital might start flowing back into the United States as a result of optimistic expectations about such policy measures being taken — indeed, judging by the rise of the dollar in April and May this year, a turn-round of this nature may already have taken place. But to keep capital flows under control, and to underline the credibility of the basic adjustment measures, the authorities will have to maintain interest rate differentials and their monetary growth rates at appropriate levels and be ready to intervene actively in the exchange markets whenever the need again arises.

A third important policy consideration concerns the adequacy of international liquidity in terms of both volume and composition. The fact that so many countries have undertaken deliberately to build up reserves by means of borrowing might suggest that there is a genuine demand for additional reserves. It should be noted, however, that part of this demand has been for reserve assets other than dollars. Allowing a large US current-account deficit to persist would clearly be the wrong answer to such two-dimensional demand, since substantial reserves cannot be created in this way without endangering the dollar itself, and hence strengthening the desire for diversification. Thus, five years after the collapse of Bretton Woods we seem to be back where we were at the time of par values: to the realisation that the provision of reserves through a large US current payments deficit is apt to have a dangerously destabilising effect on world expansion.

René Larre

General Manager

BALANCE SHEET AND PROFIT AND LOSS ACCOUNT

AT 31st MARCH 1978

BALANCE SHEET

ASSETS

(Before and after

		Gold francs
Gold		5,069,414,415
Cash on hand and on sight account with banks		328,595,064
Treasury bills		287,962,424
Time deposits and advances		
Not exceeding 3 months	31,592,963,506	
Over 3 months	18,659,959,412	
		50,252,922,918
Securities at term		
Not exceeding 3 months	2,070,382,507	
Over 3 months	386,157,853	
		2,456,540,360
Miscellaneous		938,631,360
Land, buildings and equipment		1
		59,334,066,542

Note 1: The gold franc is the equivalent of 0.290 322 58... grammes fine gold — Article 4 of the Statutes. Assets and liabilities in US dollars are converted on the basis of 1 gold franc = US $ 0.394 1...; all other items in currencies are converted at central or market rates against the US dollar.

Note 2: At 31st March 1978, gold payable against currencies on forward contracts amounted to 449,645,239 gold francs.

Note 3: The equivalent of 128,602,926 gold francs' worth of gold was pledged at 31st March 1978 in connection with deposits received.

AT 31st MARCH 1978

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	471,847,193		*519,847,193*
Special Dividend Reserve Fund	75,175,781		*75,175,781*
Free Reserve Fund	495,118,200		*567,118,200*
		1,072,211,487	*1,192,211,487*
Deposits (gold)			
Central banks			
Sight	3,674,919,870		
Not exceeding 3 months	158,694,584		
Over 3 months	91,064,122		
Other depositors			
Sight	33,082,685		
		3,957,761,261	*3,957,761,261*
Deposits (currencies)			
Central banks			
Sight	1,172,468,412		
Not exceeding 3 months	37,334,072,988		
Over 3 months	13,928,683,550		
Other depositors			
Sight	62,920,651		
Not exceeding 3 months	583,558,534		
Over 3 months	110,261,035		
		53,191,965,170	*53,191,965,170*
Miscellaneous		595,442,887	*595,442,887*
Provision for Building Purposes		24,932,478	*24,932,478*
Profit and Loss Account		191,050,134	—
Dividend payable on 1st July 1978		—	*71,050,134*
		59,334,066,542	*59,334,066,542*

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, including the notes thereon, give a true and fair view of the state of the Bank's affairs at 31st March 1978 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, 24th April 1978

PRICE WATERHOUSE & CO.

PROFIT AND LOSS ACCOUNT
for the financial year ended 31st March 1978

		Gold francs
Net interest and other income ...		256,441,348
Less: Costs of administration:		
Board of Directors ...	546,679	
Management and Staff ...	38,723,852	
Office and other expenses ...	12,693,311	51,963,842
Net operating surplus ...		204,477,506
Less: Amounts transferred to:		
Provision for Exceptional Costs of Administration ...	427,372	
Provision for Building Purposes ...	13,000,000	13,427,372
Net Profit for the financial year ended 31st March 1978 ...		191,050,134

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: 110 Swiss francs per share on 481,125 shares ...	71,050,134
	120,000,000
Transfer to General Reserve Fund ...	48,000,000
	72,000,000
Transfer to Free Reserve Fund ...	72,000,000
	—

Movement on the Provision for Building Purposes during the financial year ended 31st March 1978

	Gold francs
Balance at 1st April 1977 ...	34,450,867
Add: Exchange difference ...	6,119,450
Transfer from Profit and Loss Account ...	13,000,000
	53,570,317
Less: Amortisation of expenditure incurred ...	28,637,839
Balance at 31st March 1978 per Balance Sheet ...	24,932,478

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
Prof. Paolo Baffi, Rome
Bernard Clappier, Paris
Dr. Otmar Emminger, Frankfurt a/M.
Dr. Fritz Leutwiler, Zurich
Carl-Henrik Nordlander, Stockholm
The Rt. Hon. Lord O'Brien of Lothbury, London
Dr. Antonino Occhiuto, Rome
The Rt. Hon. Gordon Richardson, London
Dr. Johann Schöllhorn, Kiel
Cecil de Strycker, Brussels

Alternates

Dr. Mario Ercolani, Rome, or
Dr. Giovanni Magnifico, Rome
Georges Janson, Brussels
Christopher W. McMahon, London, or
M.J. Balfour, London
Karl Otto Pöhl, Frankfurt a/M., or
Dr. Leonhard Gleske, Frankfurt a/M.
Marcel Théron, Paris, or
Gabriel Lefort, Paris

MANAGEMENT

René Larre	General Manager
Dr. Günther Schleiminger	Assistant General Manager
R.T.P. Hall	Head of the Banking Department
Prof. Alexandre Lamfalussy	Economic Adviser, Head of the Monetary and Economic Department
Dr. Giampietro Morelli	Secretary General, Head of Department
Maurice Toussaint	Manager
Prof. Dr. F.E. Klein	Legal Adviser

Dr. Antonio d'Aroma	Special Counsellor

D.H. Stapleton	Deputy Secretary General
Robert Chaptinel	Deputy Manager
Dr. Warren D. McClam	Deputy Manager
M.G. Dealtry	Deputy Manager
R.G. Stevenson	Assistant Manager
Rémi Gros	Assistant Manager
Charles Altenhoff	Assistant Manager
André Bascoul	Assistant Manager
P. Hauser	Assistant Manager