BANK FOR INTERNATIONAL SETTLEMENTS

THIRTY-EIGHTH ANNUAL REPORT

1st APRIL 1967 — 31st MARCH 1968

BASLE

10th June 1968

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THIRTY-EIGHTH ANNUAL REPORT

submitted to the

ANNUAL GENERAL MEETING

of the

BANK FOR INTERNATIONAL SETTLEMENTS

held in

Basle on 10th June 1968.

Gentlemen,

I have the honour to submit herewith the Annual Report of the Bank for International Settlements for the thirty-eighth financial year, which began on 1st April 1967 and ended on 31st March 1968.

After deduction of the transfers to provisions, the net profit amounted to 45,000,000 gold francs, compared with 32,074,487 gold francs for the preceding year.

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

Chapter I of this Report deals with the most important events of the past year, in particular so far as concerns sterling, the dollar and gold, and in addition puts them in a longer-term perspective. The succeeding chapters review recent changes in output and prices in various countries, as well as developments in the field of credit, foreign payments, gold production and monetary reserves. There follows a survey of events in the Euro-currency markets and a review of the operations of the European Monetary Agreement. Chapter VII describes the current activities of the Bank and the functions it performs on behalf of the European Coal and Steel Community and as Trustee and Fiscal Agent for international loans. Finally, it touches on the Bank's rôle in promoting co-operation between central banks as well as on its relations with other international institutions.

I. STERLING, THE DOLLAR AND GOLD.

The economic situation in the spring of 1967 presented an atmosphere of relative calm that gave little indication of the stormy months ahead. The domestic economy in most of the industrial countries showed either a lull in the expansion of activity or mild recessionary tendencies. The setback was stronger in the case of Germany, and only in Japan and Italy was expansion persisting. Price inflation was continuing in quite a few countries, but its cause lay in wage pressures and lag effects rather than in excess demand. In the United States the large budget deficit constituted a threat to monetary stability against which the President had proposed a substantial increase in taxes; but in the early months of the year the threat was potential rather than actual.

In the international sphere there were various payments imbalances, though in most cases the situation showed an improvement over the year before. The position of sterling was better, the external surpluses of Italy and France were reduced, and while Germany was in rather extreme surplus, this was related to the unfavourable cyclical position of the economy. The balance of payments of the United States had worsened as a result of the direct and indirect effects of the Vietnam war, but the deficit seemed to be on a plateau that was not unmanageable for a year or two. Japan had run into external difficulties against which a change in policy seemed likely to be needed.

This calm, however, proved to be short-lived, as developments came to pass which made the year 1967–68 the most disturbed for the international monetary system since 1949. Wars in the Middle East and in Vietnam played a rôle in aggravating payments difficulties and sapping confidence, while indecisive policies allowed scope for mounting tensions. In any event, before twelve months had passed, the pound sterling was devalued, the United States moved in a large way to direct balance-of-payments controls, and the gold pool countries withdrew their support from the gold market.

This chapter deals with the proximate causes of these developments which have brought a new, though perhaps not yet fully revealed, situation to the international payments system. It is evident, however, that the past year's events do not explain all, that the disequilibria were many years in the making, and that political disturbances and speculation brought disruption because the situation was already fragile. Hence, the chapter also reviews developments over the longer period.

Sterling.

On the surface, the position of sterling was not unfavourable in the first quarter of 1967 and there were clear signs that some measure of confidence had been restored. This improvement had been brought about in two ways.

Firstly, the strong measures of restraint taken in July 1966 rather quickly had a depressing effect on the domestic economy and a consequent favourable impact on the balance of payments. The measures, which included a standstill on wages and prices until the end of the year in addition to fiscal and monetary restrictions, effectively eliminated excess domestic demand and for the first time in more than two years restored a situation in which there was not pressure on productive resources. The level of output settled down somewhat and tensions on the labour market eased as unemployment rose from 1.3 per cent. of the labour force in July 1966 to 2.0 per cent. in the first quarter of 1967. The external trade balance showed a marked improvement in the last four months of 1966, with imports lower, partly in anticipation of the removal of the special import surcharge at the end of November, and exports higher than in the earlier months of the year; with the capital outflow heavily restricted, the basic balance of payments moved into surplus in the fourth quarter of 1966. A surplus position was maintained in the first quarter of 1967 also, though the trade position deteriorated following the removal of the surcharge. The increase in imports was considered to be largely temporary and did not interfere with returning confidence in sterling.

United Kingdom: Balance of payments.

Items	1966				1967			
	1st quarter	2nd quarter	3rd quarter	4th quarter	1st quarter	2nd quarter	3rd quarter	4th quarter
	seasonally adjusted, in millions of £ sterling							
Merchandise trade (f.o.b.)								
Imports	1,345	1,316	1,363	1,239	1,405	1,424	1,368	1,476
Exports and re-exports	1,266	1,203	1,291	1,356	1,359	1,280	1,268	1,116
Trade balance	− 79	− 113	− 72	+ 117	− 46	− 144	− 100	− 360
Services (net)	+ 49	+ 23	+ 20	+ 24	+ 68	+ 23	+ 55	− 10
Current balance	− 30	− 90	− 52	+ 141	+ 22	− 121	− 45	− 370
Long-term capital								
Official	− 38	+ 3	− 14	− 33	− 22	− 3	− 15	− 14
Private								
UK investment abroad	− 76	− 93	− 59	− 64	− 77	− 68	− 61	− 137
Foreign investment in the United Kingdom	+ 51	+ 75	+ 56	+ 90	+ 103	+ 90	+ 71	+ 127
Total long-term capital (net)	− 63	− 15	− 17	− 7	+ 4	− 1	− 5	− 24
Basic balance, *seasonally adjusted*	− 93	− 105	− 69	+ 134	+ 26	− 122	− 50	− 394
Basic balance, before adjustment	− 79	− 56	− 144	+ 146	+ 3	− 61	− 126	− 356
Balancing item	+ 49	− 33	+ 37	− 66	+ 162	+ 77	− 77	+ 58
Total balance	− 30	− 89	− 107	+ 80	+ 165	+ 16	− 203	− 298

Secondly, by the first quarter both the Federal Reserve System and some continental European authorities had shifted monetary policy from restraint to considerable ease. As a result, short-term interest rates in the

United States and on the Euro-dollar market moved down substantially and the interest arbitrage position became favourable to sterling. The easier reserve position of US banks also allowed them to return to the Euro-dollar market a part of the funds which they had taken during the credit squeeze of 1966. Hence, there was conversion of dollars into sterling on a large scale and the Bank of England was able to repay the short-term central-bank assistance that had been required to support sterling in the previous year. In May a substantial repayment was made on the borrowing from the IMF and Switzerland.

Given that the balance of payments was being helped by strict controls on capital exports and that heavy Bank of England commitments had been required to hold the cost of forward cover on sterling within narrow limits, sterling could hardly be considered a strong currency. The authorities recognised that the pound had an unfavourable position in the structure of exchange rates and that a cautious policy with respect to the domestic economy would be required. None the less, there was no expectation by the market or by the authorities that a major crisis was only months away.

In these circumstances the budget of April 1967 contained no significant policy changes and was intended to be neutral in its impact on the economy. Output was expected to rise at a rate of about 3 per cent., in line with the growth of productive capacity, and the rise of exports was foreseen as a dynamic component of demand.

These prospects were soon upset, however, by political and economic events which developed both outside and inside the United Kingdom. Their quantitative importance cannot be assessed individually as it was their combined and cumulative impact which turned the balance of payments to substantial deficit and reduced confidence in the viability of the exchange parity to vanishing point. After the huge inflow of funds from January to April, Bank of England support of sterling began to be required in May, and there soon developed a massive flight from the currency, with peak outflows in July and November. The following factors contributed to the force of this movement:

1. Confidence in sterling was severely shaken by the outbreak of war in the Middle East in early June. The actual conversion of Middle East sterling balances was not large, but the threat to the reserves influenced other holders of sterling. In addition, the embargo on oil sales to the United Kingdom by Middle East producers and the blockage of the Suez Canal soon entailed added freight and oil costs to the balance of payments. The difficulties encountered over the United Kingdom's application for entry into the Common Market were also having an adverse effect on confidence.

2. Heavy demand for bank credit and capital-market funds in the United States reversed the decline in dollar interest rates in April and the interest arbitrage position of sterling soon became unfavourable.

3. As economic activity in the continental European countries shifted to pause or recession, UK exports slackened off from their high point in January — instead of recording the expected expansion. At the same time, imports continued at a level well above that in the last four months of 1966, so that there was a basic balance-of-payments deficit in both the second and third quarters of 1967.

4. The significant decline in the volume of exports tended to soften domestic activity in the second and third quarters, which pointed to quite heavy unemployment in the winter. For this reason the policy emphasis shifted to mild reflation, despite the risks involved for sterling. Interest rates had been brought down earlier in the year, with three cuts in Bank rate to 5½ per cent. As expectations of a further decline in rates and therefore of a further rise of gilt-edged security prices weakened in the spring, the Exchequer was unable to maintain sales of stock to the market and in the second quarter was forced to borrow heavily at short term from the banking system. This provided the liquidity for a rapid expansion of bank credit after mid-year. Advances by the London clearing banks to the private sector, which were not controlled by a quantitative ceiling after April, rose at an annual rate of nearly 20 per cent. in the third quarter. Moreover, hire-purchase terms were relaxed in June and again in August. In addition, higher social security payments were announced for the autumn, and transfer payments to the company sector were increased through an acceleration of investment grants and the introduction of an employment subsidy to manufacturing industry in development areas. These changes were seen to add substantially to the Exchequer's borrowing requirement, and to increase the threat of monetary instability. They cast doubt on the firmness of the priority which the authorities were giving to balance-of-payments adjustment.

5. Although the wage freeze stopped at the end of 1966, wage restraint was maintained in the first half of 1967. After the end of June, however, wages began to rise sharply, with a decided threat to the competitive position of UK industries. In the course of 1967 hourly wage rates increased by 6.2 per cent., about half of which was due to commitments made before the wage freeze.

6. At the end of September an unofficial dock strike started in Liverpool and soon spread to London. The strike was in itself damaging to confidence, but also, by affecting exports more than imports, it led to trade returns for October that were not encouraging.

No doubt there was an element of speculation in the flight from sterling during the months of June to November, but for the most part domestic and overseas business firms and financial institutions acted to prevent threatened exchange losses. To make this threat seem real there were not only the adverse accidents of 1967 but also the history of previous crises, particularly the large deficits from 1964 to 1966, and the realisation that the deflationary measures of July 1966 had not produced a solid adjustment. The government was inhibited from imposing further deflation by the existing level of unemployment and the only measures taken to stem the outflow were ½ per cent. increases in Bank rate in October and November. And so at the end the flight reached huge proportions.

As the drain on official reserves and available borrowing facilities showed a relentless momentum, the authorities were faced with the problem of whether to devalue or to continue the struggle to maintain the existing parity. In either case further restrictive measures and borrowing facilities would be needed; but it must have been thought that, with a reasonable devaluation, the chances were better that less foreign debt would be incurred and less sacrifice of economic expansion would be needed.

The decision to devalue was announced on 18th November.

* * *

While the immediate causes of devaluation were to some extent accidental, its origin lay in the history of weakness for some years before. The question, therefore, is why the currency had been subject to repeated crises and why earlier periodic efforts with restrictive policies failed to establish a firm external base for untroubled economic growth. Having been devalued in 1949, why did sterling need to be devalued again in 1967?

Since the fixed-rate system does not exclude rate adjustments to basic changes in the domestic or world economy, a possible view is that holding a fixed rate for sterling over almost twenty years is a fair performance. Such a view is not satisfying, however, because many other countries have done better and because, in the usual cases of devaluation, the failure of monetary discipline is not difficult to discover.

In the immediate post-war years many nations had the problem of re-establishing monetary stability. Some achieved this by a monetary reform, as in Germany and the Netherlands, and others by accepting the price inflation implicit in the wartime expansion of domestic liquidity and coming to a new rate of exchange, as in Italy; the United Kingdom did not undertake monetary reform, nor did it quickly accept a once and for all price inflation. Price controls and rationing were maintained, and to the extent that a balance-of-payments deficit could not be avoided by restrictions on trade and payments it was met by aid and borrowing from abroad. A low rate of private saving and rapid institution of a comprehensive welfare programme aggravated the adjustment problem.

Although there had been considerable improvement in the external accounts since the war, the UK balance-of-payments position was still weak in 1949, and there was a chronic imbalance with the dollar area. With the downturn in economic activity in the United States in 1948–49, dollar earnings of the United Kingdom and various sterling-area countries fell and contributed to the loss of reserves which precipitated the sterling devaluation.

The devaluation in 1949 was not arranged with the help of a multilateral approach calculated to secure a firm foundation for international payments flows as a whole. Many countries were aware of a dollar shortage and felt uncertain about their future competitive position; also the United Kingdom and the sterling area were important export markets. In the event, many countries outside the dollar area devalued to the same extent as sterling. Hence, the effective help to the competitive position of British industry in outside markets and vis-à-vis imports at home was much less than the 30.5 per cent. devaluation might suggest. The unplanned and widespread devaluation of currencies did not show its ill effects immediately; but it was a crucial factor in the payments problems that emerged in subsequent years.

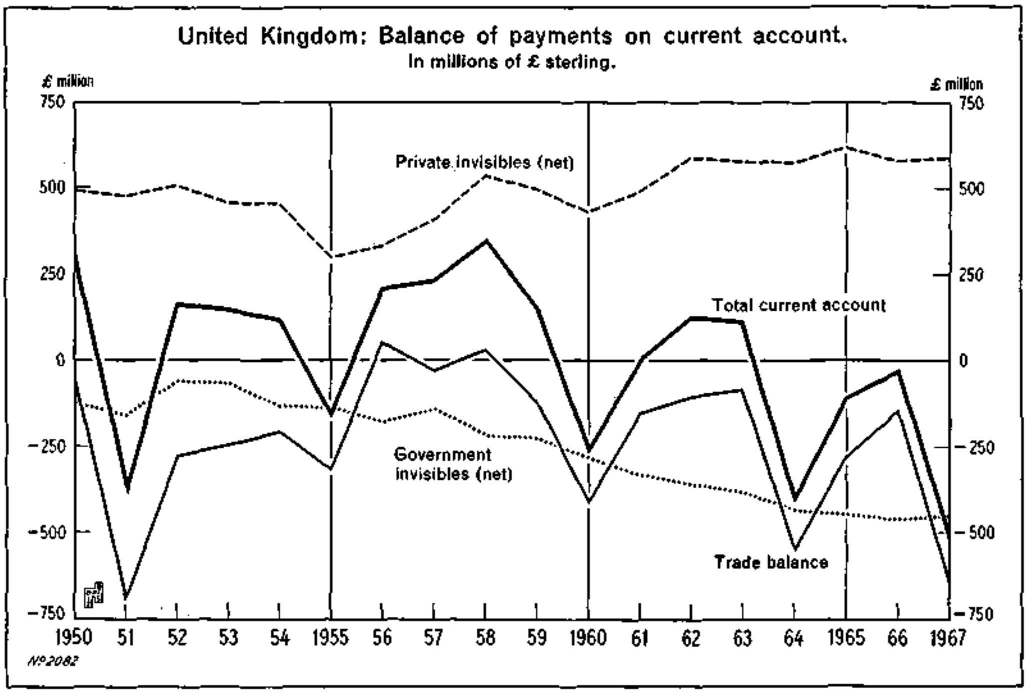
The net impact of the realignment of exchange rates on the British balance of payments cannot be isolated. Within less than a year the whole structure of international transactions was thrown into confusion by the outbreak of the Korean war and by massive rearmament programmes which were superimposed on a developing world boom. But by about the mid-1950s, when conditions were more normal, the underlying British external payments position as a whole showed a moderate improvement, with more than the whole of the adjustment having been in transactions with the dollar area, which no longer constituted a specific problem. Many other factors influenced this development, but it is evident that the sterling devaluation played a significant part in closing the UK dollar gap. The fact that the UK position in relation to other non-sterling countries did not improve suggests that the new exchange rate structure did not fit the situation after post-war reconstruction in other countries, which was slow in comparison with that in the United Kingdom, had been completed.

The relative weakening of the UK position as productive capacity abroad was restored was spread over a number of years, however, and might have been offset had domestic cost and price stability been achieved. Demand was still excessive in 1949 and inflation was being held in check by generally successful rationing and prices and incomes controls. The measures taken in support of devaluation were not designed to reduce demand to the point where controls could be relaxed, but merely to allow a further transfer of resources to production for export; this is reflected in the level of unemployment, which actually declined in the following year. So long as controls continued to be effective, the pressure of demand was not fully transmitted to the balance of payments. But it continuously threatened to swamp those controls and made the British economy particularly vulnerable to the upheavals that came with the rapid changes in world economic conditions in 1950 and 1951.

In 1950 revival in the United States and the gathering force of European recovery was beginning to take up the slack in domestic resources and to put some pressure on raw-material supplies from primary-producing countries. The situation was turned to one of outright inflation by the Korean war and by anticipation of the impact of rearmament programmes. World industrial output increased by 13 per cent., prices rose everywhere, and there was a spectacular boom in world raw-material prices, which nearly doubled before reaction set in during the spring of 1951.

In this situation the UK current balance of payments moved from approximate balance in 1949 to a surplus of over £300 million in 1950, and then swung into an even larger deficit of £370 million in 1951, bringing a severe foreign exchange crisis. The main feature of the strengthening in 1950 was a rise in the invisible surplus, but the trade balance also improved despite the adverse movement of the terms of trade. This was because the volume of imports was kept at about its 1949 level by additional restrictions, with the result that stocks of imported materials were drawn down; exports rose by 14 per cent. through the combined effect of devaluation and the rapid growth of world demand. The reversal in 1951 was almost entirely in the trade balance and, although the terms of trade again moved adversely, the dominant factor was an 11 per cent. rise in the volume of imports, reflecting stock rebuilding, priority imports related to rearmament and the beginning of OEEC liberalisation. Exports, which were to an important extent competing for particular resources with arms production, fell by 1 per cent. The effect of these fluctuations on the United Kingdom's reserves was exaggerated by similar swings in other sterling-area countries.

Many of the United Kingdom's difficulties of 1951 were self-reversing; inventory rebuilding had been abnormally high, and the terms of trade were already moving favourably by the end of the year. The level of non-sterling imports of other sterling-area countries would fall with the income effect of declining commodity prices. To this extent the crisis highlighted the inadequacy



of UK reserves and exposed the danger of the vast overhang of sterling liabilities. But other difficulties arose in this period which were of more lasting importance.

The large increase in defence expenditure announced in 1950 was not matched by cuts in other components of domestic demand. Indeed, aggregate demand remained very high until 1958; unemployment was below 1.5 per cent. of the labour force almost continuously throughout the years 1950–57, apart from 1952–53. This aggravated the pressure on prices and had a direct influence on the balance of payments. In addition, rearmament pre-empted engineering and steel capacity, limiting both exports and domestic investment.

The new defence policy also led to increased military spending abroad. For much of the 1950s this was partly offset by the receipt of defence aid; but overseas defence commitments entered into during the 1950s continued into the 1960s with an escalation of their net balance-of-payments cost.

Another development of lasting significance in this period was cost inflation, initiated by the rise of import prices. In the eighteen months to June 1951 the total import-price index rose by 59 per cent., while raw-material import prices more than doubled. This had an immediate impact on costs, which was particularly severe in the United Kingdom in view of the high import component of total output, but the more serious consequence for the longer term was that by late 1950 it had brought a two-year period of wage restraint to an end. The conditions in which wage restraint broke down appear to have set a standard for wage demands which persisted when those conditions no longer obtained. In any case, continuous wage pressure on costs and prices in the years that followed was a serious obstacle to the adjustment process.

Helped by stronger import controls, the basic balance of payments moved into surplus in 1952, and between 1952 and 1959 the current-account surplus totalled £1.2 milliard. With capital exports under tight control, apart from investments in the sterling area, there was a small overall surplus. The objective of an increase in reserves was proclaimed but not achieved; however, the United Kingdom was able to dispense with overseas assistance, re-establish external convertibility for sterling and take off both domestic controls and quantitative restraints on foreign trade. This picture might suggest that the balance of payments was not an acute problem; in fact, the external position was kept just manageable by the downward drift of raw-material import prices after the Korean war and by means of prolonged internal stagnation after 1955.

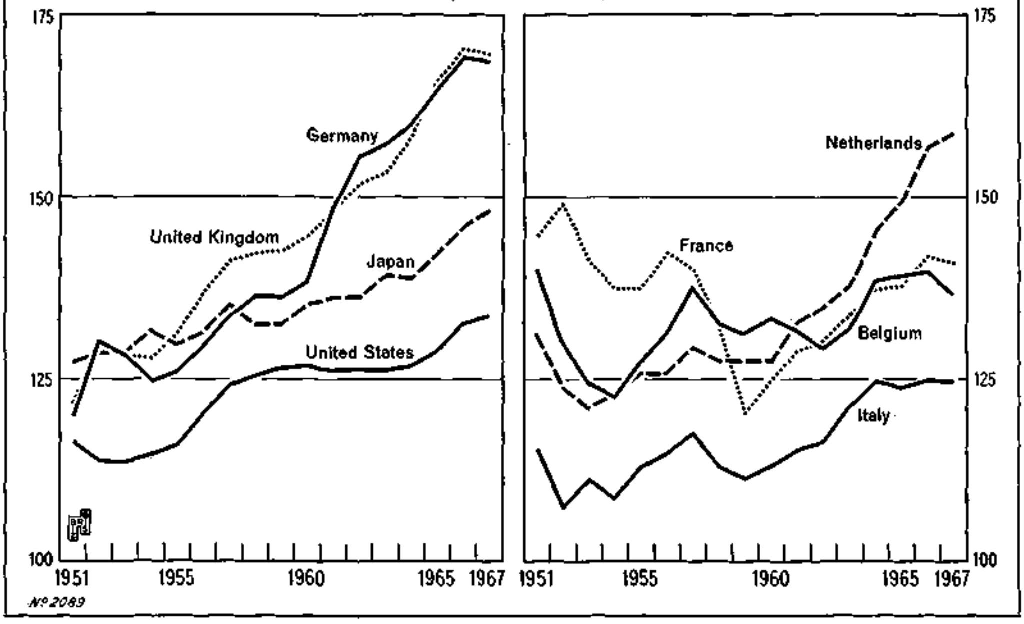
Periodic pressures arose in the exchange market in the years 1955–57. After rapid domestic expansion in 1953 and 1954, acute excess demand worsened the balance of payments. Pressure on sterling in early 1955 was met by monetary restriction; but the budget in April gave a counter-stimulus by a reduction of direct taxation. This policy mix failed to quieten the boom and the pound came under more severe pressure in the summer. The outflow of funds was intensified by rumours of a return to convertibility accompanied by wider exchange rate margins. The basic cause of the crisis, however, was the deterioration of the balance-of-payments position, which, in the main, resulted from the failure of policy to contain excess demand.

The 1956 and 1957 crises were quite different. Domestic demand had been curbed rather severely in the second half of 1955 and for three years the British economy stagnated. Unemployment rose from under 1 per cent. of the labour force in 1955 to over 2 per cent. by the end of 1958 — which was a year of general pause and recession in Europe. The absence of growth brought a substantial improvement in the basic balance of payments, which in each year from 1956 to 1958 was in surplus; in two of the three years the trade account was also in surplus. These foreign exchange crises were, therefore, unrelated to immediate balance-of-payments developments. The flight from sterling in the second half of 1956 was primarily a confidence movement associated with the war in the Middle East, and the troubles in the following year were connected with the possibility that the Deutsche Mark would be revalued. Pressure on the reserves in 1957 was increased by the coincidental weakening of the payments position of other sterling-area countries with the non-sterling world. These crises re-emphasised the fact that the persistent disproportion between reserves and sterling liabilities could be an independent cause of pressure on the exchange rate; in the event, however, subsequent attacks on sterling invariably originated in weakness of the UK basic balance of payments.

To handle the outflows in 1956 and 1957, use was made of international borrowing. The subsequent broadening of international credit facilities helped to ease the problem of the inadequacy of British-owned reserves; but financing arrangements could not resolve the fundamental problems in the balance of payments itself, which became more pronounced in the 1960s.

In view of this subsequent deterioration in the United Kingdom's external accounts, it is important to assess the underlying position at the end of the 1950s. By that time the United Kingdom had lost the trade advantage enjoyed in 1949 due to its more rapid post-war recovery and no longer had significant protection at home or abroad through discrimination against dollar goods. However, in 1958 the trade balance was positive and the current-account surplus was £350 million. This equalled the average surplus thought necessary in the 1953 Economic Survey but was below the required average surplus of £450 million mentioned in the Treasury's evidence to the Radcliffe Committee in 1958. Moreover, 1958 was in no sense a typical year. Import prices were 8 per cent. lower than in 1957, and without this the current surplus might have been nearer £50 million. And it was the third successive year of domestic stagnation. On the other hand, it was a year of recession in other industrial countries, which caused a fall in UK exports. Weighing these conditions, it seems that the underlying current surplus was small and could not support the normal outflow of long-term capital – by no means an excessive one.

Wholesale prices of manufactured goods.*
Annual indexes: 4th quarter 1949–1st quarter 1950 = 100.



* Adjusted for changes in exchange rates.

Over the preceding years there had been no improvement in the United Kingdom's cost/price position in relation to other countries; its relative performance was much worse before 1959 than in the next five years, when price inflation was marked in other European countries. Excess demand certainly contributed to the rise in wholesale prices until about 1956, and pressure in the labour market in particular strained wage costs. But there was, in addition, independent cost pressure through high wage settlements which outran increases in productivity. Several factors made British experience of wage-push relatively severe: the conditions in which wage restraint broke down in 1950 have been mentioned; there was also institutional weakness in the fragmented structure of bargaining units, which led to an almost continuous wage round in which key bargains reached in higher productivity sectors spread rapidly through the economy. Attitudes, however, were crucial; while some trade unions appeared more concerned with maximising labour's share in national output than with increasing economic growth, the authorities shied away from incomes policy as an aid to cost and price stability.

The underlying external weakness came to the surface as policy emphasised economic growth in 1959 and 1960, and there is a striking contrast between the average balance-of-payments position in the period 1960–67 and the preceding eight years. In the later period government spending overseas, particularly for defence, was much higher and the trade deficit was twice as large, owing partly to the cumulative impact of the factors affecting Britain's competitive position and partly, no doubt, to the greater overstrain (for the period as a whole) of demand on productive resources. Also, there was no longer a downward drift of raw-material import prices to help matters.

United Kingdom: Balance of payments.

Items	1952-59	1960-67
	annual averages, in millions of £ sterling	
Trade deficit	− 140	− 295
Government invisibles (net)	− 145	− 395
of which: Military	*− 70*	*−235*
Private invisibles (net)	+ 435	+ 555
Current account	+ 150	− 135
Long-term capital (net)	− 175	− 140
Basic balance	− 25	− 275
Balancing item	+ 55	+ 75
Overall balance	+ 30	− 200

Although private invisible earnings continued to increase and the outflow of private long-term capital was held back by increasingly severe controls, there was a basic balance-of-payments deficit totalling over £2 milliard in the eight-year period and an overall deficit of £1.6 milliard.

The expansionary budget of 1959 signalised a shift in policy emphasis aimed at breaking out of stagnation. As a result, the real gross national product increased by over 8 per cent. between 1958 and 1960, while the rate of unemployment fell back to 1½ per cent. of the labour force. But imports rose by about one-fifth and, although exports increased with a revival in demand overseas, the trade balance swung from a small surplus in 1958 to a deficit of over £400 million in 1960. In addition the invisible surplus halved, owing to some extent to rising government expenditure abroad. Thus, within two years of the resumption of domestic expansion, the external payments position was in deep difficulties. The trouble, in part, was an excessive stimulus to demand, which made the boom develop very rapidly. But the picture as a whole clearly indicated that sterling had a somewhat unfavourable position in the structure of exchange rates and that the external deficit was what might technically be called a fundamental disequilibrium. This judgement, if not evident from an analysis of the UK position alone, was unavoidable in view of the contrast with other countries, where expansion had not impaired the external strength of the currency.

Crisis in the exchange market was delayed for a while by a large monetary inflow of non-sterling currencies; interest differentials favoured the pound and the inflow was probably increased by the doubts which caused the eruption in the gold market. But reaction came in the spring of 1961, prompted by speculative outflows in the wake of the Deutsche Mark and Dutch florin revaluations.

In the light of this situation, it may be asked — not just with hindsight — whether a change in the exchange parity at that time might not have been desirable. It seemed that the existing exchange rate would demand some sacrifice in terms of economic growth; moreover, it had proved impossible over the previous decade to build up the reserves, and controls on capital exports had had to be maintained. These factors were on the side of some adjustment of the rate. But against this were also strong considerations. The economy was being subjected to excess demand which would have to be eliminated in any case. Also, the degree of overvaluation did not appear large and might be overcome by a few years' improvement in Britain's competitive position. It was possible also to reverse the trend of government expenditure abroad. Given these possibilities, a decisive consideration was that, sterling being the reserve currency of the sterling area, devaluation would evidently create difficulties for the United Kingdom and the sterling system over a protracted period. Thus, while a change in parity might more easily have been contemplated for a non-reserve country in a comparable situation, there was self-interest and courage in trying to do without it in the case of the United Kingdom.

Whether a change in the rate was considered by the authorities at that time is not known. In any case, their actual policy was to pursue the alternative course with insight into the character of the problem. Confidence in sterling was restored by strong fiscal and monetary restraint and by the first Basle arrangements to supplement the reserves. But there were new features in the adjustment programme. Wage increases were prohibited for six months and steps were initiated to set up incomes policy on a permanent basis. In addition, direct action was taken to affect the balance-of-payments position; official spending abroad was to be curbed, a ceiling was put on development aid, and direct investment in non-sterling countries was to be more closely controlled.

It was a severe, though realistic, programme, which produced a turn-round in the external position with small current-account surpluses in 1962 and 1963. However, the modest size of these surpluses was not reassuring in view of the margin of unused productive resources, and more ominous was the fact that the idea of incomes policy was not supported by organised labour. After the freeze was over, wages again rose at an excessive rate.

By early 1963 the policy of restraint was becoming difficult to maintain because of the consequent unemployment. This was aggravated by unusually severe winter weather and, in addition, there was deeper frustration over the slow growth in the economy since 1955. Opinion was, therefore, turning in favour of a policy of expansion. A novel theory was developed that a sustained high rate of growth could be the real key to the longer-term strength of sterling. Expansion would accelerate productivity increase, which, combined with reasonable restraint on wage increases, would in turn improve the competitive position of British industry. Hence, even though the balance of payments might initially be adverse, there would eventually be a fundamental improvement if only expansion, productivity increase and wage restraint were all steadfastly pursued. After considerable debate in the press, this strategy was taken over by the authorities and the experiment launched with a powerful stimulus to domestic demand given in the budget of 1963. The target was economic growth at an annual rate of over 4 per cent. The target for the balance of payments was rather vague, but it was stated that reserves would be used and the IMF drawn upon, if needed, to support sterling until the new day of a strong currency. This, indeed, implicitly recognised that the currency was somewhat overvalued.

It took only about a year for this philosophy to run into trouble and it was evident by the summer of 1964 that a change to policy restraint was needed. But a national election was already scheduled for October and so a calculated risk was taken to defer new action. The impact on the balance of payments was more drastic than had been envisaged. In 1964 the trade deficit rose to nearly £550 million and this included a 30 per cent. increase in the level of imported finished manufactures. The current account swung into deficit of over £400 million and, with an unusually large net capital outflow, the basic deficit soared to £775 million. Towards the end of the year a severe foreign exchange market crisis developed.

On a cold appraisal, the new government might have devalued immediately as part of a basic adjustment programme which, of course, would have had to include effective restraint on excess demand. As may be seen from the graph on page 9, there had been a progressive increase of the external deficit with successive cycles in economic activity. It cannot be said that the devaluation of three years later was already inevitable, if the nation had been prepared to accept the necessary discipline. But the mood was not to go back to stagnation, to sacrifice the very high employment level, or to keep wage increases very moderate. In any case, the government at once stated its intention to maintain the existing exchange parity. In the event, this was done not by giving appropriate priority to the balance of payments, but by borrowing abroad and drawing on reserves to fill the balance-of-payments gap — until the breakdown.

The crisis of November 1964 was met with direct action on the trade deficit through an import surcharge and a partial tax rebate on exports, and with a moderate increase in taxation. At this time, too, machinery was established to seek a workable prices and incomes policy. These measures, supported by credit restraint, set the pattern for economic policy until the summer of 1966. The objective was to correct the external deficit, relying on direct balance-of-payments measures to the extent that this seemed necessary, but to avoid over-deflation of domestic demand. This approach, backed by large international support for sterling, contained pressures in the foreign exchange markets which recurred in the spring and summer of 1965, but the pressure of demand in the economy stubbornly refused to ease.

Two factors in particular aggravated the situation during this period. Despite the emphasis put on the need for incomes restraint since 1964, the rate of wage increase accelerated. Hourly wage rates in industry rose on average by over 6 per cent. a year from mid-1964 to mid-1966 and there was much stronger wage drift, so that hourly earnings, which had risen by only about 4 per cent. a year in 1962 and 1963, now increased at an annual rate of over 8 per cent. In addition, the growth of public-sector expenditure proved difficult to control. Since about 1960 the trend rate of growth of public current spending had started to increase and there was an even sharper acceleration after 1962 in the rate of growth of public-sector investment. Parallel with this development of public-sector expenditure itself went increases in public grants to the personal sector which fed the growth of private consumption. Especially in the context of a policy of full use of productive capacity, a curb on the growth of the public sector was essential to accommodate the high level of private investment which it was the intention to encourage. But the growth of the Exchequer's borrowing after 1962 and the failure in the last two years to hold the budget results to within reasonable distance of the budget estimates illustrate the government's inability to enforce such a curb. This imposed a direct strain on the balance of payments. Moreover, the size of the government's borrowing requirement, and the semi-automatic way in which it is financed, meant that the decline in the banking system's holdings of short-term government debt, which might otherwise have resulted from the balance-of-payments deficit, did not materialise. Hence there was no automatic external adjustment through slower monetary expansion.

The conflicting claims on output may be seen from the following table, which shows changes in the structure of demand that have occurred since 1949.

During the 1950s private consumption absorbed a progressively smaller share of gross national product as personal saving recovered from its very low initial rate. Also, over the ten years as a whole government expenditure rose only a little faster than total output. Thus there was room both for a higher

United Kingdom: Uses of gross national product, at current prices.

Items	1949		1959		1967		Changes[1] 1949–67
	£ million	%	£ million	%	£ million	%	%
Consumption							
Private	8,969	71.2	16,196	66.8	25,168	64.2	+ 181
Government	1,975	15.7	3,920	16.1	7,072	18.0	+ 258
Total	10,944	86.9	20,116	82.9	32,240	82.2	+ 195
Gross investment							
Residential	332	2.6	661	2.7	1,439	3.7	+ 333
Other: Private (including public corporations)[2]	1,128	9.0	2,668	11.0	4,476	11.4	+ 297
Government[2]	182	1.4	581	2.4	1,316	3.4	+ 623
Total	1,642	13.0	3,910	16.1	7,231	18.5	+ 340
External balance of trade and services	17	0.1	231	1.0	— 270	—0.7	—
Gross national product, at market prices	12,603	100.0	24,257	100.0	39,201	100.0	+ 211
Memorandum item:							
Public-sector current *transfers to personal sector*	745	5.9	1,636	6.7	3,355	8.6	+ 350

[1] Changes reflect differences in both volume and prices; between 1949 and 1967 implicit price changes in the national accounts were as follows: private consumption, + 77 per cent.; fixed investment, + 76 per cent.; gross national product, + 87 per cent. [2] Including physical change in stocks.

level of productive private investment, measured as a share of national product, and for some improvement in the external balance. Broadly speaking, therefore, the structural change in the pattern of demand was favourable in this period. After 1959 private consumption continued to rise more slowly than total output; but, with the government now claiming a fast increasing share of national product, there was little further proportionate rise in private investment, and the external position worsened.

United Kingdom: Saving and investment.

Items	1949	1959	1967	Changes 1949–59	Changes 1959–67
	in millions of £ sterling			in percentages	
Personal sector					
Saving[1]	112	792	1,881	*+ 607*	*+ 138*
Investment[2]	273	658	970	*+ 141*	*+ 47*
Financial surplus (+)	− 161	+ 134	+ 911	.	.
Companies and public corporations					
Saving[1]	885	2,355	3,511	*+ 166*	*+ 49*
Investment[2]	919	2,428	4,275	*+ 164*	*+ 76*
Financial surplus (+)	− 34	− 73	− 764	.	.
Government					
Saving[1]	680	699	1,394	*+ 3*	*+ 99*
Investment[2]	450	824	1,986	*+ 83*	*+ 141*
Financial surplus (+)	+ 230	− 125	− 592	.	.
Total					
Gross national saving[1, 3]	1,606	4,059	6,717	*+ 153*	*+ 65*
Gross domestic investment[2]	1,642	3,910	7,231	*+ 138*	*+ 84*
Total net financial surplus (+) = net investment abroad	− 36	+ 149	− 514	.	.

[1] Excludes stock appreciation. [2] Includes physical change in stocks. [3] Includes residual error in national accounts: 1949, — 71; 1959, + 213; 1967, — 69.

The balance of saving and investment, too, shows evidence of improvement in the earlier period, followed by deterioration. In the 1950s the personal sector moved from financial deficit into moderate surplus, while the amount of external finance needed for gross capital formation by industry did not significantly increase. Although the government sector shifted from a substantial financial surplus to a financial deficit, the net balance between national saving and investment improved. The favourable trend in the personal sector continued into the 1960s. However, the proportion of self-financing by companies and public corporations now declined and the faster growth of government investment also gave rise to much heavier borrowing, even though government saving increased. In consequence, total national saving did not keep pace with the rise in home investment, and this was reflected in the external deficit.

By the summer of 1966 unemployment was only 1.2 per cent. of the labour force — lower than at any time for almost ten years; and the external position, after improvement in 1965 as stock-building reverted to a more normal level and as the direct balance-of-payments measures had their initial effect, showed no further shift towards surplus. This picture revived suspicion of the exchange parity at a time when tight monetary policy in the United States was drawing funds from London. Against this background, a national seamen's strike had a severe impact upon confidence, provoking a renewed flight from the pound, which necessitated the orthodox deflationary measures announced in July 1966. By that time, even with temporary improvement in the external accounts, there was no long-term confidence in the currency left, and it was vulnerable to political or other accidents.

To summarise, then, the following points may be cited to explain why sterling came to be devalued a second time since the war.

1. The devaluation of 1949 did not re-establish sterling as a strong currency, partly because, with so many other countries following suit, the net devaluation was not very large.

2. The devaluation was not backed up by adequate restraint of domestic demand and this was aggravated by the outbreak of the Korean war soon afterwards.

3. In particular, neither the authorities nor the public were prepared for the additional austerity needed to support the heavy rearmament programme undertaken at that time without inflationary consequences.

4. Throughout most of the 1950s the economy was kept under the pressure of an over-full employment level of demand which tended to erode the competitive benefit of devaluation.

5. Coupled with this was a continuous pressure on costs from round after round of excessive wage bargains. Based as it still is on the Trade Union Disputes Act of 1906, it must be said that British labour law is far behind the times compared to many continental industrial countries, with adverse effects on labour discipline and productivity increase.

6. It is likely that sterling was an overvalued currency by the beginning of the 1960s and that the situation had remained tenable only because of the improvement in the terms of trade. The failure to achieve the policy objective of raising reserves from their low plateau was menacing for the years ahead; and, given the prospective balance-of-payments situation, there was no room for the substantial increase in government expenditure abroad.

7. To hold the currency in the 1960s, a realistic priority in policy on the balance of payments was a necessity; and to enforce this priority, without unreasonable sacrifice of economic growth or full use of resources, demanded strict discipline over wage increases and no pressure from excess demand. In the event, once the experiment with reflation was launched in 1963, there was neither. Besides rising wage incomes, increasing public-sector expenditure assured excess demand conditions.

8. Heavy borrowing from abroad delayed the second devaluation; it could not prevent it. The basic situation had been too much weakened and confidence worn too thin by years of indecisive action.

* * *

Arranged with the help of prior consultations, the devaluation in November 1967 was not followed by significant competitive adjustment of exchange rates. While a number of smaller countries felt obliged to stay pegged to sterling, all the major industrial countries maintained their existing gold parities and so, too, did many of the larger sterling-area countries. Thus, although the devaluation against the dollar was only 14.3 per cent., compared with 30.5 per cent. in 1949, it was a more effective adjustment of relative prices vis-à-vis the outside world. International co-operation was also evident in the additional facilities made available to support the United Kingdom's reserves and to give confidence in the new parity; a total of some $3 milliard was mobilised, including an IMF stand-by of $1.4 milliard.

A further problem at that time was to assess the extent and timing of the domestic restraint needed to ensure that devaluation was successful. There was still unused capacity in the economy, but domestic demand was reviving under the stimulus of measures taken in the summer and of the sizable rate of wage increases. The strength of the revival was obscured, however, by the effect of the dock strikes on output. In this situation, and because a comprehensive policy took time to prepare, measures in support of devaluation were introduced in stages. Immediate action was limited to a sharp tightening of credit policy, including the raising of Bank rate to 8 per cent., a new ceiling on bank lending and consumer credit restrictions. But company tax changes and cuts in public spending were also announced to take effect in the following fiscal year. Two months later more radical cuts affecting defence spending, especially abroad, and education, housing, road and social services programmes were introduced, calculated to reduce the rate of increase of public-sector expenditure, in real terms, from 7½ per cent. in 1967–68 to 1 per cent. in the fiscal year 1969–70. The Prime Minister also indicated that further tax restraint would be imposed on the private sector and the date of the budget was advanced to mid-March.

Throughout this period there was heavy speculative gold-buying and foreign exchange markets were disturbed by uncertainty regarding the future of the gold/dollar relationship. This in itself prevented any very large reflux of funds into sterling, but there were also doubts about the adequacy of the measures announced when the parity was changed. These doubts increased as the strength of the upsurge of consumer spending and the threat to wage and price stability from cost increases associated with devaluation became more evident. Between October and January retail sales increased at an annual rate of 18 per cent. and industrial output at a rate of 9 per cent., and the decline in unemployment seen since September continued. Demand was inflated at this time by expectations of price increases in connection with devaluation and prospective tax increases. Over the same period import unit values rose by 8 per cent. and there was a largely related rise, of 9 per cent., in wholesale prices of fuels and basic materials. By the beginning of March exceptional demand for gold brought the pound under very severe pressure: spot sterling required substantial support and forward sterling, no longer supported since devaluation, again fell to a large discount. Further international facilities were made available to the United Kingdom in March at the time when the gold pool countries decided to stop supplying gold to the market, which brought the total of such facilities immediately available up to $4 milliard.

United Kingdom: The budget.

Items	Financial years 1967-68		Financial years 1968-69	
	Estimates after budget changes[1]	Results[2]	Estimates before budget changes	Estimates after budget changes
	in millions of £ sterling			
Revenue				
Tax revenue	10,679	10,770	11,552	12,475
Other receipts	414	407	400	400
Total revenue	11,093	11,177	11,952	12,875
Expenditure				
Supply services	9,549	10,000	10,548	10,725
Consolidated Fund standing services	810	878	764	764
Total expenditure	10,359	10,878	11,312	11,489
Surplus	734	299	640	1,386
Loans from National Loans Fund (net)	− 1,766	− 1,748	− 1,744	− 1,744
Overall deficit (−)	− 1,032	− 1,449	− 1,104	− 358

[1] Data do not correspond to those appearing on page 16 of the BIS's Thirty-seventh Annual Report, because they have been adjusted to take account of the changes introduced by the National Loans Act 1968. [2] Preliminary.

Presented against this background, the budget was necessarily severe. There were substantial increases in indirect taxes and in both the selective employment and corporation taxes on business. Although rates of income tax were not changed, certain allowances were reduced and a one-year impost on investment income of individuals was introduced. In total, additional taxation amounted to £923 million in a full year and to £775 million in the present fiscal year — the largest amount of new taxation imposed since the war. And the government was to strengthen its legal powers of control over prices and incomes. Taking account of all these changes, the official expectation is that output will rise at an annual rate of some 3-4 per cent. up to mid-1969, with exports and investment the dynamic demand components and private consumption likely to show an absolute decline. It is also expected that the basic balance of payments will shift from a recorded deficit of £540 million in 1967, of which over half was accounted for by non-recurrent special factors, into surplus during the second half of this year, and that a substantial surplus position will be attained in 1969.

Late in May monetary policy was tightened when banks were told in effect that there should be no further increase in their credit to the private sector. This implied an absolute reduction in non-priority lending.

It is evident that a continuing surplus of large size is desirable in view of the need to repay the heavy short and medium-term indebtedness built up since 1964; it must be hoped also that the severity of the capital-account controls at present in force may be gradually relaxed. The expansionary outlook in continental Europe and the United States provides a favourable economic climate for UK exports. But it will be essential that the proposed restraint on domestic incomes and public-sector expenditure become really effective, and that the budget outturn be kept closer to the estimates than in the recent past. A further problem is that the United States is also under pressure to seek a major reduction in its balance-of-payments deficit which, to some extent at least, is competitive with the external surplus aimed at by the British authorities.

The dollar.

During the first three quarters of 1967 the US balance-of-payments deficit (liquidity basis) was at a significantly higher level than in the previous year. In time this would have required more stringent measures to reduce the deficit. Over these months, however, pressure on the dollar was not severe and losses of gold reserves were small. The immediate reasons for the drastic measures announced on 1st January 1968 were the developments in the fourth quarter, namely a huge increase in the external deficit, the repercussions of the devaluation of sterling and a large gold loss to meet speculative buying in the market. As to why the dollar should have been subject to a sharp deterioration of confidence, one must look, firstly, to the evolution of the domestic economy in the past year or two and, secondly, to the persistent external deficit over many years.

It will be recalled that the US economy had been precipitated into a state of inflationary boom by the intensification of the war in Vietnam. In the absence of fiscal restraint, monetary policy was increasingly restrictive into the third quarter of 1966 and gradually put a damper on the upsurge of economic activity. The fourth quarter was a definite turning-point; while total output showed a further rise in that quarter, this was made possible only by unwanted inventory accumulation at an annual rate of $18.5 milliard, almost three times the normal rate.

The pause in economic expansion became actual in the first quarter of 1967; real gross national product declined slightly and the index of industrial production fell off a few points. However, rather than a recession, it was a sort of breathing-spell — brought about by tight money in a context of potential inflationary pressure from a growing budget deficit. The unemployment rate remained relatively low at 3.7 per cent., and increased only slightly in the second quarter. Consumer prices showed a more moderate rate of increase compared to previous quarters.

The pause in the boom reflected mainly a sharp recoil in inventory investment, with the huge rate of increase in the last quarter of 1966 dropping to $7 milliard in the first three months of 1967 and to just about zero in the second quarter. However, increases in government outlays and consumer expenditure soon tended to offset the reduction in private investment and for the first half of 1967 the gross national product in real terms increased slightly.

In the summer expansionary forces came to the fore again and during the second half of the year real output was rising at an annual rate of 4.4 per cent. The rebound of construction and inventory accumulation added to the continued rise of government outlays. The strength of the expansion was somewhat dissipated by strikes during the autumn of 1967, but by the end of the year nearly all indicators reflected a booming economy, with demand exerting pressure on productive resources.

United States: Gross national expenditure.

Items	1966		1967				1968
	3rd quarter	4th quarter	1st quarter	2nd quarter	3rd quarter	4th quarter	1st quarter
	in milliards of US dollars, seasonally adjusted, at annual rates						
Personal consumption expenditure	470.1	473.8	480.2	489.7	495.3	501.8	517.8
Durable goods	*70.9*	*70.6*	*69.4*	*72.5*	*72.7*	*73.8*	*77.9*
Non-durable goods	*209.5*	*210.3*	*214.2*	*217.2*	*218.5*	*220.3*	*228.0*
Services	*189.8*	*192.9*	*196.6*	*200.0*	*204.1*	*207.7*	*211.9*
Government purchases of goods and services	157.7	161.7	170.4	175.0	178.2	181.7	187.5
National defence	*63.0*	*65.6*	*70.2*	*72.5*	*73.3*	*74.2*	*76.6*
Other	*94.7*	*96.1*	*100.2*	*102.5*	*104.9*	*107.5*	*110.9*
Gross private fixed investment	104.9	103.7	103.3	104.6	108.4	111.6	115.5
Residential construction	*23.7*	*20.9*	*21.4*	*23.1*	*25.6*	*27.6*	*28.3*
Producers' plant and equipment	*81.2*	*82.8*	*81.9*	*81.5*	*82.8*	*84.0*	*87.2*
Changes in business inventories	11.4	18.5	7.1	0.5	3.8	9.2	3.9
Net export of goods and services	4.6	4.3	5.3	5.3	5.4	3.0	2.6
Gross national expenditure, at current prices	748.8	762.1	766.3	775.1	791.2	807.3	827.3
Gross national expenditure, at 1966 prices	745.5	752.8	752.5	757.2	765.6	774.0	785.2

Monetary policy began to be relaxed in the latter months of 1966 as the boom receded and became quite easy by December. During the months of economic pause in 1967 the Federal Reserve continued an easy monetary policy so as to prevent a downward spiral and to allow the private economy to rebuild its liquidity position. At the end of February reserve requirements against savings deposits and against a part of time deposits were lowered in two stages from 4 to 3 per cent., thereby releasing about $850 million in required reserves. At the beginning of April the discount rate was reduced from 4½ to 4 per cent. With renewed expansion starting in mid-year, and given that the outlook for fiscal restraint was not very promising, the Federal Reserve System again began a tighter policy for both domestic and external objectives. At first interest rates reacted mainly to market forces, but later in the year restrictive action was taken. When sterling was devalued in November, the discount rate was raised to 4½ per cent., and as from January 1968 reserve requirements against demand deposits were increased by ½ per cent. These policy shifts over relatively short time spans were appropriate to the changes in the economic climate, although it may be that the degree of shift was at times excessive.

The performance of fiscal policy over this period was less happy, partly owing to lack of agreement between the executive authorities and Congress. Having missed the crucial moment for increasing taxes in late 1965 or early 1966, a 6 per cent. income-tax surcharge was proposed in the budget of January 1967. At that time, however, the pause in the boom was quite clear and the proposal was not enacted by Congress. The fiscal measures applied during the pausing phase of the cycle went rather in the other direction. The 7 per cent. investment-tax credit, which had been removed in October 1966, was restored in June 1967; also, the President authorised the release of nearly $2 milliard of previously frozen public-works funds. These steps, besides aiming to prevent a further slow-down of economic activity, were intended to meet longer-term needs of the economy, and the period of pause must have seemed an opportune time to take them. Nevertheless, in the background, besides the shift to monetary ease, total public-sector expenditures were increasing at a fairly rapid rate. While the stimulative fiscal measures were explained as steps to counteract adverse cyclical developments, the tax surcharge recommendation was still pending. Some confusion was therefore generated about the nature of the underlying situation and the prospects for later in the year. However, since the slow-down in early 1967 was a suspended boom rather than a recession, the need for a tax increase had not disappeared.

As the economy showed signs of recovery after mid-year, official fiscal policy views were fairly quickly restated and strengthened. With a huge increase in the administrative budget deficit in prospect, the President in August proposed the enactment of a strong fiscal package which included the imposition of a 10 per cent. surcharge on personal income taxes (to replace the earlier 6 per cent. proposal), a 10 per cent. surcharge on corporate profits taxes, the postponement until mid-1969 of a reduction of certain excise taxes scheduled for April 1968, and the speeding-up of corporation tax collections. In all, the measures were estimated to yield $7.4 milliard of additional revenue in the fiscal year 1967–68. The fiscal proposals were not adopted by Congress, however, which seemed unconvinced that the economy was in the midst of another boom. It was contended, in addition, that anti-inflationary action should also include sharp reductions in non-defence government spending. The President later indicated acceptance of this view in order to obtain action on his tax recommendations, but an effective compromise was not arrived at.

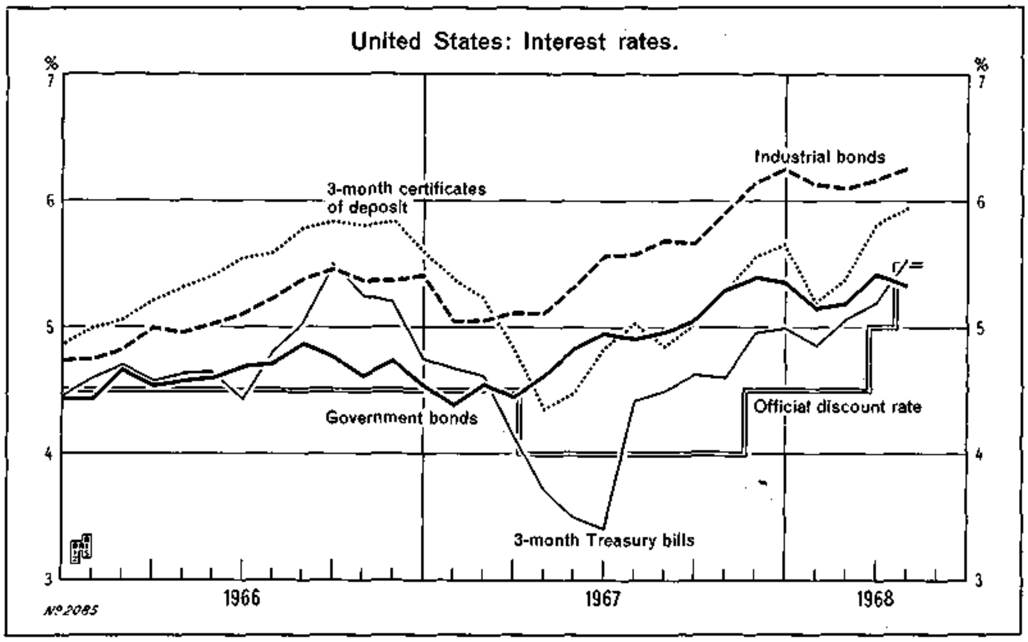
A restraining element of demand in 1967 was personal consumption expenditure. Spending on durable and non-durable goods increased quite modestly throughout the year and actually slowed down during the second half. Compared to the more "normal" 6 per cent. rate of recent years, the ratio of savings to disposable income averaged over 7 per cent. and reached nearly 7.5 per cent. in the last quarter. The behaviour of consumer spending may be explained by the mass purchases of durable goods and the relatively high growth of consumer debt in the preceding years.

After relatively moderate increases during the early part of 1967, prices started to rise significantly in the second half of the year. Wholesale prices actually declined from January until April, mainly owing to the fall in farm prices, and climbed thereafter. For the year as a whole, consumer prices went up by 3.1 per cent., but the rate of increase was close to 4 per cent. in the second half.

Wage increases in 1967 were also substantial and the former guide-line ceased to be effective. Average hourly earnings rose by 4.7 per cent., compared to 3.1 per cent. a year during the 1960–64 period, and 3.8 per cent. and 4.1 per cent. in 1965 and 1966. Thus, the price and wage increases of 1967, coming after the 1965–66 inflationary pressures, confirmed the condition of extended excess demand, with evident implications for the balance of payments.

Of all the peculiarities of the economic situation over the past year, perhaps none was so striking as the behaviour of financial markets and interest rates. With the easing of monetary tightness in late 1966 and early 1967, interest rates showed a declining trend. Short-term rates fell substantially, the yield on Treasury bills, for example, dropping from 5.3 per cent. in November 1966 to 3.5 per cent. in June 1967. For long-term rates, however, the decline was short-lived and relatively small; corporate bond yields fell by less than ½ per cent. and the low point came as early as February. The behaviour of rates was quite different from what is usual in a period of cyclical pause and reflected two forces. After the liquidity squeeze of the year before, lenders of funds preferred to maintain a strong liquidity position. At the same time, the demand for long-term money was very heavy, as borrowers were rebuilding their liquidity position and anticipating requirements for a renewed expansion of activity. Net capital issues for the year — both public offerings and private placements — at over $44 milliard, were about one-half larger than in 1966.

With these forces at work, long-term interest rates went up steadily from the early spring throughout the year; the rise was about 1 per cent. and late in the year the level of rates exceeded the peaks of 1966. In the second half of the year the trend of short-term rates was also up — even more sharply — with the prospect of the large budget deficit and lack of action on increasing taxes. Later in the year also there was a shift away from ease in monetary policy.



The evolution of the domestic situation was the dominant influence on the development of the balance of payments, though the external accounts were also affected by conditions abroad. The trouble started at the end of 1965. The mounting cost of the Vietnam conflict was superimposed on an external payments position that was already unfavourable and on conditions of high demand at home. The Vietnam expenditures worsened the balance of payments not so much in terms of their foreign exchange costs — a significant part of which flowed back to the United States through enlarged exports to foreign exchange earners — but more significantly by intensifying domestic inflationary pressures. Imports in 1966 were up almost 20 per cent., and, even though exports rose by over 10 per cent., the trade surplus was $1.1 milliard less than the year before. Given the domestic monetary stringency, however, short-term funds were attracted to the United States in such volume, mainly from the Euro-dollar market, that there was actually a small surplus on an official reserve transactions basis.

Exports continued to rise in the first quarter of 1967. But for the next two quarters they were flat, as economic pause or recession took hold in major industrial European countries. During these quarters, however, when excessive inventories were being digested in the United States, imports receded somewhat and the trade surplus for the first nine months of 1967 was $305 million larger than the year before. At the same time, both capital outflow and military expenditure were higher, so that the official reserve transactions deficit was at a level of about $2.9 milliard on an annual basis.

The situation worsened considerably in the fourth quarter. Excess demand was again becoming intense, business inventories were being rebuilt, and special factors, such as the continuing copper strike, affected the US trade position. Imports spurted ahead by $660 million and, with some decline

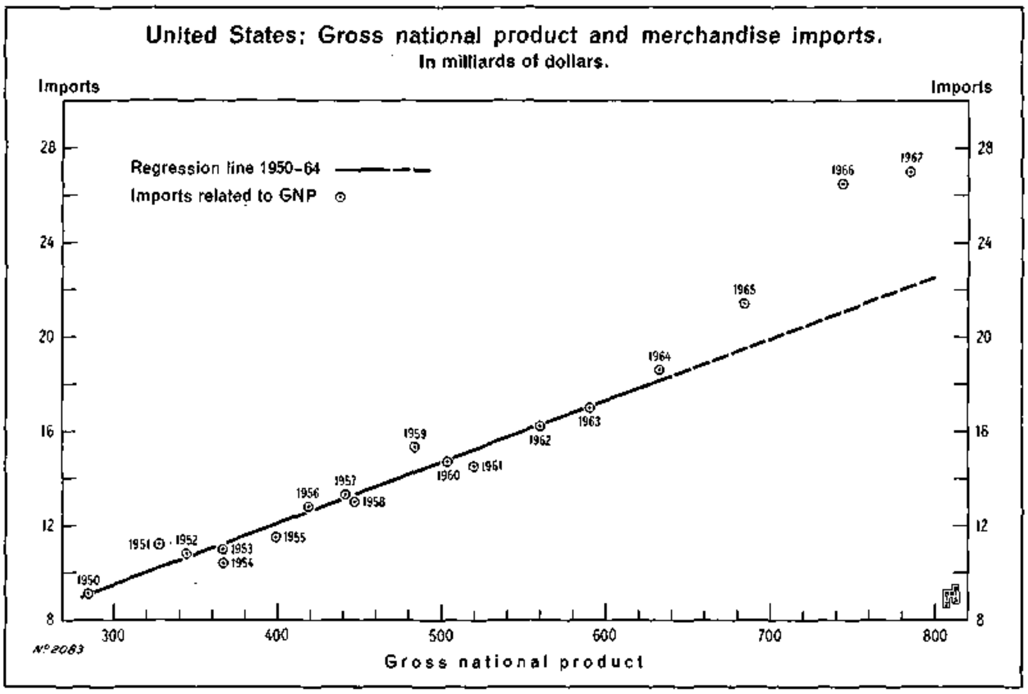
United States: Balance of payments.

Items	1966[1] 3rd quarter	1966[1] 4th quarter	1967[1] 1st quarter	1967[1] 2nd quarter	1967[1] 3rd quarter	1967[1] 4th quarter[2]	1968 1st quarter[2]
	in millions of US dollars, seasonally adjusted						
Merchandise trade							
Exports, excluding military	7,385	7,405	7,670	7,715	7,625	7,455	.
Imports, excluding military	6,580	6,680	6,660	6,560	6,550	7,210	.
Trade balance	805	725	1,010	1,155	1,075	245	105
Services (net)							
Investment income	1,305	1,355	1,285	1,290	1,555	1,505	.
Military expenditure	— 745	— 760	— 705	— 735	— 855	— 750	.
Foreign travel	— 265	— 265	— 265	— 460	— 485	— 325	.
Other services	— 225	— 215	— 235	— 325	— 240	— 225	.
Total services	70	115	80	— 230	— 25	205	.
Balance on goods and services	875	840	1,090	925	1,050	450	.
US Government grants and capital (net)	— 760	— 725	—1,200	—1,015	— 965	— 945	.
US private capital (net)							
Direct investment	— 900	—1,005	— 625	— 650	— 940	— 820	.
Other long-term capital	— 5	70	— 180	— 180	— 510	— 395	.
Short-term capital	— 25	— 230	— 180	— 285	— 290	— 395	.
Foreign capital (net)	375	780	855	1,195	805	220	.
Errors and unrecorded transactions	275	— 150	— 295	— 545	210	35	.
Balance on *liquidity* basis	— 165	— 420	— 535	— 555	— 640	—1,850	— 600
Increase in US liquid liabilities *other than* to foreign monetary authorities	1,025	400	—1,280	— 275	1,095	645	80
Balance on *official reserve* transactions basis	860	— 20	—1,815	— 830	455	—1,205	— 520

[1] For annual totals for 1966 and 1967 see table on page 31. [2] Preliminary.

in exports, the trade surplus fell by $830 million. At the same time, the capital-account deficit increased substantially, mainly because the British Treasury was withdrawing investments in the United States to bolster official reserves. In all, the seasonally adjusted fourth-quarter balance-of-payments deficit was $1.2 milliard, compared with an average of $730 million in the first three quarters. The deficit for the year was $3.4 milliard.

An indication that the import rise in recent years has been mainly due to conditions of excess demand may be seen from the following graph showing the trend of the relation between the gross national product and actual imports. Imports in 1966 and 1967 are clearly far above the normal relationship, and even 1965 seems already to have been out of line. For the fourth quarter of 1967, imports rose to about 3.7 per cent. of gross national product, the highest ratio in the post-war period. Imports of capital goods in 1965 and 1966 increased by 41 and 46 per cent. respectively, and in 1967, despite the economic pause during part of the year, with fixed investment in plant and equipment hardly increasing, capital goods imports went up by 11 per cent. In fact, after allowing for exports financed by official assistance, the trade surplus nearly vanished during 1966 and 1967.



The years 1966 and 1967 also confirm the fact that US trade has become very sensitive to the level of economic activity in western Europe. The slackening in the rate of increase of industrial production in western Europe in 1957–58, in late 1962 and early 1963 and again in late 1966 and early 1967 led to reductions in total US exports to Europe. The United States is a major exporter of investment goods — in recent years these have accounted for one-third of US exports to Europe — and, as is normal, investment is the volatile element during the economic cycle. Also, the United States appears to be a residual supplier. In times of heavy demand, Europe turns to the United States to make up for local deficiencies. At other times, not only does Europe reduce its purchases from the United States, but it also exports more aggressively when domestic demand is weak and thereby becomes more competitive vis-à-vis the United States.

The continued US payments deficit at a time when the pound sterling was in difficulties reduced the US authorities' scope for manœuvre to deal with their own problems. The devaluation of sterling in November had repercussions on the US reserve position. US gold losses in the year up to that point had been quite small, but the large speculative gold-buying wave boosted the US loss for the year to $1,170 million.

As these adverse developments unfolded in the fourth quarter, it became evident that forceful action was required to reduce the balance-of-payments deficit so as to limit reserve losses. Hence, on 1st January 1968 a new programme of drastic corrective measures was announced.

1. Mandatory controls were imposed on direct investment outflows by American corporations in place of the previous voluntary guide-lines. Direct

investment outflows for this purpose include new transfers of capital and foreign earnings, but exclude funds raised abroad and depreciation and depletion allowances on foreign operations; the limitations are based on the 1965–66 average of each company's direct investment. Direct investment in advanced continental European countries and South Africa is subject to a moratorium in 1968, with the exception of investment from foreign earnings up to 35 per cent. of the base period. For other developed countries, direct investment is limited to a maximum of 65 per cent. of the base period; and for the less-developed countries new capital outflow and reinvested profits are restricted to 110 per cent. of the 1965–66 base. These limitations are expected to reduce direct investment outflows, as defined above, by $1 milliard in 1968.

2. The Federal Reserve Board is to continue to use voluntary controls on foreign lending by banks and other financial institutions, but was given stand-by authority to impose mandatory controls. The immediate action taken by the Board severely tightens the restrictions for 1968 that had been announced in November 1967. Banks are to keep their foreign credits generally to 103 per cent. of the amount outstanding at the end of 1964, compared with the 109 per cent. ceiling set in November. In addition, the banks are not to renew (or re-lend) maturing term loans to advanced countries of continental Europe and are to reduce their short-term credits in those countries by 40 per cent. over the year. Other financial institutions are asked to reduce their foreign assets covered by the programme to 95 per cent. of the level at the end of 1967 and to repatriate all their liquid funds apart from minimum working balances. It is expected that these directives will yield a net inflow of funds from abroad of $500 million over the year, which would compare with an outflow of $400 million in 1967.

3. Americans are urged to postpone non-essential travel outside the western hemisphere for two years, and legislation was subsequently proposed to put a graduated tax on travel expenditures abroad, to extend the excise tax on domestic air travel to air travel abroad, and to reduce the duty-free allowance for returning tourists from $100 to $10.

4. Several steps were announced to reduce the government's foreign expenditures, including a cut of 10 per cent. in the number of government employees working abroad. In addition, discussions are being held with NATO allies to help offset US military spending in Europe by increasing their defence purchases in the United States and by larger purchases of longer-term US Government securities.

5. Some steps were announced to promote US exports. These included enlarged scope for the Export-Import Bank to provide assistance in export financing, an effort to secure reduction in the non-tariff barrier to US exports arising out of the Common Market's value added tax and financial assistance to joint export associations to enable smaller firms to market abroad more easily.

Full operation of the programme aims at reducing payments and increasing receipts by $3 milliard in 1968. Of course, some of the measures will take time to implement and there are bound to be some repercussions on US current or capital-account receipts from abroad, so that the net balance-of-payments improvement in the year 1968 is difficult to estimate. In any case, the improvement will in fact be intermixed with the effects of current market developments.

While direct controls to manage the balance of payments have been applied for some years, the new programme marks a big stride forward on this path. It is recognised to be a dangerous path, which could lead the world away from the liberal trade and payments practices achieved over the past fifteen years or so. The justification for the control measures is the Vietnam war and the difficulty of restoring a true equilibrium under wartime conditions. But would the return of peace allow the controls to be dismantled? Without expecting a definite answer to this question, it is appropriate to review the evolution of the US balance-of-payments problem and the ideas that have grown up for dealing with it.

* * *

The dollar is widely used for transactions and for the holding of liquid funds by many foreign business firms and financial institutions. As the growth of such private balances normally has as a counterpart a deficit in the US balance of payments on a liquidity basis, the trend of the balance of payments can generally be seen better from the balance on the official reserve transactions basis — though even then the situation may often be obscured by shifts of funds between central banks and the private banking systems. Changes in the gold reserves are generally a good indicator of the state of the US external payments — particularly in relation to changes in foreign official liabilities; a rise in the gold stock is a sign of strength, while a fall should, at least, raise questions.

The wholesale devaluation of foreign currencies in 1949 was, in retrospect, a crucial turning-point for the dollar. Before that, with reconstruction abroad in its early stages, the US balance of payments was always in surplus and the gold reserves rose — despite the fact that US aid and official loans averaged $5.5 milliard a year and dollar imports abroad were under strict quantitative limitations. It was evident that persistent US surpluses made an untenable situation for the rest of the world.

After the exchange rate adjustments, however, the United States was almost always in external deficit and the gold reserves declined most of the time. From the beginning of 1950 to the end of April 1968 the gold reserves dropped from $24.6 to 10.7 milliard, and the latter figure includes $1 milliard of gold owed to the IMF. Over the same time-span, liabilities to official institutions abroad rose from somewhat under $4 milliard to over $15 milliard. This deterioration in the relation between gold reserves and monetary liabilities to official institutions abroad went through a series of phases in which the basic forces differed greatly.

The shift to a deficit position started with a bang in 1950, when exports fell by $2 milliard from the year before and imports rose by $2.2 milliard. Over the years 1950–56 the deficit (official reserve transactions basis) averaged about $1.2 milliard. Even the large deficits in a few of these years caused no alarm, since, besides the exchange rate adjustments, they were related to direct and indirect effects of the Korean war. The deficits on the whole were considered constructive and, indeed, they helped Europe enormously to build up reserves while pursuing reconstruction rapidly. As foreign aid (grants and loans) declined from $5.6 milliard in 1949 to $2.4 milliard in 1956 while foreign discrimination against dollar goods was also tapering off, the sub-surface trends over these years were rather unfavourable to the United States. In part, this was because US defence expenditures abroad increased substantially.

During the same period the US gold reserves recorded an average annual decline of about $400 million. This was not because of doubts about the future gold convertibility of the dollar, but because the supply of new monetary gold, which averaged $440 million a year, was little more than half of the net demand from foreign official monetary institutions; they obtained the rest of their requirements from the US Treasury. This, too, was considered desirable from the standpoint of the international monetary system, since it was looked upon as creating a better distribution of world gold reserves. Taken in conjunction with the rise in official liabilities, however, the gold loss was not a good sign.

1957 was a year *hors série* for the US balance of payments. This was mainly because the war in the Middle East and the closing of the Suez Canal led to large oil purchases by European countries in the western hemisphere but in part also because the European reconstruction boom reached its climax when the US economy was turning to recession. The US trade surplus was $6 milliard in that year, a throwback to the days before the 1949 devaluations, and the balance of payments was in surplus by $1.1 milliard. It was the burst of sunshine before the storm.

In 1958 the US payments position shifted to a deficit of $2.9 milliard. The sharp turn-round was dominated by the change in the trade account; exports dropped by over $3 milliard, whereas imports declined only slightly. The cause of this change was that the boom in Europe was brought under control by 1957, and 1958 was a year of fairly general recession, which came, therefore, about half a year later than the US recession of 1957–58. The US economy started out of the recession phase earlier and expansion was more rapid in 1959; hence, the trade situation worsened in 1959, as exports remained flat while imports rose by $2.4 milliard. The large rise of imports was due in part also to heavy buying of steel abroad during the long strike in the US steel industry and to Americans' sudden passion for foreign cars, while exports of cotton and aircraft were below normal. All in all, the trade surplus in 1959 was under $1 milliard and the current account was in deficit — a situation that had only been seen before in 1953.

United States: Balance of payments.

Items	Average 1950–56	1957	Average 1958–60	Average 1961–65	1966	1967
	in milliards of US dollars					
Merchandise trade						
Exports, excluding military	13.5	19.4	17.3	22.8	29.2	30.5
Imports, excluding military	11.0	13.3	14.3	17.5	25.5	27.0
Trade balance	2.5	6.1	3.0	5.3	3.7	3.5
Services (net)						
Investment income	1.8	2.4	2.6	4.2	5.2	5.6
Military expenditure	− 2.0	− 2.8	− 2.9	− 2.3	− 2.8	− 3.0
Foreign travel	− 0.4	− 0.6	− 0.7	− 1.0	− 1.1	− 1.5
Other services	− 0.2	− 0.1	− 0.6	− 0.7	− 0.9	− 1.1
Total services	− 0.8	− 1.1	− 1.6	0.2	0.4	0.0
Balance on goods and services	1.7	5.0	1.4	5.5	4.1	3.5
US Government grants and capital (net)	− 2.5	− 2.6	− 2.4	− 3.3	− 3.4	− 4.1
US private capital (net)						
Direct investment	− 0.9	− 2.4	− 1.4	− 2.2	− 3.5	− 3.0
Other long-term capital	− 0.3	− 0.8	− 1.1	− 1.4	− 0.3	− 1.3
Short-term capital	− 0.2	− 0.3	− 0.6	− 0.9	− 0.4	− 1.2
Foreign capital (net)	0.3	0.5	0.4	0.7	2.5	3.1
Errors and unrecorded transactions	0.4	1.2	0.0	− 0.7	− 0.3	− 0.6
Balance on liquidity basis	− 1.5	0.6	− 3.7	− 2.3	− 1.4	− 3.6
Increase in US liquid liabilities *other than* to foreign monetary authorities*	0.3	0.6	0.8	0.5	1.6	0.2
Balance on official reserve transactions basis	− 1.2	1.1	− 2.9	− 1.8	0.2	− 3.4
Change in gold reserves	− 0.4	0.8	− 1.7	− 0.8	− 0.6	− 1.2

* For 1950 to 1959 figures are taken from H. B. Lary, *Problems of the United States as World Trader and Banker*, p. 13.

Thus, the worsening of the payments position in 1958–59 compared with 1956–57 was basically a cyclical phenomenon — accentuated by the reopening of the Suez Canal. It might have caused less concern had the gold losses been more moderate. Although the deficits were not much above those in certain earlier years, namely 1950 and 1953, the latter were connected with the Korean war, whereas the deficits of 1958–59 suggested more fundamental deterioration.

The cyclical position changed in 1960, when the United States was in recession again, while expansion proceeded rapidly in Europe. US exports forged ahead by $3 milliard, as imports declined by more than $0.5 milliard. Special factors were also important in the trade shift: cotton exports were depressed in 1959, awaiting the change in export price policy, and were exceptionally high in 1960; a similar change occurred in aircraft exports, awaiting the changeover to jets; and, also, steel exports rose in 1960 after having been depressed by the 1959 strike. A new factor that entered the picture, however, was a large outflow of short-term capital, mostly foreign lending by banks, so that the overall deficit was the highest yet.

The broader trends in the balance of payments over the 1950s may be seen better by comparing 1950–56 with 1958–60, thus to some extent ironing out the special and cyclical factors of particular years. During the latter period the deficit averaged $2.9 milliard and the total gold loss exceeded $5 milliard. By the end of 1960 gold reserves were down to $17.8 milliard and liabilities to official institutions up to $11.1 milliard. Comparing the trends of individual balance-of-payments components is rather artificial, since various flows of payments and receipts react on each other — e.g., higher earnings from foreign investment lead to larger direct investment, or larger defence expenditures abroad come back partly through increased exports, etc. However, the following average changes stand out.

On the one hand, average receipts were higher in the later years because the trade surplus was about $500 million larger and net earnings on foreign investments were bringing in about $800 million more. On the other hand, average outpayments were greater because of the growth of $300 million in spending on foreign travel, of $900 million in defence expenditures abroad and, above all, of $1.7 milliard in the net private capital outflow. Thus, the larger surplus on trade and investment earnings fell far short of increased capital outflows and other foreign spending.

Should one conclude that by 1958–60 private capital outflow from the United States had become over-expanded? It averaged $3 milliard (net), which, by comparison with the gross national product of $475 milliard and the high level of income per head, does not seem exaggerated. It is more reasonable to say that the average capital outflow in the 1950–56 period, of $1.4 milliard, was abnormally low. This was particularly so at the start of the decade and during the Korean war years. The rise of capital exports over the decade was associated with a return to more stable monetary conditions in foreign countries, particularly Europe, and with a lessening of tensions in the political climate. Besides the growth of investment to develop raw-material sources, the rapid reconstruction in Europe and Japan created attractive investment opportunities for US business at a time when there was a capital shortage in most of the world outside the United States.

The establishment of the Common Market in Europe also gave a strong incentive to US foreign investment and the return to convertibility of the principal European currencies in December 1958 greatly improved the climate and scope for international capital movements. With convertibility, capital flows became more sensitive to interest rate differentials, and this partly explains the recurrence of sizable short-term movements. While these developments of structure and of economic and political climate had emerged by the late 1950s, they did not have sufficient opportunity to show their full effects. The potentials of greater international capital flows showed their full impact only in the 1960s. Also, as a consequence of convertibility and of the development of the Euro-currency market, the US monetary authorities were required to take more account of the repercussions of US monetary policy on international capital flows.

If the growth of capital outflow was not exaggerated for a country with the economic strength of the United States, then the country's payments problems must be attributed to the fact that a sufficient surplus on current account failed to emerge. Earnings on foreign investment showed a highly satisfactory increase and one could abstract from defence outlays abroad in the hope that they would prove temporary. Hence, the unsatisfactory performance was the small rise in the trade surplus, the size of which was also small considering the level of foreign aid.

Was the limited gain in the trade account due to a weakening of the US competitive position? Price indexes show that the rise of US prices from 1950 to 1957 compared favourably with those of other industrial economies (see graph on page 12). In evaluating relative price performances, however, the important thing is that the levels of prices, wages and costs of the other industrial countries were much lower to start with, and that subsequent increases were more tolerable for them than for the United States. In the early years of the decade countries like Germany, Japan, Italy, France and the Netherlands did not have the export capacity to derive a trade advantage from their low price levels. But with the rapid reconstruction and expansion of productive capacity of western Europe and Japan, it was they, rather than the United States, that developed large trade surpluses. Therefore, if the exchange rate structure fixed in 1949 was to be considered inviolate, the United States could not afford the price rises of the Korean war years and of the 1955-57 boom period.

It may be added that in certain sectors important to the US export trade — iron and steel products, transport equipment and machinery, for example — the rise of US prices in these years contributed to the significant decrease in the US share of world exports of those products.

In sum, after the US competitive position was changed by general devaluation against the dollar in 1949, the receipts side of the balance of payments might have been able to support the effects of reconstruction abroad and a reasonable level of capital exports if there had not been periods of demand or wage-cost inflation from 1950 to 1957. But fate decided otherwise.

When the large deficit and gold losses continued beyond 1958, they became a threat to confidence in the dollar and a cause of official concern. But, as basic policy changes were difficult with the 1960 Presidential election coming up, the initial measures to deal with the payments problem were rather limited. The authorities began to shift some defence procurement from abroad to the United States and to tie development aid to purchases of US goods; an attempt was made to get some European surplus countries to share the foreign exchange costs of US defence expenditures in Europe; also, some of the dependents of military personnel stationed abroad were returned to the United States. And there was the inevitable announcement of an export promotion programme. However, there was little time for these measures to show results.

Gold losses were larger than in 1950–56 mainly because the deficits were larger. However, the United States would still have incurred losses of gold even had US deficits been appreciably smaller, given that new gold available annually for monetary purposes in 1958–60 was only $600 million a year, an amount hardly likely to meet the rest of the world's monetary demand.

The eruption of the market price of gold in October 1960 underlined the necessity for the new administration to deal with the external deficit and gold loss problems. However, it was faced with a dilemma because, with economic activity depressed and unemployment high, the orthodox adjustment strategy of demand restriction was unacceptable. Indeed, the new government had avowed the rather conflicting aims of increased domestic growth and a reduction in the payments deficit, a conflict that was never fully resolved.

A longish list of measures was announced early in 1961 to reduce the balance-of-payments deficit over both the short and longer term, most of which promised little by way of results. However, procurement abroad under military and aid programmes was restricted and an effort was made to reduce foreign defence expenditures, the duty-free allowance for returning US tourists was lowered from $500 to $100, and existing tax incentives to invest abroad were to be removed. Also, there was the idea that incentives given to domestic business investment would raise productivity and improve the international competitiveness of US industry. Much more important, however, the government moved actively, with the help of guide-lines for wage and price increases, to prevent cost inflation from impairing the competitive position of industry.

In the years 1961–65 the deficit (official reserve transactions basis) was significantly smaller on average than in 1958–60 — $1.8 milliard as against $2.9 milliard. However, if account is taken of advanced repayments of long-term debt to the United States, which were made to narrow the official reserve transactions gap, the average reduction in the deficit was $850 million.

The largest gain was in the trade balance. This is explained partly by the increase in US foreign aid (grants and loans), which was increasingly tied to US exports; also, total imports grew modestly, and car imports in particular receded considerably as the US industry turned out competitive compact models. As to the cyclical position, both the United States and Europe were expanding. On the face of it, the balance-of-payments effects might have been expected to cancel each other out. However, the expansion in Europe was much more intense, reaching boom proportions by 1961, with consequent pressure on prices and imports. While the United States also achieved a high rate of expansion and absorbed a considerable margin of unused labour and industrial capacity from 1960 to 1965, it enjoyed an unprecedented stability of prices. It is a tribute to the moderation of wage and price increases over these years that the trade surplus was able to widen despite the exceptional growth of the national output. In contrast, the trade surplus of the Common Market countries declined from $1.7 to 1.2 milliard between 1958–60 and 1961–65 and their current-account surplus fell from $2.7 to 1.1 milliard.

The other big gain was in earnings from foreign investment, which reached a record level of $6.8 milliard by 1965, as against foreign earnings in the United States of $1.7 milliard. Net military expenditures declined by about $600 million, through both larger defence purchases in the United States by foreign countries and smaller US expenditures abroad. Taking these gains together, there was thus a quite substantial improvement in the current account. On the capital account, however, the upward trend of the net outflow which had been seen in the 1950s continued; taking the change in "errors and omissions" to reflect largely capital movements, the average export of private capital rose from $2.7 milliard in 1958–60 to $4.5 milliard in 1961–65.

Although the deficit was not as large in the years 1961–65 as in 1958–60, it was still substantial; this meant fairly continuous pressure on the dollar in exchange markets and a sizable intake of dollars by foreign central banks. The authorities attempted to deal with the situation in two ways: one was a series of arrangements to minimise the losses of gold reserves; the other was further measures to contain the balance-of-payments deficit itself.

The steps to hold down gold losses involved techniques for absorbing temporary heavy pressures on the dollar which might be reversed and special arrangements to finance the deficit. Thus, first the Treasury and later the Federal Reserve System intervened in the foreign exchange market at times when the dollar was under pressure; the United States, with various European countries, established the gold pool to keep the market price under control; and the reciprocal network of swap arrangements with other central banks was set up and enlarged over the years to provide exchange resources with which to take up temporary excess flows of funds. As to more lasting means of financing, the United States issued non-marketable securities denominated in foreign currencies (Roosa bonds), which were sold against dollars to foreign official institutions; the interest rate ceiling payable by banks on time deposits was removed for foreign official institutions; the substantial US gold tranche position with the IMF was drawn upon from time to time; and several European countries co-operated also by advanced repayments of long-term debts owed to the United States.

In their approach to a basic improvement in the balance-of-payments position, the alternatives available to the authorities were subject to several limitations. Firstly, a drastic curtailment of defence forces abroad was considered impracticable in the prevailing international political situation; secondly, it was not judged appropriate to change the dollar price of gold, either with or without alterations in exchange parities; and thirdly, low long-term interest rates were considered essential to promote a higher rate of domestic economic growth, so that the pressure of opinion was against giving more emphasis in monetary policy to balance-of-payments considerations. As interest rates in Europe started to rise after 1961, the disparity in rates was an important factor in the rising capital outflow from the United States. Action was confined to a measure known as "operation twist", which tended to hold up short-term rates without affecting long-term rates. Some observers contended that a change in the fiscal/monetary policy mix on both sides of the Atlantic was necessary from the standpoint of the imbalance in international payments; but political difficulties, it would seem, were an obstacle to effective action along these lines. The large reduction in the US capital-account deficit which occurred in 1966, when a tight monetary policy was pursued to counter domestic inflation, shows that a significant result could have been achieved earlier by this kind of policy approach.

However, the authorities called upon more direct controls to limit the rise in capital exports. The interest equalisation tax was levied on purchases of foreign securities by US citizens, effective from mid-1963, and in 1965 voluntary programmes were introduced to limit bank lending abroad and direct foreign investment by corporations. Another type of measure was the provision of more liberal export credit and insurance through the Export-Import Bank. How much these measures may have helped it is difficult to say, not only because there are always leakages but also because they may have affected confidence unfavourably. In any case, they gave the framework for the wider and stronger controls announced on 1st January 1968.

The decline of US gold reserves in the years 1961–65 was much smaller on average than in 1958–60. This was due more to the other means of financing called upon than to the lower average deficit itself. Besides, other countries were reluctant to convert dollar reserves into gold in the strained circumstances of the time. The United States, on balance, obtained a substantial volume of gold from the operations of the gold pool between 1961 and 1965, while France converted a large volume of dollars into gold at the US Treasury as its reserve policy shifted.

As to the years 1966–67, the adverse balance-of-payments effects of the Vietnam war, and particularly the demand inflation that accompanied it, have been discussed earlier. It may be hoped that the elimination of these factors as well as renewed expansion in continental Europe will significantly reduce the payments deficit.

* * *

The buoyancy of demand prevailing in the late months of 1967 has accelerated thus far in 1968. In the first quarter of the year the gross national product increased by $20 milliard as a result of sharp expansion in all the major components of final domestic demand. Consumption expenditures in particular rebounded from the somewhat below "normal" ratio to disposable income of the second half of 1967. The inflationary state of affairs is shown by the fact that the rise of real output accounted for only three-fifths of the gross national product increase. The pressure on resources is indicated by the decline in unemployment to 3.5 per cent. in April, the lowest level in fifteen years. In the first quarter of 1968 wholesale prices for industrial products were rising at an annual rate of 4.4 per cent. and the advance of consumer prices was close to 4 per cent. Owing to the recent higher wage settlements, average hourly earnings are increasing by about 6 per cent. at an annual rate.

The Federal budget for the fiscal year 1968–69 called for a $11.8 milliard reduction in the budget deficit compared to 1967–68 (in terms of the new "unified budget" concept). In view of the expected increases of $3.3 milliard for defence outlays and $5.4 milliard for social security, the effect of the total budget would still be fairly stimulative. The main point, however, is that the budget is based on an increase in taxation expected to yield some $13 milliard in the fiscal year 1968–69. Without these added revenues, the budget deficit would be much larger than in previous years. Hence, the stalemate in Congress on the proposed tax increase has been watched by the outside world with some amazement. However, by the end of May there were indications that a fiscal package containing both a tax increase and a spending cut was likely to receive Congressional approval.

For both internal and external reasons, the Federal Reserve System has followed a fairly severe restrictive policy and the rate of increase of the money supply has steadily declined in recent months. By ½ per cent. increases on 15th March and 19th April, the discount rate has been raised to 5½ per cent., its highest level since 1929, which has confirmed the monetary tightening. The interest ceilings payable on large denomination certificates of deposit were also raised. Reflecting the situation, the yield on Treasury bills rose from 5.10 per cent. in mid-March to 5.85 per cent. in late May, the prime rate was increased to 6½ per cent., and the pattern of other rates increased similarly. Credit restraint has been applied more moderately than in 1966, probably to avoid disruption in credit markets. But this means, at the same time, that it has not had (as yet, at least) the same impact in dampening the boom. Too much monetary restraint could also have adverse effects internationally, by drawing short-term funds to the United States on a large scale.

In the first quarter of 1968 there was a further decrease in the trade surplus. The March returns were particularly unfavourable, owing chiefly to a decline of exports, and the trade account was actually in deficit by $158 million. The further deterioration of the US trade position is mainly attributed to the adverse effects of labour difficulties, both actual and anticipated, in the copper and steel industries and at the New York docks. However, the impact of excessive domestic demand on external trade remained the principal cause of the overall weak US trade performance.

For the first quarter, the balance-of-payments deficit on a liquidity basis declined to $600 million from $1,850 million in the final quarter of 1967. Measured on an official reserve transactions basis, the first-quarter deficit amounted to $520 million, compared with $1,205 million in the fourth quarter of 1967. On an annual basis, however, the deficits — the liquidity at $2.4 milliard and the reserve transactions at $2.1 milliard — although smaller than those of 1967, remained sizable.

It is too early to see the results of the new balance-of-payments measures. The legislation relating to foreign travel expenditures has not yet been completed by Congress and prospects for the expected gain in the trade surplus this year do not appear promising. As regards the capital control measures, some clarifications and exceptions have been announced, including full exemption for Canada, with the understanding that Canada will prevent its capital market from being used as a "pass-through" by other countries. Indications are that US banks are approaching the $400 million target set for them for reduction in their outstanding foreign credits, and the heavy demand by US corporations for funds abroad suggests that they are reducing their capital outflows for direct investment. Higher interest rates in the United States may also be attracting some inflow of funds. In any case, the dollar has been rather strong in exchange markets since the gold pool withdrew its support from the gold market.

In May discussions which may lead to a settlement of the Vietnam war began in Paris. Of course, a successful outcome in this matter would have significant implications for the economic situation — both domestic and external.

Gold.

The principal factors that brought about the gold crisis of 1967–68 were the deterioration of the payments and reserve positions of the United Kingdom and the United States, and in particular the repercussions of the devaluation of sterling. But here, too, the events of the past year can be understood only in the light of the trends over quite a few years before.

As the flight from sterling grew in the fourth quarter of 1967 and was intensified by substantial speculation against the pound, the market demand for gold also grew. Whereas the net sales in the market would normally be three or four tons a day, they were often twice that size in the weeks before devaluation. The demand rose to unprecedented levels in the week after 18th November and there was also a movement out of dollars into other currencies. A factor in the intense speculation was the revelation that France had since June ceased to participate in the gold pool's supplying of gold to the market. On 26th November 1967 the active members of the gold pool met in Frankfurt to appraise the situation. Besides announcing their intention to continue to stabilise the gold market at around the official price and to maintain existing exchange parities, they agreed on several measures designed to ease market tensions. These included steps to maintain liquidity in the Euro-dollar market, to discourage forward purchases of gold, to limit the buying of gold with bank advances and to impede official buying in the market.

Conditions in the gold market then became calmer for a time. Heavy buying of gold was resumed in mid-December, however, as a result of fears that the London gold market might be closed. But the situation then eased again in late December, following renewed official assurances that the gold price and market arrangements would not be changed. Some idea of the cost to the gold pool of holding the market price around $35.20 during this period may be obtained from the fact that western monetary gold stocks (including those of international institutions) fell by $1.4 milliard during the last quarter of 1967.

1968 opened with the announcement of a new balance-of-payments programme by the United States. This caused a further easing of market tensions and the price of gold went down temporarily to below $35.14 an ounce. With the market in a heavily overbought position, relative calm reigned all through February, but then a fresh wave of gold-buying began early in March. A further statement by the gold pool countries at the time of the regular meeting of central-bank governors in Basle on 10th March failed to calm the market; on the contrary, speculative pressures built up further during the next few days to such an extent that it was decided that the gold market in London should be closed on Friday, 15th March. There was no gold-dealing in Zurich on that day, but the turnover on the Paris market was substantial and the price went above $44 an ounce.

During the following week-end the central-bank governors of the countries active in the gold pool met in Washington to review the situation. In the communiqué issued after their meeting they noted that "the US Government will continue to buy and sell gold at the existing price of $35 an ounce in transactions with monetary authorities. The Governors support this policy and believe it contributes to the maintenance of exchange stability." Furthermore, the governors expressed their belief that "henceforth officially-held gold should be used only to effect transfers among monetary authorities" and they therefore agreed "no longer to supply gold to the London gold market or any other gold market". They added that "as the existing stock of monetary gold is sufficient in view of the prospective establishment of the facility for Special Drawing Rights, they no longer feel it necessary to buy gold from the market. Finally, they agreed that henceforth they will not sell gold to monetary authorities to replace gold sold in private markets." In the communiqué they also invited "the co-operation of other central banks in the policies set forth above".

Thus, the gold pool arrangement for putting a ceiling on the market price was suspended; while official transfers of gold would continue to be effected at the price of $35 an ounce, the market would be left free to find the price that equated demand and supply. The Bank of England decided to keep the London market closed for two weeks; when it reopened for business on 1st April the price was $38 an ounce. In the interval gold had been quoted in other markets at between $37 and 40. Although the speculative overhang in the market was perhaps around $1.5 milliard, the market price had gone above $42 in the second half of May.

Before the speculative buying that led to the Washington decisions the overall supply/demand situation for gold had been unfavourable throughout 1967. On the supply side, western production declined a little (for the first time since 1953) from $1,440 to 1,410 million; in addition, there had been no Russian gold sales for the second successive year. Total new supplies, therefore, were the smallest for any year since 1960. In the second half of the year, also, supplies coming into the market were less than current output because South Africa's balance of payments was in surplus. In physical terms the decline in western production compared with 1966 was about one million ounces; output in each of the three largest producing countries — South Africa, Canada and the United States — was down by over 300,000 ounces.

Supply and uses of gold.

Items	1965	1966	1967
	in millions of US dollars		
Gold production	1,440	1,440	1,410
Sales by the USSR	550	—	—
Total	1,990	1,440	1,410
Changes in western official gold stocks	215	— 50	— 1,600
Other uses	1,775[1]	1,490[2]	3,010[3]

[1] Including estimated purchases by China of $150 million. [2] Including estimated purchases by China of $75 million. [3] Including estimated purchases by non-western countries of $200 million.

Absorption of gold by users and holders other than western monetary authorities exceeded new supply in each quarter of 1967. By the end of September western official gold stocks were $225 million below the December 1966 level, and the $1.4 milliard drop during the last quarter brought the excess of what may be called "market" demand over supply to $1.6 milliard for the whole year. Total market demand for gold during the year was $3 milliard, roughly double the 1966 figure. Allowing for gold purchases by eastern-bloc countries in both years, western non-monetary demand may be estimated to have doubled between 1966 and 1967, from $1.4 to 2.8 milliard.

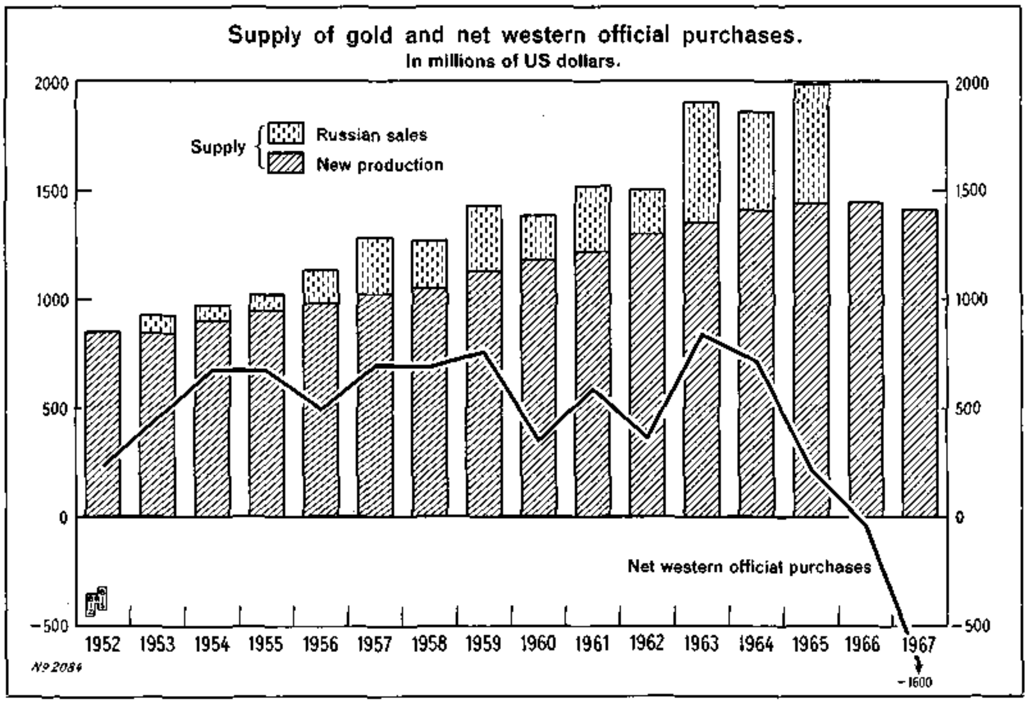
While the fact that the gold-market crisis came to a head in March 1968, and not at some other time, was linked to the devaluation of sterling and the deterioration in the US balance of payments, the underlying relation between new gold supplies and total demand had been changing throughout the 1960s. And this made it likely that sooner or later the position of the gold pool would become untenable. The origins of the gold pool go back to the October 1960 gold crisis, when intense demand for gold arose, both from private and from official buyers. As there was no mechanism for a temporary imbalance between market demand and supply to be equalised at that time, this pushed the London market price out of line with the official price, some dealings having taken place at as much as $40 an ounce. The immediate cause of the crisis was the large US payments deficit since 1958, coupled with uncertainty about the future US gold policy. But the basic position at that time was that a part of new gold supplies was available every year for adding to monetary reserves. This is shown by the fact that, despite the October crisis, western official gold reserves went up by $310 million in 1960. The fundamental idea of the gold pool, therefore, was to control temporary market disturbances, on the assumption that the buying and selling combine would be in net surplus over time. By 1967 the basis for this assumption had, leaving aside the special situation that developed in that year, become very flimsy.

The 1960 crisis occurred after a number of years in which there had been a not negligible margin of new gold available for monetary purposes. Between 1954 and 1959 annual additions to world gold reserves had averaged about $650 million — nearly twice as much as in the preceding six years. This was made possible by the opening of the Orange Free State goldfields and the arrival on the scene of the Soviet Union as a regular seller of gold. Both these factors began to make themselves felt in 1953, with the result that by 1959 total new gold supplies had risen to $1,425 million, as against $925 million six years earlier. In percentage terms this was a rise of 55 per cent. Over about the same period, however, non-monetary demand had risen by 125 per cent. There was a very big increase in 1956, the Suez crisis year, from $350 to 640 million; but more significant was the fact that in the three following years, when no such major political disturbance occurred, non-monetary demand averaged something over $600 million a year. This pointed to a strong underlying upward trend and suggested also that most of the gold bought during the Suez crisis was being firmly held.

The 1960 gold crisis jolted non-monetary demand up again sharply, to $1,070 million. And, as in the post-Suez period, there was no substantial fall in demand thereafter: the average for the four years 1961–64 was $1,065 million. This period includes 1962, the year of the Cuba crisis; however, the lowest figure in any one of these four years was $910 million — over one-third above the largest pre-1960 figure.

Despite the much higher plateau which non-monetary demand reached from 1960 onwards, annual additions to monetary gold stocks averaged about $550 million between 1960 and 1964, only $100 million below the 1953–59 average. Western production continued to increase steadily as more new mines opened up in South Africa; and, in addition, Russian sales rose to about $500 million in both 1963 and 1964, when there were exceptional purchases of foreign wheat. In 1964 total supplies were $1,855 million, 30 per cent. above their 1959 level; over the same period non-monetary demand had risen by 70 per cent., and 1964 was a year when there was little evidence of speculative buying in the market.

In 1965 supply reached a new peak of just on $2 milliard, which included record Russian sales of $550 million. But this was quite overshadowed by a rise of over $600 million in non-monetary demand to $1,775 million (including Chinese purchases of $150 million), so that only $215 million was left for adding to monetary reserves. With both reserve-currency countries simultaneously in payments deficit, private demand was stimulated early in the year by the announcement that France's payments surpluses would in future be taken in gold, as well as by the French Government's advocacy of a return to the gold standard. Later in the year the conflict between India and Pakistan and the Vietnam war gave a further stimulus to private buying.



In 1966 the situation on the supply side changed completely. For the first time since 1952 there were no Russian sales, and furthermore western production, the upward trend of which had been tapering off for a year or two already, stopped rising altogether. Hence, total new supplies dropped from $1,990 to 1,440 million. While non-monetary demand, too, was lower than in 1965, it was high enough to bring about a slight decline of $50 million in western gold reserves.

Thus, by 1967 the gold situation had become precarious. Compared with the position a year or two earlier, the main difference was on the supply side: the plateau of western production and the absence of Russian sales. Looked at in a longer perspective, however, the main reason for the changed situation was that non-monetary demand for gold had gone up so much — it had, in fact, more than doubled since 1956 and was almost 50 per cent. above the 1960 level.

Conceptually, private demand may be divided into three categories: industrial consumption; saving or investing in the form of gold, which, besides traditional saving, may include substantial gold-holding as a hedge against some particular currency risk; and shorter-term speculation on, or hedging against, a possible rise in the price or limited availability of supplies. The only statistical distinction that can be made, however, is between reported industrial consumption in certain countries, on the one hand, and all other non-monetary demand, on the other hand. The least unsatisfactory data on industrial consumption cover twelve high-income countries. And they show roughly a threefold rise between 1956 and 1966, from about $170 million a year to something over $500 million. This may be explained partly in terms of rising incomes, especially as regards jewellery, and partly by new industrial uses of gold in the electronics and space industries. But the magnitude of the increase suggests that the fixed gold price, compared to the upward trend of prices in general, also played a rôle in increasing demand. Total industrial use in the western world may be estimated roughly to have risen from $250 to 750 million over this period.

If total industrial use is taken as having roughly tripled between 1956 and 1966, non-industrial private demand went up some five times between 1955 and 1966, say, from $150 to 750 million. Most of this rise took place in four jolting movements. The first of these was in 1956, at the time of the Suez crisis; the second in 1960, when the market price broke loose; the third in 1962, the year of the Cuba crisis; and the fourth in 1965. All these sudden upward surges were connected with major political or financial events. And although they were all followed by some reaction, in each case demand remained at a substantially higher level than before. This indicates not only that a good part of the gold bought in each crisis was being rather firmly held as savings but also, apparently, that each successive crisis raised saving or hedging in the form of gold to a permanently higher level.

In sum, the increase in non-monetary demand for gold between the mid-1950s and the mid-1960s did not contain a large element of short-term speculative holdings — it was largely a rise in industrial and savings demand for the metal. And by 1966 this demand, not unaffected by the stability of the gold price and by the persistent decline in the US gold stock, had come to absorb about the whole of current western production. Hence, when speculative demand sprang up on a substantial scale in late 1967 and the first quarter of 1968, all of it had to be met out of the reserves of the gold pool countries. As there was no practical means of holding the market price while maintaining free access to the market in perpetuum, there was no practical means of getting market absorption back to the pre-crisis norm. Not surprisingly, the gold pool decided to call it a day.

* * *

Since these dramatic changes in the international payments and monetary sphere, not enough time has elapsed as yet to clarify the prospects in the year or so ahead. This is all the more true because the significant innovation represented by the special drawing rights facility in the IMF has recently been completed and submitted to governments for approval. This new instrument of international liquidity, which is described in Chapter IV of this Report, holds out considerable promise of greater flexibility for the international monetary system. For longer-term success, however, the SDRs will have to be used in a way that assures their general acceptability.

II. DEVELOPMENTS IN CONTINENTAL EUROPE, CANADA AND JAPAN.

In 1967, for the third year in succession, the growth of real output in continental western Europe slowed down. As in the United States, the retardation was the result of deliberate policy efforts the year before to dampen inflationary excesses largely by means of monetary restraint. However, balance-of-payments considerations did not play an important rôle except in a few countries like Sweden, Denmark and, perhaps to some extent, Germany and the Netherlands. In general, the problem of inflation had been fairly acute in all countries except Italy and France, and the reaction to it was strongest in Germany. Last year, for the first time in the post-war period, Germany experienced a serious recession.

In the course of 1967 monetary ease was restored throughout continental western Europe, and a number of countries sought also to revive activity through measures of fiscal policy. A leading part was played by Germany, where an upturn gathered some momentum in the autumn. Since the turn of the year activity has been advancing fairly well in almost all countries, fostered largely by continued adherence to easy monetary policies.

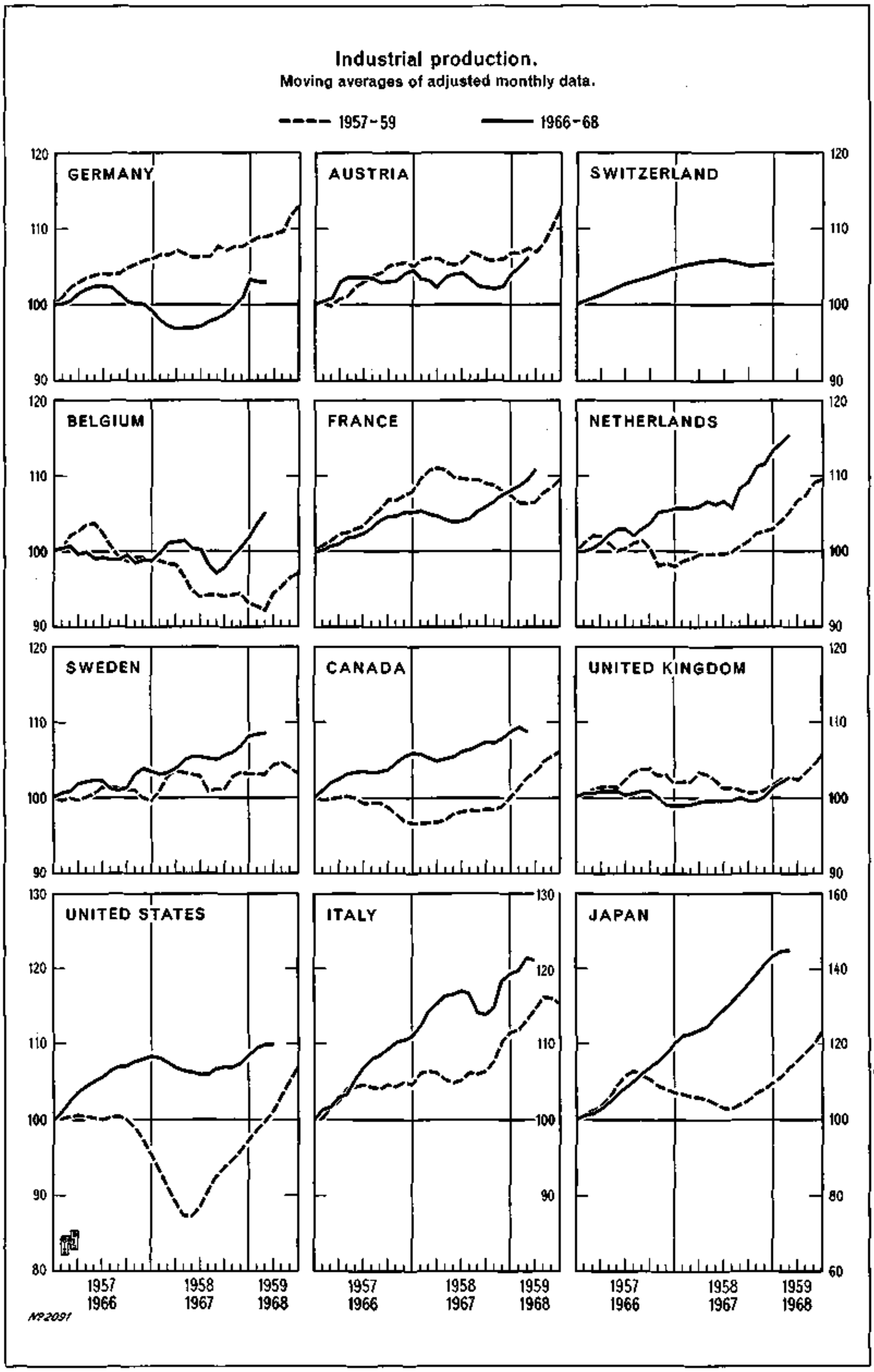
In the countries of eastern Europe (see pages 78–80) the tendency towards slower growth evident in the earlier 1960s appears now to have been checked, and in 1967 industrial performance was particularly good. In Yugoslavia, however, expansion was halted by monetary restraint imposed to curb the excessive growth of money incomes.

In Canada the rate of increase of output since early 1967 has not been enough to absorb the growing labour force. Nevertheless, wages and prices have continued to rise excessively, necessitating a tightening of monetary and fiscal policy. A return to restraint was also required in Japan, where a substantial external deficit emerged as the domestic boom moved into an advanced stage.

Production, wages and prices.

In terms of production and employment, developments on the Continent last year fell into two distinct phases: a slowing-down, or even decline, up to the summer, followed by a gradual upturn which gathered force around the turn of the year.

The initial phase marked the most pronounced slow-down since the recession of 1957–58. It is therefore useful to compare the trend of output in the various countries over these two periods. The graph on the next page relates movements in industrial production in the years 1966–68 to those in 1957–59.


Industrial production.
Moving averages of adjusted monthly data.
1957-59
1966-68
GERMANY
AUSTRIA
SWITZERLAND
BELGIUM
FRANCE
NETHERLANDS
SWEDEN
CANADA
UNITED KINGDOM
UNITED STATES
ITALY
JAPAN
120
110
100
90
130
80
160
140
80
60
1957
1966
1958
1967
1959
1968
Nº2091

The retardation of output in 1966–67 was generally not as great or as widespread as in the earlier period. The outstanding exception was Germany, which had registered only a moderate decline in the rate of expansion in 1957–58. In Austria, and probably in Switzerland too, the slow-down was also more pronounced than in the earlier period.

On the other hand, the dip in output in France was much milder than that in 1958, when the recession had been a reaction to the sharp inflationary expansion experienced in 1956–57. In Belgium, too, the decline in output, extending from early 1966 to the summer of 1967, was a good deal less marked than in 1957–58. In Italy, where industrial production had flattened out in 1957–58, and in the Netherlands, where it had declined throughout 1957, economic growth in 1966–67 continued fairly well. In Sweden output deviated little from its upward trend in either period of adjustment.

Canadian production, after a mild slow-down during the winter, began to rise again as from April 1967, while Japanese output expanded rapidly over the entire period.

On the Continent a turning-point came in the summer of 1967. At that time, when activity had also begun to rise in the United States and Canada, the upswing in Germany got under way. In France production also turned upwards, and in the Netherlands it accelerated sharply. Output gains in other countries followed with a certain time-lag. By late 1967 and early 1968 industrial production in most countries was running well ahead of its level a year earlier.

The disparate movements of output in 1967 were generally also reflected in the behaviour of wages and prices. In the countries where output slowed down the most, upward pressures on wages and prices appear to have eased perceptibly, though lack of comparability of data renders any firm judgement difficult. In Germany and Austria the growth of hourly earnings from the turn of 1966–67 onwards was clearly less fast than before, and a deceleration was also evident in Belgium and Sweden. For other countries data are available on a regular basis only for wage rates, which are less responsive than earnings to changes in demand and output. In Switzerland wage rates moved upwards somewhat more slowly in 1967, but in France, despite the dip in output, they continued to rise steadily. And in Italy and the Netherlands, where output was buoyant most of the year, the upward trend of wage rates remained much the same as before. In Canada and Japan the increase in earnings proceeded at an unduly high rate over the entire year.

Consumer prices in a certain number of continental countries have, over the past year or so, risen about as fast or even faster than over the twelve months to June 1966. A clear exception was Germany, where the price index in December 1967 was less than 1 per cent. above its level a year earlier. In Switzerland and Sweden, too, the increase in the year to March 1968 was smaller than before. In France the rise in consumer prices accelerated in the second half of 1967 as a result of increases in charges for social security and public services. In addition, the extension of the value added

Labour market, wages and prices.

Countries	Unemployment[1]			Wages[2]			Consumer prices		
	June 1966	June 1967	Dec. 1967	June 1966	June 1967	Dec. 1967	June 1966	June 1967	March 1968
	in thousands			12-month rate of change, in percentages					
Austria	71	73	72	6.2	7.1	3.8	— 1.1	1.3	3.1
Belgium.	61	88	96	10.3	6.3	6.1	5.0	2.1	2.9
Denmark	19	32	26	12.0	8.6	8.9	5.9	4.9	10.4
Finland	43	48	54	7.3	8.5	.	3.6	4.8	7.3[4]
France	145	198	226	5.9	5.9	6.1	1.2	2.4	3.8
Germany	157	624	408	6.6	2.1	2.4[3]	3.4	1.5	1.2
Italy	790	631	654	2.8	4.3	3.4	2.0	2.0	1.7
Netherlands. . .	40	98	80	11.0	5.5	7.1	5.7	3.8	4.6
Norway	10	13	12	4.7	8.3	7.1	2.4	5.4	4.4
Portugal	.	.	.	6.4	10.0	14.8	3.6	3.3	6.7
Spain	103	128	179	15.3	13.2	.	7.4	5.0	6.4[4]
Sweden.	23	40	40	5.8	12.8	7.3	7.7	4.2	2.1
Switzerland . . .	—	—	—	6.1	5.4	5.2	4.8	4.3	3.4
Canada	259	326	363	5.7	7.2	8.2	3.4	3.5	4.6
Japan	410	450	640	10.3	12.2	12.2	5.3	2.4	5.2
United Kingdom.	341	627	584	5.1	2.7	5.1	3.9	2.4	3.4
United States . .	2,938	3,090	2,901	3.8	4.1	5.1	2.5	2.7	3.9

[1] Seasonally adjusted except for Finland and Spain. [2] Earnings. Wage rates in the case of France, Italy, Netherlands, Switzerland and United Kingdom. [3] October. [4] February.

tax to retail trade caused the index to rise at the turn of 1967–68, as was also the case in Germany, when at the beginning of 1968 this method of taxation was substituted for the turnover tax. In Denmark about half of the 10 per cent. rise in prices in the year to March 1968 was accounted for by higher indirect taxes.

In Japan the rate of price increase quickened to over 5 per cent. as the economy moved closer to full employment. In Canada prices also rose somewhat more than in 1966, despite the slow-down in activity.

The changing pattern of demand.

The real gross national product of the principal continental countries is estimated to have increased in 1967 by 2.9 per cent., compared with 3.7 per cent. in 1966 and 4.5 per cent. in 1965. Moreover, as the rate of growth tapered off, the external balance on trade and services account improved, thus suggesting that demand pressures eased more than elsewhere. So far as domestic demand is concerned, the rate of increase of fixed investment, more particularly of plant and equipment, declined the most. The expansion of private consumption also dropped off — more so, in fact, than did that of public consumption, which in some countries was used as a buffer to sustain or reactivate demand.

The slower growth on the Continent in 1967 was, as suggested earlier, largely accounted for by the recession in Germany. In three of its smaller neighbours — Austria, Belgium and Switzerland — real product rose by no

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

Countries	Years	Sources of demand						Resources	
		Consumption		Gross fixed domestic investment			Exports of goods and services	Imports of goods and services	Gross national product
		Private	Public	Total	Plant and equipment	Dwellings			
		in percentages							
Austria	1965	5.0	— 1.2	5.0	5.8	1.0	6.4	11.6	2.3
	1966	4.7	3.6	7.1	8.3	0.7	6.6	10.6	4.6
	1967	3.3	3.3	0.4	0.7	— 1.5	5.7	2.7	2.5
Belgium.	1965	4.1	6.9	3.3	4.6	0.6	8.2	7.5	3.5
	1966	2.9	6.7	5.6	10.4	— 7.8	3.8	7.9	2.7
	1967	1.8	6.0	1.2	.	.	5.5	2.5	2.7
Denmark*	1965	4.0	4.1	4.8	4.2	7.6	8.1	7.3	4.5
	1966	2.9	5.4	3.0	3.3	1.8	3.5	5.5	1.9
	1967	3.4	5.8	7.1	5.9	13.0	5.6	6.6	3.4
Finland	1965	5.4	5.3	10.7	11.2	8.9	4.4	8.2	5.2
	1966	4.2	3.9	1.0	— 0.2	5.1	7.4	4.6	2.4
	1967	4.0	4.0	— 2.0	— 2.3	— 1.5	5.0	— 2.0	3.0
France	1965	4.0	3.7	6.8	4.1	9.9	11.3	3.6	4.2
	1966	4.7	3.5	5.8	8.6	0.1	7.0	11.1	4.9
	1967	4.0	4.5	6.9	.	.	3.4	5.4	4.2
Germany	1965	6.4	6.9	6.6	7.7	0.1	7.7	15.2	5.6
	1966	3.5	1.0	0.2	— 0.1	2.5	10.8	2.7	2.3
	1967	0.6	3.2	— 7.7	— 7.2	—10.0	9.2	— 0.4	— 0.1
Italy	1965	2.2	3.6	— 8.4	— 9.5	— 6.2	20.8	1.9	3.5
	1966	5.9	3.5	3.4	5.9	— 1.3	13.2	13.7	5.7
	1967	6.1	2.7	10.1	13.1	4.1	6.0	10.5	5.9
Netherlands. . .	1965	7.2	— 0.1	5.1	3.6	11.5	7.7	6.6	4.7
	1966	2.7	2.6	6.8	6.6	7.3	5.8	7.7	2.5
	1967	4.3	5.0	6.8	5.3	12.8	6.5	4.2	4.8
Norway*	1965	3.5	8.0	10.3	11.1	5.5	7.1	9.4	6.2
	1966	4.2	3.0	5.9	6.1	4.5	7.7	8.9	3.9
	1967	4.1	4.9	8.6	8.4	9.9	11.1	12.0	4.3
Sweden*	1965	4.5	6.4	3.5	3.6	3.2	4.0	11.5	3.7
	1966	1.7	5.9	5.9	8.5	— 2.0	5.4	2.9	2.9
	1967	2.8	6.5	6.7	4.1	15.6	6.4	4.6	3.6
Switzerland . . .	1965	3.7	0.8	— 1.6	— 1.4	— 4.5	12.0	3.1	4.3
	1966	2.3	5.4	— 0.4	— 0.2	— 4.8	6.2	3.5	2.8
	1967	2.0	2.5	— 1.4	— 1.2	— 2.0	3.3	2.2	1.6
Total for above countries . .	1965	4.5	5.3	3.5	3.8	2.6	9.6	8.2	4.5
	1966	4.0	3.2	3.2	4.0	0.6	8.4	6.9	3.7
	1967	3.0	4.0	1.4	1.8	0.0	6.6	3.9	2.9
United Kingdom .	1965	1.7	3.4	4.0	4.4	2.1	6.0	2.8	2.3
	1966	1.9	3.7	1.5	2.6	— 3.2	3.0	2.6	1.6
	1967	2.0	4.4	5.4	4.5	8.9	— 2.0	4.1	1.0
United States . .	1965	6.6	1.8	8.7	13.2	— 4.8	2.7	11.7	6.1
	1966	4.9	9.8	4.4	9.2	—12.7	8.8	15.6	5.8
	1967	2.9	13.3	— 0.6	0.3	— 4.8	4.2	6.9	2.6
Canada	1965	6.0	3.4	12.2	14.7	0.3	5.7	13.0	6.9
	1966	5.1	10.4	13.0	16.1	— 3.9	12.3	12.9	6.5
	1967	4.8	2.3	— 1.7	— 2.0	0.5	9.9	4.9	2.8
Japan.	1965	6.2	1.6	2.2	— 0.5	17.1	23.6	7.1	3.7
	1966	8.4	7.8	9.5	9.9	7.2	16.0	12.1	10.7
	1967	9.4	10.1	21.7	22.6	17.3	7.8	23.6	13.7

* In the case of Denmark, Norway and Sweden the official data for domestic investment include maintenance and repairs; these are excluded from the above figures.

more than $1\frac{1}{2}$–$2\frac{1}{2}$ per cent. A common feature in all four countries was the development in fixed investment, which in Germany declined sharply and in the others showed little change either way. In France, on the other hand, the overall growth rate of 4.2 per cent. was only slightly below that of 1966, thanks to an acceleration in fixed investment and public consumption which offset an easing of exports and private consumption.

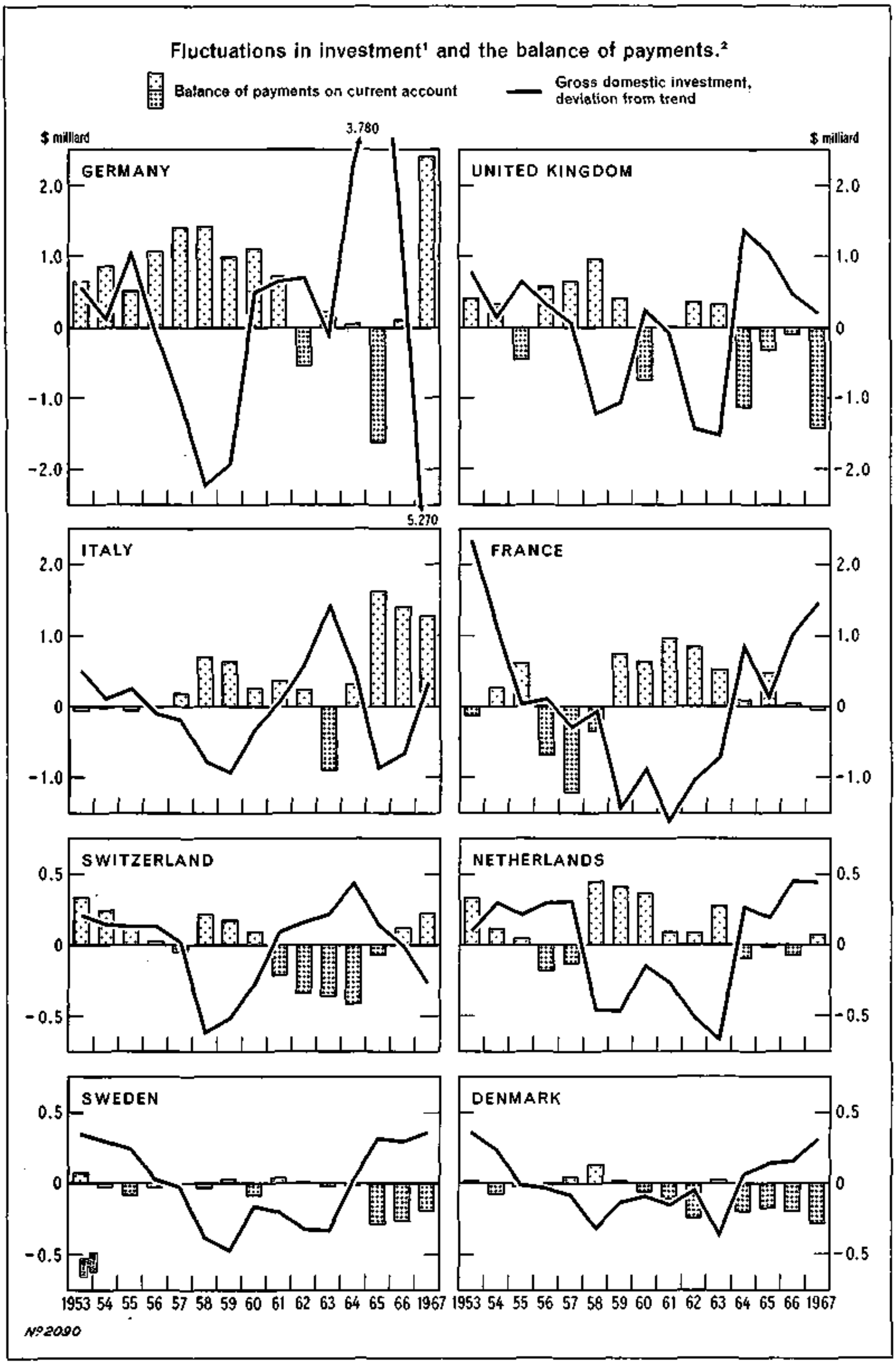
In Italy, the Netherlands and the Scandinavian countries the rise in real product last year was actually greater than in 1966 — in some cases substantially so. One of the main reasons for this was the marked increase in the rate of house-building — except in Italy, where rising investment in plant and equipment was the important factor, and in Finland, where exports rose appreciably. Another dynamic element of demand, again with the exception of Italy, was a speeding-up of public consumption. Private consumption played a fairly passive rôle, and in the case of the Netherlands, Norway and Sweden lagged behind the growth of real product.

In Canada the decline in the growth of real national product, from 6.5 per cent. in 1966 to 2.8 per cent. in 1967, was much the same as in the United States. But, in contrast to the latter country, public consumption expenditure increased only modestly, and investment in plant and equipment actually declined. However, demand was sustained by a higher level of exports, as well as by a fairly large increase in private consumption.

In Japan the growth of real product speeded up further in 1967 under the impetus of a big increase in investment. As this led to an acceleration in imports at a time when foreign markets were weakening, the external current-account balance deteriorated sharply.

The most important single factor underlying variations in the external current-account positions of western European countries in 1967 would appear to be the different rates of change of domestic investment. This, not surprisingly, also seems to hold true for practically the whole of the past fifteen years. The reason lies primarily in the volatile nature of investment, both fixed capital and inventories, which tends to fluctuate more than other elements of domestic demand and hence also more than national saving. Thus, an acceleration of domestic investment usually tends to be associated with increased imports and depressed exports. Matters are not always that simple, of course, and the external balance may at times depend more on such factors as the level and composition of foreign demand, the state of public-sector budgets, shifts in domestic income distribution and the appropriateness of the exchange rate.

It will be seen from the following graph that changes in the rate of investment in Germany have been quite similar to those in the United Kingdom in timing but not in amplitude. Over the period 1956–58, when the rate of investment slowed down in both countries, substantial current-account surpluses were recorded. In 1959–60, as investment in both cases accelerated, Germany retained its surplus while the United Kingdom moved into large



[1] Gross domestic investment in current prices expressed as deviations from the 1953–67 trend, which is represented by the zero line. [2] Current-account balance of payments in absolute terms.

deficit. However, the revaluation in Germany in 1961, together with a marked cut-back in the rate of investment in the United Kingdom in the 1961–63 period, left both countries with similar current-account positions by about 1963. From 1963 to 1964 investment accelerated sharply in the United Kingdom, accompanied by the emergence of a large external deficit, while in Germany the speeding-up of investment was spread over two years, giving rise to a deficit in 1965. Since 1965 the rate of investment in Germany has declined much more than in the United Kingdom, and Germany's large external surplus is surely not unrelated to this fact. Public-sector investment kept capital outlays in the United Kingdom relatively high in 1967 despite the general restraint measures introduced earlier.

Italy and Switzerland followed a somewhat similar pattern to that of Germany. In the years 1958–60, when the rate of investment was below the long-term trend, external surpluses were recorded. However, as the rate of investment accelerated, the surpluses diminished in size and eventually gave way to substantial deficits. From about 1964 onwards the rate of investment slowed down markedly in both countries, giving rise to sharp swings back into external surplus. In Italy a new reversal began in 1965, and by 1967 investment was again on its long-term trend.

France's series of substantial current-account surpluses from 1959 to 1963 occurred when investment was running well below the long-term trend. From 1964 onwards, apart from the temporary reversal in 1965, France held to a higher rate of investment, which was accompanied by return to approximate external balance. During this period public investment was stimulated to compensate for weakness in private investment, and the underlying rate of saving was increased through a strengthening of the budget. Similarly, the Netherlands achieved successive external surpluses over the years 1958–63, when investment was below trend. The higher rate of investment since 1964 has usually been associated with external deficits, whereas the aim of policy has been to maintain a surplus.

In Sweden and Denmark, just as in France and the Netherlands, investment since 1964 has been above the long-term trend. In Denmark the move to a higher rate of investment, leaving aside the year 1963, appears to have been a gradual development dating from 1958. Beginning in 1960, current-account deficits have been recorded in seven out of eight years. For Sweden substantial deficits began in 1965 in conjunction with a marked acceleration in investment that started in 1964.

But while domestic investment and external balance often seem closely interrelated, the policy implications of this relationship are less obvious. In the first place, investment includes not only fixed capital expenditure but also inventories, which are tied rather more closely to changes in the level of total demand. Secondly, the relationship does not necessarily imply that the solution to a balance-of-payments deficit lies simply in cutting back the rate of fixed investment. For example, France, by strengthening its budget position from late 1963 to 1965, increased national saving as well as investment without falling into external disequilibrium. By the same token, an excessively rapid acceleration of investment does not imply the need to emphasise monetary rather than fiscal restraint. The latter, by damping down final demand while also adding to national saving, may help to maintain a higher rate of investment over the long run. What the relationship does suggest, however, is that countries must strive to keep changes in the rate of investment more closely within the bounds of available saving.

Interest rates and the flow of funds.

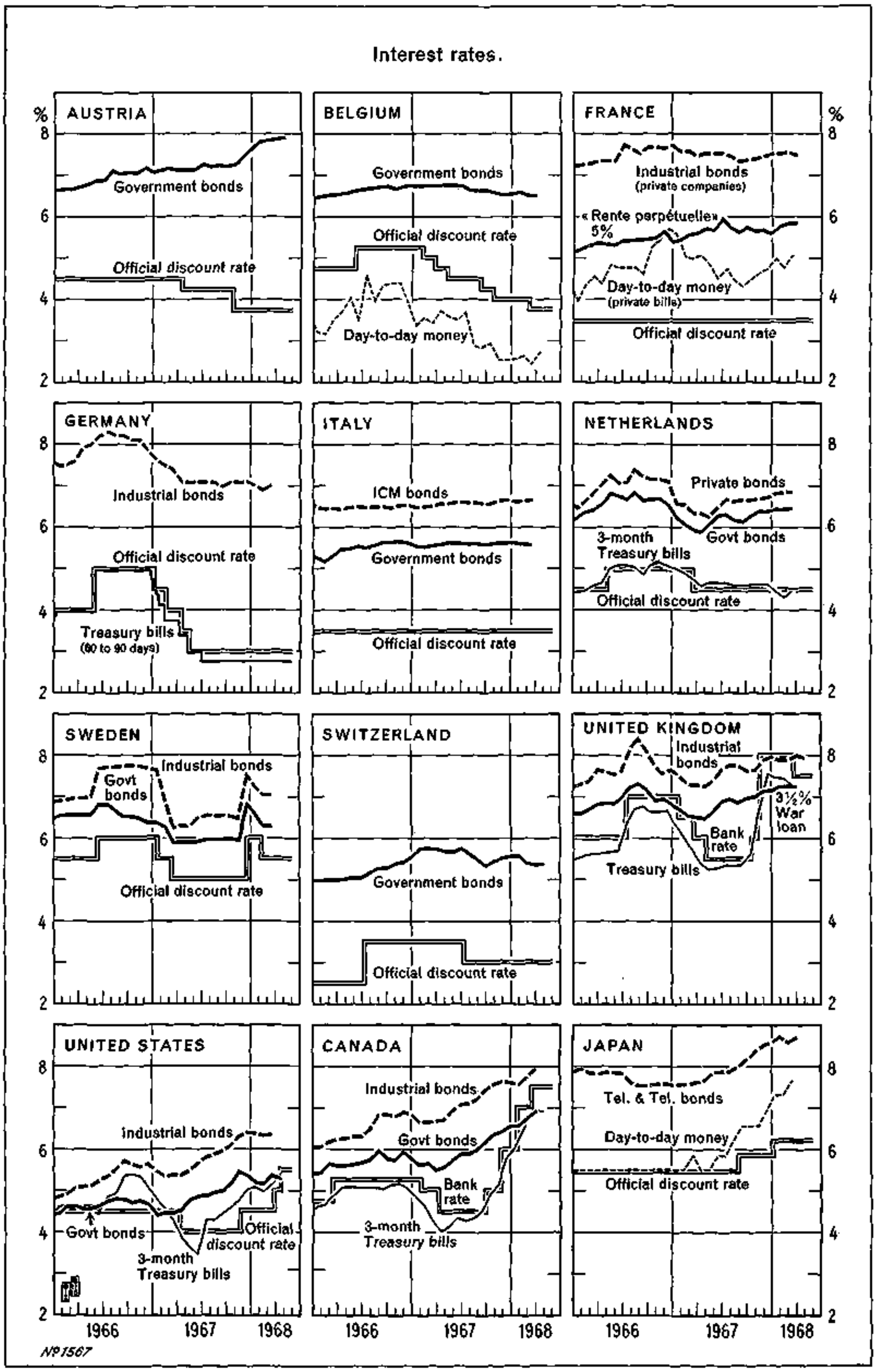
On the Continent active steps to ease monetary conditions did not start until Germany provided a lead from the beginning of 1967 onwards. Between January and May the Bundesbank reduced its discount rate in stages by altogether 2 per cent., helped by the fact that downward adjustments were also made by the United States, Canada and the United Kingdom. From January up to the autumn the official discount rate was brought down in Belgium by 1¼ per cent., in Sweden by 1 per cent., in Austria by ¾ per cent. and in the Netherlands and Switzerland by ½ per cent. In France and Italy monetary policy remained relatively easy, as before.

Changes in official discount rates since 1965.

Country and date of change	Official discount rate in %
Austria	
27th June 1963	4½
18th April 1967	*4¼*
26th October 1967	*3¾*
Belgium	
3rd July 1964	4¾
2nd June 1966	5¼
2nd February 1967	*5*
23rd March 1967	*4¾*
11th May 1967	*4½*
14th September 1967	*4¼*
26th October 1967	*4*
7th March 1968	*3¾*
Canada	
24th November 1964	4¼
6th December 1965	4¾
14th March 1966	5¼
30th January 1967	*5*
7th April 1967	*4½*
27th September 1967	*5*
20th November 1967	*6*
22nd January 1968	*7*
15th March 1968	*7½*
Denmark	
11th June 1964	6½
19th December 1967	*7½*
19th March 1968	*7*
France	
14th November 1963	4
8th April 1965	3½

Country and date of change	Official discount rate in %
Germany	
5th May 1961	3
22nd January 1965	3½
13th August 1965	4
27th May 1966	5
6th January 1967	*4½*
17th February 1967	*4*
14th April 1967	*3½*
12th May 1967	*3*
Greece	
17th January 1963	5½
25th July 1967	*4½*
Iceland	
29th December 1960	9
1st January 1965	8
1st January 1966	9
Japan	
18th March 1964	6.57
9th January 1965	6.205
3rd April 1965	5.84
26th June 1965	5.475
1st September 1967	*5.84*
6th January 1968	*6.205*
Netherlands	
4th June 1964	4½
2nd May 1966	5
15th March 1967	*4½*
Portugal	
12th January 1944	2½
1st September 1965	3

Country and date of change	Official discount rate in %
Spain	
9th June 1961	5
27th November 1967	*5⅝*
Sweden	
6th November 1964	5
9th April 1965	5½
10th June 1966	6
3rd February 1967	*5½*
10th March 1967	*5*
15th December 1967	*6*
9th February 1968	*5½*
Switzerland	
3rd July 1964	2½
6th July 1966	3½
10th July 1967	*3*
United Kingdom	
23rd November 1964	7
3rd June 1965	6
14th July 1966	7
26th January 1967	*6½*
16th March 1967	*6*
4th May 1967	*5½*
19th October 1967	*6*
9th November 1967	*6½*
20th November 1967	*8*
21st March 1968	*7½*
United States	
24th November 1964	4
6th December 1965	4½
7th April 1967	*4*
20th November 1967	*4½*
22nd March 1968	*5*
19th April 1968	*5½*


Interest rates.
AUSTRIA
Government bonds
Official discount rate
BELGIUM
Government bonds
Official discount rate
Day-to-day money
FRANCE
Industrial bonds
(private companies)
« Rente perpétuelle» 5%
Day-to-day money
(private bills)
Official discount rate
GERMANY
Industrial bonds
Official discount rate
Treasury bills
(60 to 90 days)
ITALY
ICM bonds
Government bonds
Official discount rate
NETHERLANDS
Private bonds
3-month Treasury bills
Govt bonds
Official discount rate
SWEDEN
Industrial bonds
Govt bonds
Official discount rate
SWITZERLAND
Government bonds
Official discount rate
UNITED KINGDOM
Industrial bonds
3½% War loan
Bank rate
Treasury bills
UNITED STATES
Industrial bonds
Govt bonds
Official discount rate
3-month Treasury bills
CANADA
Industrial bonds
Govt bonds
Bank rate
3-month Treasury bills
JAPAN
Tel. & Tel. bonds
Day-to-day money
Official discount rate
%
8
6
4
2
1966
1967
1968
Nº1567

These changes, supplemented by other policy actions to supply liquidity, marked a general return to easy monetary conditions on the Continent. Subsequently, in late 1967 and early 1968, largely as a consequence of the sterling devaluation and its repercussions in the gold and exchange markets, discount rates were raised sharply in the United Kingdom, the United States, Canada and Japan. Even over this period, however, no continental country that kept to its old exchange parity, other than Sweden, found it necessary to raise its discount rate. In March 1968 Belgium reduced its rate once again.

On the other hand, even though aggregate demand on the Continent remained subdued throughout most of 1967, long-term interest rates refused to respond much to easy monetary conditions. In Germany the decline in government bond yields from their unusually high level in the summer of 1966 came to a halt at just under 7 per cent. in the spring of 1967, and official intervention was later needed to keep them from rising again. In the Netherlands, formerly a country with low rates, the government bond yield dropped briefly below 6 per cent. in the spring, but subsequently kept within a range of about 6¼–6½ per cent. In Belgium, notwithstanding the succession of discount rate reductions, the yield on government bonds declined only hesitantly from the summer onwards. In Switzerland, even more than in Belgium, long-term yields were higher in the summer of 1967 than a year earlier, and they were brought down only temporarily by the July reduction in the discount rate. In Italy and France yields remained fairly stable in 1967 and early 1968.

Three factors explain the downward stickiness of long-term interest rates in 1967: (1) the strong preference for liquidity, (2) the demand for long-term funds, particularly by public authorities, and (3) in some countries the flow of funds to the international bond market.

1. *Liquid asset formation.* In most countries money and quasi-money, particularly the latter, expanded more rapidly in 1967 than in the previous year. This was partly a reflection of the normal process of building up liquidity that accompanies an economic slow-down, and it was facilitated by easy monetary policies combined in most cases with external surpluses. But a further reason was that the prospect of renewed expansion, and the retrospect of tight money in 1966, fostered expectations of a possible new upswing in interest rates.

These same conditions, together with the relatively high cost of long-term funds, stimulated the demand for bank credit. Lending to the private sector accelerated in Belgium, Finland, France, the Netherlands and Sweden, but grew less fast than before in Germany and held to its former trend in Italy and Switzerland. Lending to the public sector speeded up in Austria, Denmark, France and Germany. At all events, the buoyancy of credit to the domestic economy, coupled with the strong preference for liquidity, led to large increases in liquid assets held with the banking system.

Domestic liquid assets.

Countries	Years	Annual changes in money and quasi-money[1]	Money and quasi-money[2] as percentage of GNP	Countries	Years	Annual changes in money and quasi-money[1]	Money and quasi-money[2] as percentage of GNP
Austria	1965	14.53	53.5	Norway	1965	2.54	51.1
	1966	13.72	54.7		1966	2.32	51.4
	1967	14.03	56.4		1967	2.81	51.9
Belgium	1965	32.70	45.4	Spain	1965	144.70	66.4
	1966	33.90	45.9		1966	130.70	66.9
	1967	33.20	47.0		1967	174.50	68.7
Denmark	1965	3.02	47.1	Sweden	1965	3.02	66.7
	1966	4.16	48.1		1966	5.95	65.9
	1967	3.63	48.8		1967	8.94	67.1
Finland	1965	1,060	40.7	Switzerland	1965	6.01	129.3
	1966	1,352	42.1		1966	5.47	128.9
	1967	1,020	42.6		1967	8.51	132.3
France	1965	18.04	37.4	United Kingdom	1965	896	34.0
	1966	18.86	38.6		1966	528	34.1
	1967	24.48	39.7		1967	1,410	35.0
Germany	1965	22.40	40.0	United States	1965	28.00	43.1
	1966	21.20	42.0		1966	16.70	42.7
	1967	29.40	46.8		1967	35.30	44.0
Italy	1965	3,490	65.0	Canada	1965	1.98	35.8
	1966	3,658	69.6		1966	1.24	34.6
	1967	4,129	73.1		1967	3.10	36.6
Netherlands	1965	4.20	59.1	Japan	1965	3,872	76.1
	1966	3.61	58.9		1966	4,128	77.7
	1967	5.83	60.1		1967	4,575	75.7

[1] *In milliards of national currency units (Finland and United Kingdom, in millions).* [2] *Annual averages.*
Source: IMF, *International Financial Statistics.*

In Canada the substantial growth in bank deposits in 1967 was partly connected with the acceleration of credit demand but was partly also due to the strengthened competitive position of the banks under the new Bank Act introduced in the spring of that year. In Japan the expansion of bank deposits was limited to some extent by the external deficit and a return to monetary restraint.

2. *Domestic capital issues.* Despite easy monetary conditions, the private sector's continuing strong liquidity preference somewhat inhibited the volume of new capital issues in 1967. Although capital issues in most continental countries recorded an increase, it was generally small viewed in relation to the rise either in the gross national product or in liquid assets held with the banks.

In Germany, it is true, the capital market staged a certain recovery last year, with net issues rising again to about their 1965 level after having fallen off sharply in 1966. However, apart from a resumption of borrowing by public authorities, most of the increase was accounted for by issues of bank bonds which were taken up by other banks. Private-sector purchases remained subdued. In France and Italy net issues declined, partly reflecting in both cases a reduction in long-term borrowing by the central government. In Denmark, although there was a small rise, issues were still below the level

Domestic capital markets: Net issues.

Countries	Years	Public		Private[1]		Foreign issues	Total	Private and foreign issues	Total net issues
		State	Local authorities and public bodies	Shares	Bonds				
		in milliards of national currency units						as percentages of GNP	
Belgium.	1965	17.21	12.09	11.46	15.30	0.26	56.32	3.2	6.6
	1966	12.97	12.24	13.95	14.12	0.46	53.74	3.1	5.9
	1967	12.17	24.09	11.96	22.10	.	70.32	3.5	7.2
Denmark	1965	−0.14	—	0.30	4.82	—	4.99	7.3	7.1
	1966	−0.16	—	0.23	4.20	—	4.27	5.8	5.6
	1967	−0.16	—	0.28	4.37	—	4.50	5.5	5.4
France	1965	0.11	0.69	5.02	6.27	0.12	12.16	2.4	2.6
	1966	0.56	0.84	3.66	7.13	0.20	12.39	2.2	2.5
	1967	0.30	0.85	3.35	6.92	0.20	11.62	2.0	2.2
Germany	1965	1.15[2]	1.96	3.96	9.36	1.36[3]	17.79	3.2	3.9
	1966	0.36[2]	0.06	2.71	5.10	1.34[3]	9.58	1.9	2.0
	1967	2.11[2]	2.98	1.91	10.23	0.82[3]	18.05	2.7	3.7
Italy	1965	161	501[4]	406	1,295	14	2,377	4.8	6.7
	1966	719	832[4]	470	1,198	72	3,291	4.5	8.5
	1967	1,006[4]		396	1,389	20	2,811	4.3	6.7
Netherlands . .	1965	−0.03	0.59	0.11	0.71	0.04	1.41	1.2	2.0
	1966	−0.02	0.66	0.06	0.80	−0.07	1.43	1.1	1.9
	1967	0.32	0.76	0.06	0.26	−0.04	1.37	0.4	1.7
Spain	1965	26.51	8.91	34.76	25.93	—	96.11	4.7	7.5
	1966	24.44	6.75	40.08	26.19	—	97.46	4.5	6.6
	1967	27.80	10.09	46.55	28.71	—	113.16	4.5	6.8
Sweden.	1965	−0.29	0.29	0.93	2.73	—	3.66	3.7	3.7
	1966	−0.14	0.37	0.72	4.60	—	5.55	4.9	5.1
	1967	1.20	0.52	0.56	5.62	—	7.89	5.2	6.6
Switzerland[5] . .	1965	−0.22	0.75	1.54	1.81	0.26	4.15	6.0	6.9
	1966	0.00	0.90	1.21	1.59	0.42	4.11	5.0	6.4
	1967	0.06	0.89	1.20	1.60	0.71	4.46	5.1	6.5
United Kingdom .	1965	0.22[6]	0.21	0.07	0.37	0.02	0.90	1.3	2.5
	1966	0.23[6]	0.19	0.19	0.51	−0.02	1.11	1.8	2.9
	1967	0.53[6]	0.22	0.07	0.41	0.11	1.33	1.5	3.4
United States[7] . .	1965	3.60[8]	6.10	3.00	8.10	1.60[9]	22.40	1.9	3.3
	1966	6.30[8]	5.50	5.00	11.10	1.50[9]	29.40	2.4	4.0
	1967	12.70[8]	9.40	5.00	15.80	1.90[9]	44.80	2.9	5.7
Canada	1965	−0.06	0.73	0.46	0.99	0.02[9]	2.15	2.8	4.1
	1966	0.42	1.41	0.58	0.53	0.04[9]	2.98	2.0	5.1
	1967	0.82	1.57	0.47	0.68	—	3.54	1.8	5.7
Japan.	1965	−10	151	277	1,391[10]	—	1,809	5.5	5.9
	1966	797	205	433	1,576[10]	—	3,011	5.7	8.6
	1967	645	177	398	1,699[10]	—	2,919	5.0	7.0

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

recorded two years earlier. In the Netherlands the central and local governments had greater recourse to new issues, but other borrowers restricted their activity. In Switzerland the moderate rise in issues was accounted for mainly by the bigger volume of non-resident issues, which were taken up to a large extent by foreign investors.

On the other hand, the increase in new issues in Belgium and Sweden was quite substantial in 1967. In Belgium, given an external surplus and conditions of monetary ease, the public sector covered a larger proportion of its financial requirement by borrowing at long term. In Sweden the rise was a matter of increased borrowing by both the public and the private sectors.

In Canada, the United States and, to a lesser extent, the United Kingdom new issues expanded last year. While in Canada and the United Kingdom the rise was accounted for mainly by public-sector borrowing, in the United States corporate issues also showed a substantial increase. In Japan total issues fell off slightly under conditions of monetary restraint.

3. *The international bond market.* The pull of long-term funds to the international bond market was a third factor tending to sustain domestic interest rates in certain continental countries, though others benefited as net takers of funds. In most countries, except those in Scandinavia, residents are free to purchase bond issues on the international market (so-called Euro-bonds), which frequently offer net yields well above those prevailing on domestic markets. The net flow of funds to this market from such countries as Germany, the Netherlands, Belgium, Italy and Switzerland appears to have been considerable last year, though no precise data are available on this. The market is also supplied to an important extent by funds coming from other parts of the world, such as the Middle East and Latin America. On the other hand, purchases by UK residents are limited by the scope existing for converting sterling into investment dollars at a premium, while those by US residents are subject to the interest equalisation tax.

According to estimates of the Bank for International Settlements, total foreign and international bond issues rose from about $1,940 million in 1963 to $4,210 million in 1967. Most of this growth reflected the rapid expansion of international bond issues, i.e. those arranged by international underwriting syndicates for sale in a number of different countries. Thus, international issues in 1967 accounted for 44 per cent. of total issues abroad, as against only 7 per cent. in 1963 when the US interest equalisation tax was introduced. About 90 per cent. of these issues were denominated in US dollars, as against about 60 per cent. four years earlier. On the other hand, foreign issues, i.e. "classical" issues on a single national market denominated in the currency of that market, showed relatively little increase between 1963 and 1967. Moreover, approximately four-fifths of the total growth in that category was accounted for by issues on the US capital market by Canada, which is exempt from the interest equalisation tax.

International issues went up sharply from $1,105 million in 1966 to $1,860 million in 1967. One reason for this was the readier availability of investible funds as a result of the return to monetary ease on the Continent, which was accompanied in some countries by a decline in long-term interest rates from their 1966 peaks. In addition, foreign holders of German bonds,

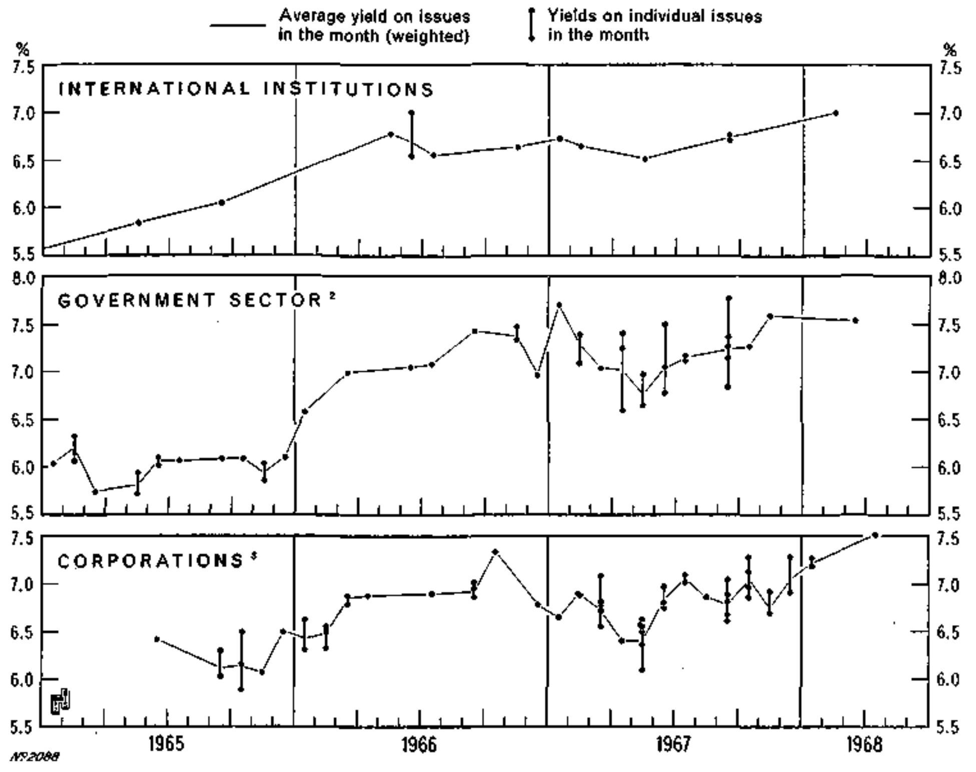
Foreign and international bond issues.[1]

Borrowing countries or areas	Years	Foreign issues: Markets of issue — Continental Europe[2]	United Kingdom	Canada	United States	Total	International issues[2]	Total issues abroad
		in millions of US dollars						
Continental Europe	1963	159	—	—	307	466	88	553
	1964	81	4	—	35	120	408	528
	1965	75	4	—	25	104	456	559
	1966	90	14	—	—	104	426	531
	1967	58	—	—	15	73	859	931
United Kingdom	1963	16	—	—	40	56	—	56
	1964	15	—	—	6	20	—	20
	1965	23	—	—	80	103	25	128
	1966	12	—	—	—	12	40	52
	1967	23	—	—	—	23	51	74
Canada	1963	—	—	—	748	748	—	748
	1964	—	—	—	777	777	—	777
	1965	—	—	—	1,034	1,034	—	1,034
	1966	—	—	—	1,070	1,070	—	1,070
	1967	—	—	—	1,172	1,172	—	1,172
United States	1963	9	—	—	—	9	—	9
	1964	—	—	—	—	—	—	—
	1965	10	—	—	—	10	331	341
	1966	190[3]	—	—	—	190	439	629
	1967	71	—	—	—	71	527	598
Japan	1963	25	14	—	138	177	20	197
	1964	37	—	—	—	37	162	199
	1965	10	—	—	63	73	25	98
	1966	—	—	—	—	—	—	—
	1967	—	—	—	15	15	—	15
Rest of the world	1963	28	129	—	123	280	25	305
	1964	45	55	—	216	316	5	321
	1965	—	59	—	215	275	83	357
	1966	—	42	—	204	246	101	347
	1967	31	102	—	237	370	305	675
International institutions . .	1963	68	—	—	—	68	5	73
	1964	95	8	—	150	253	121	373
	1965	70	—	23	200	293	128	421
	1966	182	—	37	175	394	101	495
	1967	114	—	—	510	624	120	744
Total issues placed	1963	306	143	—	1,356	1,805	137	1,942
	1964	272	68	—	1,184	1,523	696	2,219
	1965	188	63	23	1,617	1,892	1,046	2,938
	1966	474	56	37	1,448	2,015	1,107	3,123
	1967	296	102	—	1,948	2,347	1,861	4,208

[1] With a currency period of five years or more. Including known private placements. Company borrowing through foreign subsidiaries is normally treated as borrowing by the country of the parent company. [2] Non-resident issues in Germany between March 1964 and the end of 1967 are generally treated as international issues. In March 1964 the 25 per cent. withholding tax (coupon tax) on interest payments on German bonds held by non-residents was announced. As a result, non-resident issues, which are not subject to that tax, were sold until recently mainly to foreigners at interest rates below those prevailing on the domestic market. [3] Consists mainly of a US company issue in exchange for shares of a German company (Texaco/Deutsche Erdöl).

who are subject to the 25 per cent. coupon tax, reduced their holdings on a large scale, presumably switching in part to international bonds. On the demand side, an important factor was the doubling of the volume of international issues by continental borrowers, mostly from Austria, Belgium, France and the Scandinavian countries. Issues by US companies and their overseas affiliates rose from about $440 million in 1966 to over $525 million in 1967.

Yields on new international issues denominated in US dollars.[1]



[1] Yields to maturity according to terms of issue for new long-term loans offered publicly. [2] Including government-guaranteed issues. [3] Including issues of nationalised industries, but excluding convertible bonds.

Interest yields on new issues of international bonds denominated in US dollars, after having increased between 1965 and late 1966, dropped back considerably in early 1967 with the general easing of international monetary tensions. In the late spring and early summer, however, yields moved up again to a higher level, tending to stabilise within a range of 6¾–7¼ per cent., the exact rate depending on the type of borrower. In late 1967 and early 1968 pressure on the dollar, accompanied by a tightening of US monetary policy and the new balance-of-payments programme, contributed to a further rise in yields.

Over the past three years the yields on new international issues by corporations have fluctuated less widely than those on issues by governments and governmental bodies. One reason is that corporations tend, whenever yields rise above certain levels, to shift over to convertible issues. This was the case in early 1966 and again in early 1968. At any given time, moreover, the yields on corporate issues have tended to concentrate within a narrower range at a lower level than those on government issues. This is mainly a reflection of the fact that the corporations in question have generally been a homogeneous group of borrowers of high international standing.

In the first four months of 1968 total public offerings (i.e. excluding private placements) of foreign and international bonds amounted to $1,630 million, as against $1,145 million in the corresponding period of 1967. The most important change was that in international issues by US companies and their subsidiaries, which in the first four months of 1968 soared to about $740 million from $165 million in the earlier period — a direct consequence of the tightening of the US balance-of-payments programme at the beginning of 1968. Of this total, about 85 per cent. took the form of convertible issues.

In 1967 the paradox of easy monetary policies and high long-term interest rates presented a new problem to monetary authorities on the Continent. If easier conditions prevailed on the capital market, it might not only contribute to a revival of industrial investment but also facilitate capital outflows and external adjustment. To help towards this end, therefore, the authorities in various countries adapted their policies in ways designed to reduce upward pressures on long-term interest rates. These policies are discussed below in the context of developments in individual countries.

Continental western Europe.

Germany. Although investment and output had been declining since the previous summer, monetary policy did not shift towards active ease until the turn of 1966–67, by which time government finances had been put on a sounder basis and price inflation had weakened. But, once started, the return to ease proceeded quickly. The discount rate was brought down in four stages from 5 per cent. in January to 3 per cent. in May, and the rate on advances against securities was reduced by an additional ½ per cent. in August. Furthermore, minimum reserve requirements were progressively lowered up to September, by which time DM 6 milliard had been released from compulsory reserves. However, as private credit demand remained weak until the summer, and as arbitrage margins were attractive, the credit institutions used their liquidity accruals in large part to invest at short term abroad. This outflow, though it tended to limit the decline in domestic interest rates, served to offset Germany's large external basic surplus.

Fiscal policy, too, was used to stimulate activity. Although certain cuts in expenditure and increases in taxation had been deemed necessary in the 1967 budget, it was decided in January to allow the cyclical decline in revenue to have its full effect on the deficit. In addition, a "contingency budget" was implemented, providing for credit-financed investment outlays of DM 2.5 milliard. The Bundesbank lent support to deficit financing by broadening its money-market operations and supplying liquidity generously. Furthermore, an incentive was given to private capital outlays by granting, until October, special depreciation allowances on new investment.

By the summer a trough was reached and recovery slowly got under way. The improvement derived mainly from the capital goods sector, under the impetus of both domestic and external orders. Besides the influence of expansionary policies, the turn-round in investment was encouraged by a widening of profit margins related to gains in productivity. Public-sector investment remained weak, however, as also did consumption and inventory accumulation. To speed recovery on its way a second contingency budget was introduced in July. It called for public investment of DM 5.3 milliard, which was to be financed chiefly by the government and carried out mainly by local authorities.

In the spring and early summer the capital market began to show signs of renewed strain. With long-term yields rising abroad, principally in the United States and on the international bond market, foreigners began to unload their holdings of German bonds, which for them are subject to a 25 per cent. coupon tax. Market pressures were also aggravated by the social security institutions' need to sell off some of their holdings. Moreover, with new issues expanding and recovery getting under way, the banks became more reluctant to take up new securities. In these circumstances, in order to make its policy of monetary ease effective, the Bundesbank embarked in August on a new policy of open-market purchases of long-term government bonds. By the end of the year it had taken up some DM 1.3 milliard's worth, and the yield on such bonds came down from 6.9 per cent. last summer to 6.7 per cent. early in 1968. Other yields rose, but only slightly.

As a result of the policy of monetary ease, together with the continuing external basic surplus, the banks' free liquid assets increased over the year by almost DM 15 milliard to nearly DM 35 milliard. Favoured also by a sharp rise in resources at long term, the banks were in a position to respond easily to domestic credit demand. However, private-sector borrowing did not revive until the summer, and the total for the year, at DM 15.4 milliard, was well below the DM 19.1 milliard taken up in 1966. Public-sector borrowing, on the other hand, accelerated under the influence of deficit spending, amounting to DM 11.7 milliard, as against DM 6.4 milliard the year before. Moreover, by stepping up their lending to foreigners, the banks accounted for a major part of the steep rise in net long-term capital exports.

Reflecting mainly a resumption of issues on behalf of the public sector, net bond issues by residents rose to DM 15 milliard in 1967. This result was made possible by the credit institutions' unprecedentedly large purchases of DM 11.6 milliard. Purchases by private households, at DM 2.6 milliard, were only about half as high as in the years leading up to the bond-market crisis of 1966.

An encouraging outgrowth of recent experience has been the use, for the first time, of flexible budgeting as an element of stabilisation policy. Under the law on the promotion of economic stability and growth, which came into force in June 1967, fiscal policy has to be adjusted to cyclical conditions. The authorities not only have the power to introduce the necessary measures but are also bound to undertake forward budget planning over a five-year period in order to promote stability. Another provision envisages "concerted action" on the part of employers and employees if equilibrium is threatened by income and price developments. On longer-term grounds the 1968 Federal budget provides for certain increases in taxation, together with cuts in consumption expenditure and increases in investment. On balance, however, the budget remains expansionary, and overall deficit spending is expected to be close to DM 8 milliard, or about the same as in 1967.

In the spring of 1968 aggregate demand was advancing fairly well, reinforced by a long-postponed building-up of inventories.

France. The slow-down of expansion discernible in the second half of 1966 turned into a mild dip in the first half of 1967. The main causes lay in a slackening of exports and a slower growth of consumption, but private building had also weakened and some destocking occurred in view of the impending extension of the value added tax to retail trade as from 1st January 1968. A rise in investment, though greater last year than called for under the Fifth Plan, was insufficient to offset the depressive influences. However, since these forces were partly external or temporary, the authorities remained cautious in adopting more expansionary measures.

The budget had been permitted to move into deficit already in 1966, partly as a result of measures to encourage public and, to a lesser extent, private investment. From June 1967 onwards the stimulative effect of the budget was increased and applied over a wider field. Thus, during the summer measures were taken to accelerate expenditure by nationalised industries and to increase credit for building and public investment. To stimulate consumption the minimum wage in industry and agriculture was raised, family allowances and unemployment benefits were improved, consumer-credit terms were eased and income tax was reduced for the lower income brackets. These measures were largely offset, however, by rises in public-utility charges and the reform of the social security system (an increase in employees' contributions and a reduction in benefits) which came into operation between June and October 1967.

The cumulative effect of policy relaxation, coupled with a renewed growth of exports, led to a revival of activity in the autumn. But the recovery was not generalised and strong, and unemployment continued to rise. On the assumption of further improvement ahead, the budget for 1968 called for a deficit of only Fr.fr. 1.9 milliard, but provision was made for contingency measures in case the assumption should prove wrong.

For 1967 as a whole the central government's budget deficit came to Fr.fr. 7.2 milliard, as against Fr.fr. 2.0 milliard in 1966. It was again financed partly by the issue of a National Equipment Loan (Fr.fr. 1.25 milliard compared with Fr.fr. 1.5 milliard in 1966) and partly out of postal savings and funds supplied by the Treasury's correspondents. However, whereas in 1966 Treasury operations had extinguished liquidity by some Fr.fr. 1.7 milliard, last year they contributed Fr.fr. 2.7 milliard to liquidity creation.

Credit granted by the banking system (including the central bank) to the private sector went up last year by Fr.fr. 24.1 milliard, as against Fr.fr. 17.4 milliard in 1966. This high rate of expansion was bound up chiefly with a deterioration in enterprise profits paralleled by larger outlays for equipment. On the other hand, with the balance of payments in deficit from mid-year onwards, external transactions contributed Fr.fr. 1.4 milliard to liquidity creation, as against Fr.fr. 2.35 milliard in 1966. Moreover, this addition to liquidity took place in conjunction with a sharp deterioration in the banks' net foreign position. In aggregate, the volume of money and quasi-money supplied by the banking system rose by Fr.fr. 25.3 milliard, or 11.7 per cent., against 9.6 per cent. in 1966.

The growth of the money supply dropped from 7.6 per cent. in 1966 to 4.7 per cent. in 1967. At the same time, quasi-monetary resources administered by the banking system rose by almost two-thirds, while the increase in short-term savings placed with the savings banks, the Treasury and the National Agricultural Credit Bank went up from 10.8 to 13.0 per cent. This shift in the flow of funds was chiefly due to measures taken in June to stimulate saving, which prohibited the payment of interest on sight deposits, freed bank creditor rates on deposits in excess of Fr.fr. 250,000 or of more than two years' duration, and abolished the limits for deposits on most types of savings books. The resultant larger growth in the banks' resources, combined with a marked increase in their recourse to central-bank credit, enabled them to expand their credit-granting to the economy by Fr.fr. 24.4 milliard, or 19.3 per cent., against 15.3 per cent. in the previous year, while also becoming again a net supplier of funds to the Treasury.

This sharp expansion of bank credit goes some way to explain the slightly slower growth of credit granted to the economy by the specialised institutions, finance companies and the Treasury, which dropped to 14.7 per cent. from 16.3 per cent. in 1966.

Net security issues fell slightly, from Fr.fr. 12.4 milliard in 1966 to Fr.fr. 11.6 milliard last year. With the trend on the equity market still unfavourable, share issues accounted for only 21.4 per cent. of gross issues, against 35 per cent. in 1964. New-issue yields generally remained stable.

On the money market, notwithstanding an end-of-year rise, day-to-day rates showed a fall of roughly one percentage point over the year to average 4.76 per cent. in December. Money-market rates were largely influenced by the Bank of France, which entered the market as both lender and borrower. The object of these operations was more to minimise net inflows or outflows of funds than to ease tension, which was not significant owing to the high degree of bank liquidity.

In 1967 the introduction of the system of compulsory reserves was carried out as planned. Thus, on 21st October the ratio for sight deposits was raised to 4½ per cent. and that for deposits at up to three years to 2 per cent. The transitional minimum ratio of holdings of medium-term securities, which was fixed at 20 per cent. in January 1967, was progressively reduced to 16 per cent. by the end of the year and will be brought down to zero over the next few years. Moreover, the banks' minimum Treasury bill ratio, which was part of the former "coefficient de trésorerie", was gradually lowered from

5 per cent. to nil between January and September 1967. Finally, as from 21st December the Bank of France discontinued its advances against short-term government paper, hitherto granted at the discount rate, and made discounting above the prescribed ceilings subject to a uniform rate 2½ per cent. above the discount rate.

At the beginning of 1968, with the economic trend less favourable than had been expected, the authorities embarked on a new expansionary programme with a view to achieving the annual growth target of 5 per cent. The cost is put at about Fr.fr. 3.4 milliard, which widens the budget deficit for 1968 to an estimated Fr.fr. 5.3 milliard. Consumption was to be stimulated by a reduction in personal income tax and increases in old-age and family allowances, while investment was favoured by certain tax concessions and by higher loans for house-building, nationalised industries and regional development. In the early spring of 1968 the economy seemed already to be pursuing a steadier upward course.

Italy. Against a background of continuing monetary ease, gross investment accelerated in 1967 for the second year in succession, advancing by 14.3 per cent. in current prices. As a proportion of gross national product, it rose from 19.6 to 20.6 per cent., which is still much below the average of 24.8 per cent. reached in the years 1961–63. However, through an intervening shift in income distribution, saving has since become concentrated more in the household sector, where the saving ratio is usually relatively low. Thus the economy appears to be moving towards equilibrium at a lower investment rate than in the early 1960s.

Budget policy facilitated the further upswing in investment: directly through selective increases in funds for public investment and indirectly through the gradual restraint brought to bear on consumption expenditure. The impact of rising activity on revenue, together with the extra taxation imposed in November 1966 because of flood damage, led to a considerable strengthening of the overall budget position. A factor tending to improve the budget but to restrain investment was the shifting back to employers of social security charges that had been temporarily assumed by the government in order to help sustain profit margins. The central administration's current budget surplus (in national-income terms) increased from Lit. 445 milliard in 1966 to Lit. 1,430 milliard in 1967. The overall budget, after investment expenditure and capital transfers, changed over from a deficit of Lit. 785 milliard to a surplus of Lit. 195 milliard. The Treasury's net borrowing requirement, which also includes government lending for investment purposes, declined from about Lit. 1,850 milliard in 1966 to Lit. 1,280 milliard in 1967.

In conjunction with its smaller borrowing requirement, the Treasury cut back mostly its net issues of medium and long-term loans, which in 1967 came to Lit. 1,010 milliard, as against Lit. 1,565 milliard in 1966. Concurrently, the credit institutions reduced their new acquisitions of government securities by nearly the same amount, i.e. from Lit. 800 milliard in 1966 to about Lit. 300 milliard in 1967.

The credit institutions' loans to the economy rose by about 16 per cent. in 1967, compared with 14 and 7 per cent. in 1966 and 1965 respectively. At the same time deposit liabilities went up by 15 per cent., just as in 1966. Thus the acceleration of loan-granting was facilitated by the afore-mentioned reduction in acquisitions of government securities. The credit institutions' net security purchases, including issues of semi-public institutions but excluding those of the central government, came last year to Lit. 700 milliard, as against Lit. 630 milliard in 1966.

Bank liquidity was brought under pressure last year both by the reduction in the Treasury's cash deficit and by the further decline in the external payments surplus. The combined increment to liquidity deriving from these two sources was insufficient to offset the drain associated with the increase in the currency circulation and in the banks' compulsory reserves. The situation was eased, of course, by the reduction in the Treasury's net issues, as well as by a moderate curtailment in open-market security sales. None the less, in order to accelerate their lending activity, the credit institutions had to borrow substantially from the central bank. Their borrowing through discounts and advances, after having already shown a large increase of Lit. 570 milliard in 1966, rose last year by Lit. 850 milliard.

The loans of the special credit institutions to the private sector, mainly at longer term for investment in industry, building and agriculture, rose in 1967 by about 16 per cent., or slightly more than in the preceding year.

Over the past two years or so a principal aim of monetary policy has been to stabilise the yield on long-term government bonds and hence conditions on the capital market. Last year net capital issues declined to Lit. 2,810 milliard from Lit. 3,300 milliard in 1966. But, since this decline reflected mainly a reduction in the Treasury's borrowing requirements, the monetary authorities' indirect support to the market via the banking system could be correspondingly curtailed. Meanwhile, given the stability of bond prices, the general public's purchases continued at much the same high level as before. Apart from Treasury borrowing, the market was largely dominated by issues of the special credit institutions and semi-public industrial groups. Bond and share issues by private companies remained very small.

Netherlands. Demand paused at a high level in the first half of 1967, with a decline in equipment outlays and an easing-off in consumption being offset to some extent by an advance in housing activity. In view of this, and also of an improvement on external trade account, monetary policy was relaxed. The discount rate was lowered from 5 to 4½ per cent. in March, when it was also stated that banks exceeding their ceiling on short-term lending to the private sector would not have to make penal deposits with the central bank. In June the quantitative restrictions on short and long-term bank lending to the private sector were abolished altogether.

The fact that unemployment emerged only in certain sectors of the economy led the government to refrain from any general measures of budget stimulus. None the less, the budget deficit widened, as revenue grew more slowly than anticipated, and the government financed it to a limited extent by recourse to monetary financing. To combat localised unemployment, six special programmes were introduced during the year, involving total outlays of Fl. 613 million. Only part of this sum called for fresh borrowing, because the outlays were offset to some extent by expenditure reductions in areas of high employment. In addition, the government eased restrictions on building licences and granted credit guarantees, interest subsidies and special investment facilities to certain industries or regions.

From the middle of 1967 onwards economic activity turned sharply upwards. With exports rising well and public investment and house-building showing new strength, the advance soon became more generalised, leading to a recovery in consumption and a return to inventory accumulation. By December industrial production was running 9½ per cent. above its level a year earlier.

Short and medium-term bank lending to the private sector expanded sharply from the spring onwards, rising for the year as a whole by Fl. 2.1 milliard, or close on 23 per cent., i.e. almost twice as fast as in 1966. A simultaneous acceleration in long-term lending and in credit-granting to the public sector brought the commercial banks' total new loans to Fl. 2.9 milliard, as against Fl. 1.5 milliard in 1966. Lagging behind, but still large, was a Fl. 2.5 milliard increase in deposits, as compared with one of Fl. 0.6 milliard in 1966. In these circumstances the banks again abstained from security purchases and further reduced their net foreign assets from Fl. 630 to 300 million over the year.

On the capital market the funds taken up by domestic borrowers — mainly, as usual, in the form of direct loans — rose to Fl. 7.9 milliard from Fl. 7.1 milliard the year before. The increase was more than accounted for by the growth of public-sector borrowing. The central government, whose cash deficit went up from Fl. 1.6 milliard in 1966 to Fl. 2.1 milliard last year, covered over three-quarters of it by capital-market means. The local authorities' financial requirements, at over Fl. 1.7 milliard, were approximately the same as the year before but, in contrast to that year, were covered almost fully by long-term funds. A ceiling on their bank borrowing, established at 105 per cent. of the end-July 1966 level, helps to explain this, as does also the requirement that these authorities centralise their capital-market borrowing through official credit institutions. The private sector's demand for funds shifted partly from the capital market to the banks last year. On the supply side, it was very largely financial institutions, favoured by the growth of saving, that provided the increased flow of long-term funds.

The larger flow of capital-market funds did not avert, and in fact was partly linked to, a return to higher interest rates. The yield on long-term government bonds, after falling below 6 per cent. in the spring of 1967, began rising again and stood at around 6½ per cent. at the turn of the year. High yields on the international bond market played a part in keeping yields up in the Netherlands.

In the spring of 1968 demand and output continued to advance well, though unemployment had not yet been absorbed and the external payments position was still less strong than desired. Wages, which continued to increase substantially in 1967, were freed from control in January 1968. Against this background, fiscal policy became more cautious. Certain increases in taxation, mainly on consumption, are to keep the 1968 budget deficit to roughly the same size as in 1967, though a greater part of it is to be covered by short-term borrowing. In addition, the special programmes to combat regional unemployment are to be continued.

Belgium. Industrial production, after having remained flat throughout 1966, moved to a somewhat higher level in the early months of 1967. But this development, which reflected signs of strength in exports and investment, proved short-lived. A renewed decline in exports, together with a general weakening of domestic demand, caused output to fall in the late spring and early summer. Unemployment, which had increased slightly during 1966, rose considerably up to October 1967. It remained high in the fourth quarter, although exports surged upwards again and output rose to above the level of the preceding year.

In the latter part of 1966 a continuation of upward pressures on costs and prices had induced the authorities to proceed cautiously in relaxing policy. The budget for 1967, introduced early in the autumn, had provided for a substantial reduction in the deficit, though also for higher extraordinary expenditure if the situation should warrant it. Moreover, at the end of 1966 the ceiling on bank credit had been prolonged for six months, although the exemption applying to investment credits was extended to include export credits.

However, from early 1967 onwards, as unemployment rose and an external surplus emerged, the authorities turned to a more active programme of economic expansion.

In the monetary field, a policy of relaxation was carried out gradually over the entire year. Between February and October, in five stages of ¼ point each, the National Bank lowered its discount rate from 5¼ to 4 per cent. However, in view of the rising trend of rates abroad from the spring onwards, rates paid on deposits at less than one year were reduced to only a minor extent. In the middle of the year the ceiling on bank lending was removed altogether, though the banks were asked to exercise moderation in their credit-granting. In July hire-purchase terms were eased.

Action in other fields consisted mainly of measures — cyclical and structural — taken under the law of 31st March 1967, which was designed to give the government special powers to revive the economy. The first set of measures, in April, sought to help investment by establishing a B.fr. 5 milliard Fund for Economic Expansion and Regional Reorganisation, by granting certain fiscal privileges and by encouraging foreign investment. These steps were accompanied by fiscal changes, mainly in indirect taxation, calculated to yield B.fr. 1.5 milliard in 1967. In May a second set of measures gave certain public credit institutions greater freedom in their portfolio and investment operations, enlarged the scope for government-guaranteed investment credits and introduced more favourable amortisation arrangements. Further steps in the autumn included the adoption of new short-term financing techniques for the Road Fund, fiscal incentives for companies increasing their capital and tax reductions benefiting the stock exchange.

As a result of the government's expansionary budget policy, together with an acceleration of Road Fund expenditure, the Treasury's net financing requirement rose in 1967 to about B.fr. 22 milliard, from B.fr. 17 milliard in the preceding year. Owing to the higher rate of domestic financial saving last year, the Treasury was able to raise over B.fr. 25 milliard on the domestic market, mostly at long term, and thereby to repay about B.fr. 3 milliard of foreign indebtedness. On the other hand, the heavy volume of new capital issues by the Treasury and semi-public institutions had the effect of keeping long-term interest rates at a high level. The average yield on long-term government securities, after rising gradually from 6.45 per cent. at the end of 1965 to 6.77 per cent. in the spring of 1967, closed the year at 6.58 per cent.

The volume of money and of quasi-money held with the banking system rose in 1967 by over B.fr. 33 milliard, or 7.7 per cent., compared with 8½ per cent. in 1966. Within the total there was a pronounced shift towards the acquisition of quasi-monetary assets. Lending to the private sector came to B.fr. 26 milliard, as against B.fr. 20 milliard in 1966, while the banking system's net foreign assets increased by B.fr. 18 milliard after declining by B.fr. 4 milliard the year before. Monetary financing of the public sector, which had amounted to B.fr. 15 milliard in 1966, fell to negligible proportions last year.

In January and February 1968 the government introduced further recovery measures, including an easing of hire-purchase regulations, a public-works and housing programme, and more and cheaper credit for investment, particularly for smaller firms and in depressed areas. Subsequently, in March the official discount rate was lowered from 4 to 3¾ per cent. In the spring the economy advanced fairly buoyantly, stimulated by both external and domestic demand.

Switzerland. The growth of aggregate demand and output moderated further in 1967, reflecting mainly a levelling-off in investment. The labour market remained tight, however, and the rise in consumer prices was not much less than in 1966. The Confederation's budget changed over from approximate balance to a deficit, though a smaller one than anticipated. Otherwise, the authorities' policy efforts were concentrated on relieving upward pressures on interest rates and thus indirectly also on rents, wages and agricultural costs and prices.

To some extent monetary conditions eased in early 1967 as a result of the expiry of restrictions imposed for a limited time by the emergency legislation of 1964. Thus, mandatory control of bank lending had already been replaced by guide-lines late in 1966, while the interest ban on foreign-held Swiss franc deposits expired in March 1967, as did also the provision that banks had to balance net accruals of foreign funds by placements abroad. Furthermore, compulsory control over domestic capital issues ended and was replaced by a voluntary arrangement between the banks and the National Bank.

In the early months of 1967 bank liquidity was fairly tight, and interest rates remained high in spite of decreases abroad. To relieve this situation, the National Bank in April released one-third (Sw.fr. 345 million) of the commercial banks' deposits that had been blocked in 1961 after a large-scale inflow of money from abroad. Monetary conditions eased in the early summer, when war in the Middle East led to heavy inflows of capital, mainly through repatriations. In July, after market rates had come down, the National Bank lowered its discount rate from 3½ to 3 per cent. The call-money rate fell from over 4 per cent. in May to less than 1 per cent. in September. Rising interest rates abroad caused monetary conditions to tighten in the autumn. This, together with a loan of Sw.fr. 450 million by a group of Swiss banks to the United Kingdom, led the authorities in December to release the Sw.fr. 690 million remaining in the banks' blocked accounts with the central bank. About this time, too, unrest on the gold and foreign exchange markets brought a new inflow of funds from abroad.

Bank liquidity also benefited over the year from an increase in the external current-account surplus and a high rate of deposit formation with the banks, particularly at long term. Owing partly to more favourable interest rates on cash certificates, the liabilities of 75 representative banks rose by Sw.fr. 10.9 milliard, or 13 per cent., as compared with 8 per cent. in 1966. Their loans, however, increased by only Sw.fr. 5.2 milliard, or 9.1 per cent., which was about the same rate of growth as in 1966. Lending to foreigners, moreover, accounted for a larger proportion of the increase than in the preceding year. To a considerable extent the banks used their liquidity accruals to build up their foreign assets, which on a net basis rose from Sw.fr. 0.9 to 2.1 milliard in the twelve months to September 1967. The continuing weakness of domestic credit demand led the National Bank in September to abolish its guide-lines for the maximum permissible expansion of lending.

The new-issue market showed in 1967, under voluntary control, about the same results as the year before. Net bond issues by residents came to Sw.fr. 2,545 million, compared with Sw.fr. 2,485 million in 1966. Issues by non-residents, still subject to official approval, were allowed to increase from Sw.fr. 425 million in 1966 to Sw.fr. 710 million in 1967 (of which Sw.fr. 300 million represented parts of international issues taken over by a Swiss banking syndicate). However, about half this amount was placed with non-residents and did not involve the export of Swiss capital. As a result of higher saving, together with the continued rationing of new issues, bond-market conditions eased slightly in 1967 for the first time for a number of years. Coupon rates came down over the year by about one-quarter of a percentage point to 5 per cent. for cantonal bonds and to about 5¼–5½ per cent. for power-station loans.

Early in 1968, with slow growth and a continuing labour shortage in prospect, new measures affecting the supply of labour were introduced. These give greater mobility to part of the foreign labour force, which in the aggregate, however, will be kept at a stable level.

Austria. Industrial production, which had remained fairly stationary during 1966, declined slightly in the course of 1967. Exports, after stagnating for many months, had already begun to rise again late in 1966. But by that time industrial investment and house-building had started to level off and the growth of consumption was weakening.

In these circumstances economic activity was given some support by an increasingly expansionary budget policy. The original 1967 budget had in any case called for an 11 per cent. increase in expenditure and a small reduction in taxes on income. The cyclical weakness, however, caused revenue to fall short of expectations and, on top of this, it was decided to put into effect a second reduction in taxes on incomes in October. In addition, expenditure exceeded original estimates, partly because of an increase in civil servants' salaries. As a result, the actual budget deficit (excluding debt repayment and foreign transactions) rose last year to Sch. 4.3 milliard from Sch. 0.9 milliard in the preceding year.

Monetary conditions became very much easier in 1967. Apart from the liquidity effects of the budget deficit and an improved external current-account position, there was a sharp increase in long-term borrowing abroad by both the public and the private sectors. In April the discount rate was lowered from 4½ to 4¼ per cent. and that on advances against government paper from 5½ to 4¾ per cent. In addition, the National Bank reduced the minimum reserve ratios by one percentage point, thereby releasing about Sch. 1.5 milliard, and it also offered to repurchase money-market paper up to Sch. 0.5 milliard. This latter figure was increased to Sch. 1 milliard in June, when simultaneously the rediscount ceiling for export bills was raised and access to central-bank advances facilitated. Further measures were taken in October, partly with a view to encouraging a shift of borrowing back to domestic markets. The discount rate was lowered to 3¾ per cent. and other central-bank rates were reduced correspondingly. In addition, reserve ratios were cut again, thereby releasing another Sch. 1.5 milliard.

Reflecting both lower activity and the economy's shift over to foreign borrowing, bank lending (excluding security purchases) rose in 1967 by only Sch. 9.9 milliard, as against Sch. 14.7 milliard in 1966. The credit institutions' deposit liabilities, on the other hand, increased by Sch. 12.2 milliard, or at a slightly higher rate than in the previous year. They were thus able to repay indebtedness to the central bank, to build up their cash resources and to reduce their net short-term foreign liabilities from about Sch. 3.8 to 2.4 milliard by the end of 1967.

As the slow-down continued all last year, the 1968 budget was designed to stimulate demand, particularly investment. Deficit spending via the regular budget, which will again be financed mostly by borrowing abroad, will be only slightly smaller than in 1967. In addition, a Sch. 2.4 milliard credit-financed contingency budget was introduced, of which half was activated early in 1968.

Spain. In early 1967 developments were under the influence of the various stabilisation measures adopted the previous autumn, when price inflation and the external deficit had reached serious proportions. The programme had included measures to curb public consumption and to keep public investment provisionally at the 1966 level. Supervision over prices and profit margins had been extended to all commodities and services. Hire-purchase terms had been tightened. Furthermore, the expansion of bank credit to the private sector continued to be subject to the ceiling — 17 per cent. per annum — introduced earlier in 1966.

In late 1966 and early 1967 industrial production levelled off and then declined, reflecting primarily a slowing-down in investment. In this period imports, after having fallen appreciably in the spring and summer of 1966, kept to a fairly stable, but high, level. Exports were stronger than the year before, but the overall payments deficit was still substantial and reserves continued to fall.

Industrial production recovered somewhat in the spring and early summer, but weakened again in the autumn, ending the year at about the same level as in late 1966. Over the year as a whole consumer prices increased by 6½ per cent., compared with 5.3 per cent. in 1966, while wholesale prices remained stable. Wages appear to have risen considerably over the year. In October the national minimum daily wage was increased by 14.3 per cent. to Pesetas 96, after having been raised the year before from Pesetas 60 to 84.

The government succeeded in reducing the expansion in budget spending to about 13 per cent. from its rate of over 21 per cent. in the preceding year. However, partly owing to larger outpayments to local authorities, its net borrowing requirement declined only from Pesetas 33.2 milliard in 1966 to Pesetas 31.0 milliard last year. As at the same time it sold a larger volume of securities than in 1966, it was able to reduce its net recourse to the central bank to negligible proportions.

Lending by the credit institutions (including the central bank) to the public sector, in large measure through acquisitions of securities, increased in 1967 by 19.4 per cent., or at the same rate as in 1966. Similarly, credit to the private sector expanded by close on the ceiling rate of 17 per cent. Reflecting partly the external drain on liquidity, which was smaller last year, money and quasi-money rose by 16 per cent., compared with 14 per cent. in the previous year. During the year the percentage of their deposits which banks must invest in government securities was raised in two stages from 17 to 19 per cent., after having been increased from 15 to 17 per cent. in 1966. The banks had further recourse to borrowing from the central bank, though not as much as the year before.

In November the peseta was devalued in line with sterling. A variety of stabilisation measures, designed to slow down price increases chiefly through restraint on consumption, were immediately announced. These included a reduction in government staff, a price and wage freeze effective until the end of 1968, a 10 per cent. profits surtax for most private companies and a 5 per cent. increase in hire-purchase down-payments. A few days later, on 27th November, the Bank of Spain raised its official discount rate from 5 to $5^{3}/_{8}$ per cent.; at the same time bank lending rates were increased by ½ per cent. and interest on savings accounts by 1 per cent.

In 1967 real national product grew by only 3½ per cent., compared with nearly 8 per cent. in 1966. However, industrial production appears to have risen at the beginning of 1968, and the devaluation should help towards a further advance in combination with an improvement in the external accounts. This will depend to a large extent on the government's success in controlling the expansion of public expenditure and the course of price inflation.

Portugal. Thanks to a marked swing in agricultural production and a continued advance in services, the rate of growth of real domestic product accelerated to 5½ per cent. last year, after having fallen from 7 per cent. in 1965 to only 3 per cent. in 1966. On the other hand, there was a slackening in the expansion of industrial output. Although building activity was fairly strong, gross fixed investment, which had risen considerably in recent years, declined by over 10 per cent. This appears to have been partly associated with higher costs stemming from increases in wages, particularly in the industrial sector. A continuing rise in consumer prices was moderated somewhat by the recovery in agricultural output.

The central administration's ordinary and extraordinary expenditure increased in January–November 1967 by some 18 per cent., as against about 8 per cent. in the corresponding period of 1966. At the same time, however, tax revenue rose sharply as collection procedures improved and new fiscal codes came into force. Hence the overall surplus was again about the same as in 1966.

Reflecting the slowing-down of industrial output, the banking system's lending to the private sector, which consists largely of discounts of commercial bills, expanded in 1967 by only 7½ per cent., compared with 13 per cent. in 1966. On the other hand, in conjunction with the larger balance-of-payments surplus, money and quasi-money grew by 11 per cent., or nearly as much as in the preceding year. Consequently, the banks stepped up their purchases of securities and increased their cash holdings, while reducing their recourse to central-bank credit.

Several measures designed to improve the efficiency of the credit system and to increase the availability of domestic credit were taken in the summer of 1967. As the recession had apparently been exacerbated by sudden revoking of short-term credits, on which industry is highly dependent, the establishment of central agencies for export credit insurance and for collecting information on credit risks was announced. At the same time the availability of public funds for export finance was greatly increased. Higher interest rates were decreed throughout the credit system, though these are still generally below rates prevailing abroad. The rule that 51 per cent. of any domestic company's capital must be under Portuguese control was abolished. The commercial banks' minimum cash ratios for sight deposits and time deposits at up to 90 days were reduced by 1 per cent., to 14 and 9 per cent. respectively, while the ratio against deposits at longer term was increased from 5 to 6 per cent.

By the final quarter some recovery was evident in both exports and industrial production. With regard to investment, however, there will be some way to go before it is brought into line with growth plans. With this objective in view, the government in early 1968 reduced customs duties on imported raw materials and equipment goods and introduced fiscal incentives designed to stimulate investment in industry.

Denmark. In the first half of 1967, despite weakness in exports, output and earnings continued to advance strongly in conjunction with increases in residential construction, personal consumption and public expenditure. To some extent consumer expenditure rose in anticipation of the changeover in July from the turnover tax to a value added tax of 10 per cent., which was to broaden the coverage from 40 to 80 per cent. of total consumption and thereby nearly double revenue from this source in a full year. With the official discount rate at 6½ per cent., credit policy remained restrictive. The commercial and savings banks continued to be subject to the provision, introduced in 1965, that 20 per cent. of any increase in deposits should be placed in a special account with the Nationalbank or used to improve their net foreign position. From December 1966 quoted bonds with less than ten years to maturity could be deposited with the Nationalbank in fulfilment of this requirement.

After the middle of the year consumption slowed down and investment weakened. Profits had come under growing pressure, but bank advances, which had expanded strongly in the first half-year, increased much more slowly, partly because the banks were seeking actively to restore liquidity. Quantitative controls on building were lifted, but house-building expanded more moderately. On the other hand, exports began to rise again, while public expenditure went on increasing as before. In the months prior to the sterling devaluation, however, output as a whole appears to have been falling, as evidenced in rising unemployment.

In November Denmark followed the sterling devaluation a little more than half way, changing its dollar parity by 7.9 per cent. This move, though partly a reflection of the importance of the British market for Danish agricultural exports, was for other reasons not unwelcome. In recent years cost inflation had become a serious problem. Over the five years to 1966 hourly wage earnings had risen by about 10 per cent. a year, thus considerably exceeding productivity gains, and the consumer-price index had gone up by about 6 per cent. annually. Partly because of expectations concerning inflation, long-term interest yields were, already for several years prior to devaluation, in a range of 8–10 per cent. On these counts, therefore, devaluation appears to have been a realistic step in terms of trading relationships generally.

As a result of the lower rate of expansion after the middle of 1967, commercial-bank credit to the domestic economy grew by only 9 per cent. in 1967, compared with 15 per cent. in 1966. Deposits, on the other hand, expanded by 11 per cent., despite an external deficit and a drain on official reserves. The reason lay largely in a shift in the central government's cash budget from surplus into deficit, which was reflected partly in its accounts with the central bank. Moreover, in order to ease pressures on interest rates, the central bank continued to make purchases of government bonds, which together with government debt redemption came to D.kr. 1.5 milliard, compared with D.kr. 1.0 milliard in 1966. The commercial banks, after putting D.kr. 275 million into frozen reserve accounts and keeping their total investments almost unchanged, improved their liquidity position by over D.kr. 500 million following a deterioration of D.kr. 650 million in 1966.

A post-devaluation restraint programme was somewhat slow to evolve. Trade margins were immediately frozen until June 1968. On 19th December the discount rate was raised from 6½ to 7½ per cent. and central-bank support of the bond market terminated. Over the year as a whole, consumer prices rose by 10 per cent. — or 5 per cent. if the effects of tax changes are excluded — and the yield on long-term government bonds went up from about 9 to 9¼ per cent.

In late February the government introduced proposals aimed at achieving a cash budget surplus of D.kr. 450 million in the fiscal year beginning in April, following the deficit of D.kr. 360 million in 1967–68. These measures include expenditure cuts, an increase in the value added tax from 10 to 12½ per cent. as from April, higher agricultural subsidies so as to limit price increases and, finally, a price freeze in many fields until November 1968. Against this background, and in order to encourage some revival of industrial investment, the discount rate was lowered from 7½ to 7 per cent. in March 1968.

Norway. At the beginning of 1967, after several years of sustained rapid growth and with a considerable rise in public spending in prospect, strains on resources seemed likely to increase. The announced aim of credit policy for 1967 was to cut back the expansion of commercial and savings-bank loans to N.kr. 1,250 million, or about 6½ per cent., as against a rise of some 9½ per cent. in 1966. In March a series of mildly restrictive measures were taken, including the postponement of government projects, a spacing-out of lending by the state banks, selective curtailment of new building, increased incentives for lodging funds in investment accounts at Norges Bank and a tightening of hire-purchase terms.

In the second quarter output fell back somewhat as investment and consumption demand eased off, and it remained down in the third quarter, when exports weakened too. However, higher receipts on capital account kept the external payments position in surplus. Conditions in the labour market did not ease much and wages continued to drift upwards.

From the early autumn onwards output was again on the rise. The 1968 budget, presented in October, provides for a slower expansion in public expenditure and an increase in the surplus before loan transactions. Owing to a fairly substantial rise in loans to the state banks, however, the government's net borrowing requirement is to be somewhat higher than in 1967. In November minimum liquidity ratios for the commercial and savings banks were raised by one percentage point in order to curb credit expansion and bring it within the normative limits laid down for 1967.

Following the sterling devaluation the Norwegian krone came under a certain amount of pressure, leading the central bank to intervene for a time on the forward market. However, reserves soon began to rise again and forward commitments were gradually reduced.

In December, as a matter of structural change, Norges Bank secured an agreement with the credit institutions aiming to make domestic long-term interest rates more independent of external developments. The credit institutions undertook to consult with Norges Bank before changing deposit or lending rates, not to conclude agreements among themselves tying these rates to the discount rate, to fix mortgage rates, previously variable at notice, for five to ten years at a time and, where possible, to finance long-term investments by long-term credits.

Over 1967 as a whole the commercial and savings banks increased their loans to the private sector by 8½ per cent., which was appreciably above the ceiling laid down at the beginning of the year. At the same time, the banking system's lending to the public sector actually declined, reflecting mainly an improvement in the central government's position vis-à-vis the central bank. However, in conjunction with an external surplus larger than in 1966, the supply of money and quasi-money expanded by about 9½ per cent., or a little faster than before. The recommended ceiling on the increase in loans by the commercial and savings banks together has been established for 1968 at N.kr. 1,750 million, which implies about the same rate of growth as in 1967.

Sweden. Earlier policy restraint and a weakening of exports had combined to produce some slackening in the growth of demand around the middle of 1966. By early 1967 exports had begun to show new gains but industrial investment was falling. The budget for the year beginning July 1967, presented in January, aimed selectively at restraining consumption, through an increase in indirect taxation and a rise in pension contributions, and also non-priority building, through the imposition of a 25 per cent. investment tax. On the other hand, S.kr. 500 million was allocated for a new Industrial Development Fund for rationalisation and development projects. Against this background, monetary policy shifted towards greater ease, and the discount rate was lowered twice, in February and March, bringing it down from 6 to 5 per cent.

With domestic demand remaining subdued and exports declining once again, new policy measures were introduced from the late spring onwards to check rising unemployment. Investment funds held by industry on blocked Riksbank accounts were released in three stages — in May for building projects and equipment purchases, in October for stock accumulation and in December again for equipment. The timing for certain public orders was advanced, with local-authority orders receiving a government grant of 20 per cent. Public building projects were stepped up and measures to facilitate residential construction were extended. Furthermore, exemptions were granted from the investment fee and labour retraining activities were strongly expanded. The resulting rise in public expenditure, together with the cyclical shortfall in revenue, increased the budget deficit for the fiscal year 1967–68, the revised estimate for which comes to S.kr. 3.3 milliard, compared with a deficit of S.kr. 1.6 milliard in the preceding year.

As a result of these measures, Sweden succeeded last year in achieving a fairly satisfactory rate of economic growth. A pronounced recovery in housebuilding, an increase in public expenditure and a modest rise in private consumption more than offset the weakness in exports and private investment. Real output rose at the rate of 3.6 per cent., which was higher than in 1966 and nearly the same as in 1965. Unemployment, however, reached a level that is somewhat high by past standards.

The net increase in lending for the credit system as a whole came to S.kr. 17.3 milliard in 1967, compared with S.kr. 12.7 milliard in 1966 and S.kr. 10.3 milliard in 1965. From 1966 to 1967 borrowing by the central government rose sharply from S.kr. 1.3 to 3.0 milliard, about half of which was supplied by the banks, for which government claims count as an element of liquidity. The central bank's lending to the government increased less than in 1966 and consisted very largely of purchases of long-term bonds. New credit to the housing sector, based mainly on mortgage bond issues, rose from S.kr. 5.5 milliard in 1966 to S.kr. 6.9 milliard in 1967. Business borrowing, which went up from S.kr. 4.6 to 5.8 milliard, was covered to the extent of two-thirds in the capital market, as in the previous year. The banks' liquid assets rose in 1967 by S.kr. 3.1 milliard, after a gain of S.kr. 1.8 milliard in 1966, reflecting mainly an increase in their holdings of government securities and mortgage bonds and an improvement in their net foreign position.

Monetary policy was tightened sharply in November to counter capital outflows following the sterling devaluation. Thus, after the Riksbank had lost almost S.kr. 1 milliard of reserves in one month, the discount rate was raised from 5 to 6 per cent. and a penal interest rate of 9 per cent. was imposed on commercial-bank indebtedness to the central bank in excess of 50 per cent. of own funds. Moreover, half of banks' foreign balances were no longer allowed to count towards the liquidity ratios which they must satisfy to avoid paying penal rates on indebtedness to the central bank in excess of 25 per cent. of own funds. This was reinforced by the temporary requirement that larger banks freeze 2 per cent. and smaller banks 1 per cent. of their deposits at the Riksbank. This end-year tightening accounted for an increase over the year of S.kr. 1 milliard in commercial-bank indebtedness to the central bank. Some capital reflux permitted reduction of the discount rate to 5½ per cent. in February, and frozen deposits were released.

In the spring of 1968 policy remained cautious. Although employment programmes are to be intensified, the budget for 1968–69 envisages a reduction in the deficit to S.kr. 2.7 milliard. Changes in taxation, related mainly to the introduction of a value added tax system in January 1969, are to have a roughly counterbalancing effect on revenue.

Finland. In October 1967, scarcely ten years after its exchange parity had been lowered by 28 per cent., the Finnish markka was devalued again, by 23.8 per cent. The difficulties which led to this step, though they reached a culmination last year, stretch back over a longer period. They appear to have derived mainly from the persistence of cost/price inflation, the intensity of which was ascribable partly to the widespread use of indexation arrangements. The most crucial single year seems to have been 1964, after which official reserves declined almost without interruption despite considerable recourse to foreign borrowing.

In the years 1964–66 hourly earnings rose by an average of 10 per cent. a year, the biggest increase having been that of 13.2 per cent. in 1964, when a 10 per cent. cost-of-living adjustment was granted. Over the same three years consumer prices moved ahead at the rate of 6½ per cent. annually. Exports, it is true, rose quite satisfactorily in 1964 and 1965, a fact which may even have accentuated the inflationary spiral. But imports rose by almost 25 per cent. in 1964 alone and by an average of 13 per cent. per annum over the three-year period. After 1965 exports grew more slowly, and the rise recorded in the first three quarters of 1967 was entirely attributable to increased exports to the Soviet Union.

In the first half of 1967 monetary policy remained restrictive. In this period the banks were under an obligation to reduce their rediscounting to within certains limits. Moreover, in order to offset the effect of a F.mk. 300 million central-bank loan to the Treasury in December 1966, they had to make special deposits with the Bank of Finland related to the increase in their resources. In June the banks were given detailed directives on lending priorities. In the previous autumn, moreover, fiscal policy had become more restrictive, with the 1967 budget providing for increases in purchase tax and in the personal income and property tax. Under the influence of monetary and fiscal restraint, productive investment and housing weakened, leading to a fall in output in the spring. Although imports fell too, the emergence of unemployment and the stagnation of exports, together with the gradual exhaustion of the IMF credit arranged the preceding March, led to devaluation in the autumn.

Devaluation was accompanied by an export levy — initially 14 per cent. and reducible in stages — the proceeds of which were to be frozen at the central bank pending release for specified investment purposes. Other measures included the advance abolition of duties on EFTA imports, higher taxes on tobacco and cigarettes and a price freeze relating to all items in the cost-of-living index. Partly owing to the liquidity effects of the external deficit, the credit institutions' lending remained under restraint, rising in 1967 as a whole by 8.4 per cent., as against 11.6 per cent. in each of the two preceding years.

The 1968 budget, presented after the devaluation, though calling for a substantial increase in public lending and investment, was in overall balance. More significantly, the government embarked in April 1968 on an extensive stabilisation programme providing for the abolition of indexation arrangements in respect of wages, bank deposits, new government bond issues and most other contracts. In addition, it called for a limit on increases in wages and agricultural prices, together with a freeze on other prices, rents and bank lending rates up to the end of 1969. Public spending is to be restrained, supplementary budgets are to be abolished, no tax changes are to be made before the end of 1969 and government loan issues are to be confined essentially to amounts needed for debt redemption. On the other hand, with balance-of-payments prospects improved, direct central-bank credits to the private economy have been increased in order to stimulate investment.

Eastern Europe.

Unusually good weather in 1966 had brought an exceptionally strong expansion of agricultural output in eastern European countries, which was an important factor behind the rapid growth of their total material product in that year. In 1967, therefore, it was to be expected that the overall rate of growth would slacken. But, despite more difficult conditions, the level of farm output was maintained in 1967 and industrial production in the area as a whole rose by 9½ per cent., compared with about 8½ per cent. in each of the two previous years. As a result, the slow-down in the pace of expansion of the material product was surprisingly moderate. This achievement was enhanced by the fact that the industrial expansion was almost everywhere associated with accelerated productivity increases, and included more rapid growth of consumer goods output, which permitted a further substantial improvement in real consumption standards.

These characteristics of progress in eastern Europe as a whole were particularly pronounced in the *Soviet Union*. There, global agricultural output managed a small advance on last year's record performance, with a 14 per cent. fall in the grain harvest offset by higher output in the animal sector. The feature of the year, however, was a 10 per cent. increase in industrial production — the highest rate of expansion achieved in the 1960s — made possible by improved productivity, which rose by 7 per cent., compared with 4½ per cent. in 1966. During 1967 wholesale prices were revised, making profits a less unreliable reflection of enterprise performance. It thus became possible to extend managerial independence to wider sectors of industry, leaving profit-linked incentives to stimulate productive efficiency at plant level. These incentives must be in terms of real living standards, however, if they are to be effective, and consumer supplies are receiving growing emphasis. This was reflected in last year's output pattern and in this year's production plan, which envisages faster expansion in the consumer goods sector than in the capital goods industries, thus breaking with a long-standing principle of Soviet planning.

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

Country	Net material product			Global industrial output			Global agricultural output		
	1965	1966	1967	1965	1966	1967	1965	1966	1967
	real annual increases, in percentages								
Albania	3.0	9.0	7.5	6.4	12.0	12.6	— 3.0	15.0	12.0
Bulgaria	7.1	11.1	9.0	13.7	12.2	13.4	1.8	14.3	1.0
Czechoslovakia .	3.4	10.8	8.0	7.9	7.4	7.1	— 3.9	10.5	3.5
Eastern Germany	4.4	5.3	5.0	6.2[1]	6.4[1]	6.8[1]	.	.	.
Hungary	1.1	8.4	7.0	4.8	6.6	9.1	— 5.3	7.9	1.0
Poland	7.0	7.2	6.0	9.0	7.4	7.5	7.7	5.4	2.3
Rumania	9.7	9.8	7.5	13.1	11.7	13.5	6.7	14.0	1.0
USSR.	6.9	7.5	7.0	8.7	8.6	10.0	2.0	9.8	1.0
Yugoslavia . . .	3.4[2]	8.6[2]	0.3[2]	8.0	4.0	0.0	— 9.1	16.0	— 2.0

[1] Commodity production (i.e. excludes work in progress). [2] Gross material product.
Source: UN Economic Commission for Europe, *Economic Survey of Europe in 1967*.

Because of the slow growth of the industrial labour force, the acceleration of productivity gains is particularly important in *eastern Germany*, where stable industrial expansion was maintained in 1967. This applies also to *Czechoslovakia*, where, after the difficulties of the early 1960s, industrial output has now risen by over 7 per cent. for three years running. In Czechoslovakia, especially, future progress depends upon the outcome of the present economic reforms, which are more far-reaching than those in most other eastern European countries and which aim at establishing a form of market socialism open to the stimulus of external competition. Planning in many sectors has now become indicative in function, rather than directive, and producers already enjoy considerable independence in their decision-taking. It is, therefore, inevitable that transition to a new basis for price formation, started during 1967, should raise difficulties. But it is a crucial step towards more efficient resource allocation within the economy and closer economic integration with the rest of the world.

In *Hungary*, where comparable changes in the management of the economy are being introduced this year, industrial development in 1967 was encouraging. Production rose by 9 per cent., compared with 6½ per cent. in 1966, with above-plan increases in both employment and productivity, and the structure of output improved with the closure of high-cost coal-mines and rapid growth of production in the food-processing and light industries. The development of *Polish* industry in 1967, on the other hand, was somewhat disappointing and differed significantly from that in other countries. Expansion of the consumer industries slowed down and the overall rate of industrial expansion was maintained largely through higher employment, with productivity growth falling to 3.5 per cent. — the lowest in the area (excluding Yugoslavia). Both these developments tended to aggravate tension in the consumer market during the year.

Among the less industrialised countries of the group, *Rumania* and *Bulgaria* both raised industrial output by some 13½ per cent., compared with around 12 per cent. in 1966. While Rumania achieved the greater increase in output per worker — 9½ per cent., against 8 per cent. in 1966 — the productivity improvement was more marked in Bulgaria, with an increase of over 8 per cent. in 1967 compared with one of under 3 per cent. a year earlier. Industrialisation also speeded up in *Albania*, where output rose by 12.8 per cent., and it now seems to have regained momentum after the more modest progress registered in the first half of the decade. This may be partly associated with increased supplies of agricultural materials, since a further large rise in farm output was recorded in 1967, bringing the level of production to well over 25 per cent. above that achieved in 1965.

Throughout eastern Europe industrial performance in the past two years has been significantly above the planned level. This may be related to the greater emphasis given to material incentives offered in relation to attainable targets, which has helped to arrest the longer-term trend towards slower industrial growth. Plans for 1968 are again modest in that they are generally below the rates of expansion achieved last year. There is similar moderation, by comparison with past years, in agricultural planning. These targets must now, however, be regarded as the probable minimum rates of expansion.

Economic performance in *Yugoslavia* during 1967 provides a somewhat bleak contrast with the progress in other eastern European countries. Gross material product showed no significant advance, with agricultural output below its record 1966 level and industrial production stagnating. The pause in the industrial sector was essentially policy-induced, resulting from stringent monetary restriction introduced in the second half of 1966 and strengthened early in 1967, the aim being to restore wage discipline by cutting back enterprise liquidity. This policy was relaxed once the pressures had moderated in 1967 and further stimulus was given in the spring of this year. With spare capacity in the economy, industrial expansion at a rate of some 3–4 per cent. is expected in 1968.

The excessive expansion of money incomes, further import liberalisation and the slower growth of markets in western Europe contributed to an increase in Yugoslavia's visible trade deficit last year to $450 million. Thanks to higher net invisible earnings, however, the current account worsened by only $12 million to a $60 million deficit and, as this was more than met by a net inflow of capital, official reserves rose by $19 million.

Canada.

Although monetary policy had been eased somewhat the previous summer, a continuing decline in house-building and inventory accumulation caused output to fall by the first quarter of 1967. A rebound in these same two spending categories pushed output up again from the spring onwards. By this time, however, business investment had begun to decline and this kept down the overall rate of advance.

The upturn in activity, which began well before that in the United States, was encouraged partly by the buoyancy of exports and partly by a timely relaxation in monetary and fiscal restraints. In two stages the Bank of Canada lowered its discount rate from 5¼ to 4½ per cent. by early April and concurrently provided liquidity to the banks on a generous basis. Moreover, as industrial investment was flagging, the government removed certain deterrents that had been imposed in the 1966–67 budget — the 5 per cent. refundable tax on corporate profits, the reduction in depreciation allowances and the special tax on new machinery and equipment. Finally, public-authority mortgage lending was temporarily increased and the budget presented in June was mildly stimulatory in tone.

With business investment falling, the expansion of output was insufficient to absorb the rapidly growing labour force. Unemployment consequently increased from 3½ to 4½ per cent. over the year. On the other hand, as a result of wage settlements amounting typically to 8–9 per cent., earnings moved well ahead of productivity gains. Labour unit costs reached a level 10 per cent. above that of three years earlier, and consumer prices for non-food items rose faster than in 1966.

In view of these cost/price pressures, new measures were forthcoming in the autumn. From late September onwards monetary policy was tightened, being reflected in a decline in the banks' liquid assets. In two steps, one before and the second after the sterling devaluation, the Bank of Canada raised its discount rate from 4½ to 6 per cent. At the end of November the government presented an autumn budget in which it proposed by means of expenditure economies and revenue measures to reduce its cash requirement from $1,500 million in the fiscal year 1967–68 to half that figure in the year beginning next July. However, this programme was partially rejected by Parliament early in 1968, leading the government to make new proposals, the main features of which were a temporary 3 per cent. surcharge on personal and corporate income taxes and a speeding-up of corporation tax collection.

In 1967 deposits with the chartered banks in Canadian dollars, together with the currency circulation, rose by 14 per cent., as against 6.7 per cent. in 1966. This acceleration was to a considerable extent a result of the entry into force in May of the new Bank Act, which strengthened the banks' ability to compete with other institutions for funds. The interest rate ceiling on loans was raised from 6 to 7¼ per cent. for the remainder of 1967 and was removed altogether at the beginning of 1968. The banks were also given the power to make mortgage loans and to issue debentures not subject to cash reserve requirements. In line with their greater resources, the banks accelerated their lending, particularly in the form of term loans to business, and they also added substantially to their holdings of government securities.

Beginning in the spring of 1967 the capital market came gradually under increasing strain. While developments in the United States were very influential, large issues by the central government, related to its growing budget deficit, also played an important rôle. Total new issues in Canadian dollars in 1967 were 20 per cent. higher than in 1966. Between the spring and the end of the year the average yield on long-term government bonds rose by a full percentage point to over 6½ per cent.

The announcement of the US balance-of-payments programme in January 1968 gave rise to a large-scale capital outflow from Canada and brought new tensions to financial markets. On 22nd January the official discount rate was raised from 6 to 7 per cent. Later, as another step, designed indirectly to reduce outflows of short-term capital, the chartered banks were asked not to enter into or renew swap agreements providing their customers with foreign currency deposits. On 7th March the United States granted Canada complete exemption from the balance-of-payments measures announced in January. In the middle of March, following the increase in the US discount rate, the Bank of Canada raised its rate to 7½ per cent., and shortly afterwards the yield on long-term government bonds rose to above 6.9 per cent.

Japan.

The economic upswing that had begun in mid-1965 gathered strong momentum in 1966 and continued unabated throughout 1967. In the first half of the year exports fell back, but this was compensated by an investment-led acceleration in domestic demand. In this period pressures on the labour market became more intense and earnings went on rising rapidly. The budget for the fiscal year beginning April 1967, though less expansionary than the preceding one, continued to give considerable impetus to spending. Up to the summer no new monetary steps were taken, but the drain on liquidity associated with the external deficit had some tightening effect.

Beginning in late July both fiscal and monetary conditions became progressively more restrictive. At that time scheduled flotations of government and government-guaranteed bonds were reduced by 10 per cent. on the grounds of increasing buoyancy of revenue. In addition, ceilings on credit from the central bank were tightened for the big city banks. On 1st September the official discount rate was raised from 5.475 to 5.84 per cent., and quantitative ceilings on the expansion of bank lending, which had been suspended in mid-1965, were reimposed. The increase in lending by the big city banks was limited in the third quarter to 95 per cent., and in the fourth quarter to 85 per cent., of that in the corresponding period of 1966. In early September the government announced the postponement of public expenditure to the amount of Yen 310 milliard, representing 7 per cent. of the total.

As a result of these measures, monetary expansion slowed down noticeably in the later months of 1967. For the year as a whole, however, the banking system's monetary and quasi-monetary liabilities rose by 15.5 per cent., or only slightly less than the increase of 16.3 per cent. in 1966. These figures are almost identical with the corresponding ones for changes in lending to the private sector. The banking system's lending to the public sector, though proportionately small, again rose substantially in percentage terms, while net foreign assets declined.

At the turn of 1967–68, when the rise in consumer prices had accelerated and the external deficit had become larger, still further difficulties were threatened by the sterling devaluation and the US balance-of-payments programme. To help remedy the situation, the Bank of Japan in December lowered the limit on the expansion of bank lending in the first quarter of 1968 to 71 per cent. of the figure in the corresponding period of 1967. In addition, in early January it raised the official discount rate to 6.205 per cent. The budget for 1968–69, which was introduced about this time, provides for an increase in expenditure somewhat less than the estimated rise in gross national product. The growth in general-account expenditure is to fall to 11.8 per cent., from 16.2 per cent. last year, while the investment and loan programme is to increase by only 7.3 per cent., as against 18.2 per cent. The limit on government bond flotations was also correspondingly reduced.

The tighter monetary conditions prevailing in the early spring of 1968 are reflected in interest rates. The yield on government ("Telegraph and Telephone") bonds stood at about 8.7 per cent., or about 1¼ percentage points higher than a year earlier. The call-money rate, at nearly 7.7 per cent., had risen by about 1.8 points over the year.

III. WORLD TRADE AND PAYMENTS.

The expansion of world trade slowed down in 1967. World exports, measured in current values, rose by 5 per cent., compared with 10 per cent. in the previous year and an average of 10 per cent. during the years 1963–66. This slower rate of growth reflected the slackening of economic activity in certain key industrial areas. The deceleration was most marked in the developing countries, whose exports increased by only about 1.5 per cent., compared with an average annual rise of 7.5 per cent. in the preceding four years. The growth rate of world exports also slackened perceptibly in the course of the year, from 7.5 per cent. in the first quarter (as compared with the corresponding period of 1966) to 2.5 per cent. in the fourth quarter.

International trade.

Areas	Exports			Imports			Changes in volume of	
							exports	imports
	1965	1966	1967	1965	1966	1967	1967	
	in milliards of US dollars						in percentages	
Developed areas								
Western Europe								
EEC	47.9	52.7	56.2	49.2	53.7	54.9	+ 6.5	+ 3.0
EFTA	26.6	28.5	29.1	32.2	33.9	35.8	—	+ 5.0
Other countries	5.1	5.7	6.1	8.8	10.0	10.0	+ 9.0	—
Total for western Europe	79.6	86.9	91.4	90.2	97.6	100.7	+ 5.0	+ 3.0
United States	27.5	30.4	31.6	23.2	27.7	29.1	+ 3.5	+ 5.0
Canada	8.5	10.0	11.0	8.7	10.2	11.0	+ 7.5	+ 7.0
Japan	8.5	9.8	10.5	8.2	9.5	11.7	+ 5.0	+26.0
Other areas[1]	5.5	5.9	6.5	7.5	7.3	7.8	+13.5	+ 6.0
Total for developed areas	129.6	143.0	151.0	137.8	152.3	160.3	+ 5.5	+ 7.0
Developing areas								
Latin America	10.4	11.0	11.0	8.8	9.7	10.0	+ 3.5	+ 3.0
Other areas	25.4	27.4	28.2	28.5	30.5	31.1	+ 1.0	+ 2.0
Total for developing areas	35.8	38.4	39.2	37.3	40.2	41.1	+ 1.5	+ 2.0
Grand total[2]	165.4	181.4	190.2	175.1	192.5	201.4	+ 5.5	+ 6.0

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

In terms of volume, however, the slowing-down in the growth of world exports was less than appears from the value figures — namely, from 7.5 per cent. in 1966 to 5.5 per cent. This was because export prices, which had risen by 2 per cent. in 1966, declined last year by 1 per cent. Whereas prices of manufactured goods as a whole remained stable, prices of primary commodities fell by 3 per cent. The decline was mainly due to a fall in the prices of non-food agricultural products, particularly those exported from developed countries. Wool prices went down by 15 per cent. and those of oils and fats by 8 per cent. Prices of food products remained stable in both developed and developing areas. As regards the trend in the course of the year, commodity prices remained unchanged in developing areas, while in developed areas they declined continuously, reflecting the fall in prices of non-food agricultural products. In the last quarter of 1967 they were 6 per cent. lower than in the corresponding period of 1966. This movement was reversed in the spring of 1968.

In contrast with 1966, when exports from North America and Japan had expanded faster, in terms of value, than those from western Europe, the rates of increase in these areas were closer to each other last year. Exports from Canada registered the fastest advance, 10 per cent., owing mainly to record sales of motor-cars to the United States. The EEC group of countries and Japan followed, with increases of nearly 7 per cent. each. Exports from the United States and the EFTA countries went up by 4 and 2 per cent. respectively. Imports into most industrial areas rose less than in the previous year. The deceleration was most marked in the United States, where the growth rate fell from 20 to 5 per cent., mainly in response to recessionary conditions in the first half of the year. In Japan, on the other hand, a vigorous expansion pushed imports up by 23 per cent., compared with 16 per cent. in 1966.

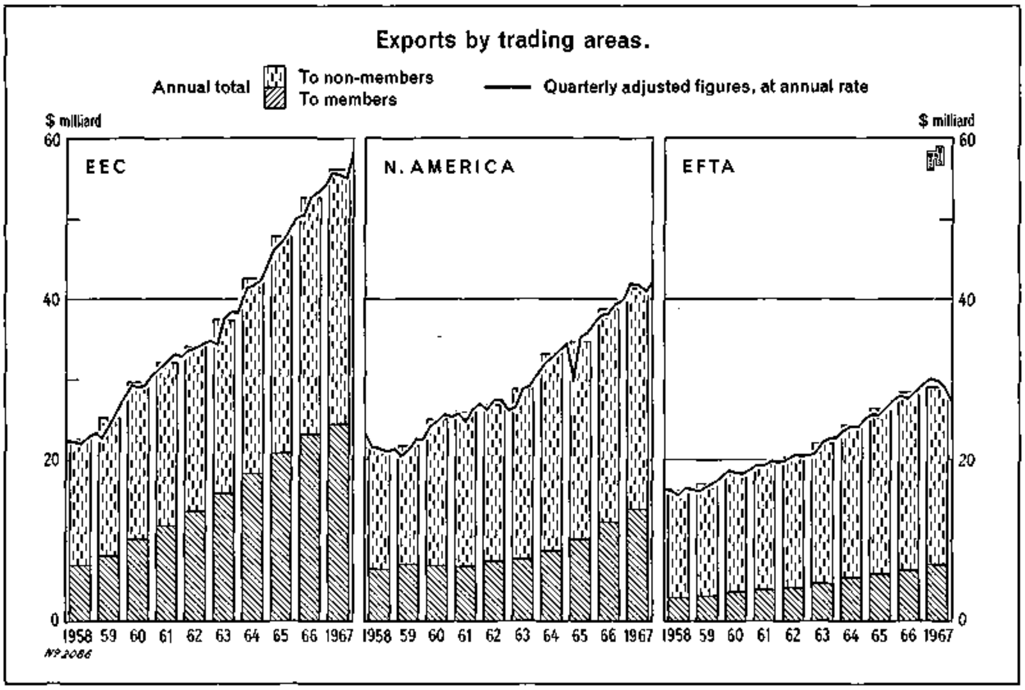
Exports of the group comprising Australia, New Zealand and South Africa went up by 12 per cent. last year. While New Zealand's exports declined by 7.5 per cent. because of a sharp fall both in the volume of sales of wool and in wool prices, Australian exports rose by 10 per cent., as the volume of its sales of wheat roughly doubled. Exports from South Africa, which are more diversified than those of the other two countries, expanded by nearly 15 per cent.

Trade between the EEC countries, which had risen by 11.5 per cent. in 1966, increased by only 5.5 per cent. last year, mainly on account of the German recession. (Germany's imports from its partner countries fell off slightly and its total imports declined by 3.5 per cent.) EEC sales to third countries advanced by 8 per cent., practically as much as in the previous year. Total exports from Germany, Italy and the Netherlands grew by about 8 per cent. and those from the BLEU and France by 3 and 4 per cent. respectively. The deceleration from 7 to 2 per cent. in the growth rate of exports from EFTA countries reflected the decline in UK sales by 2 per cent. in terms of dollars, although they remained unchanged in terms of sterling. The other six countries' exports expanded by about 7 per cent., those of Denmark showing the least progress.

Although the OECD countries' trade with the centrally-planned economies remains small in absolute terms — in 1967 exports to these areas amounted to $6.2 milliard, or less than 4.5 per cent. of OECD countries' total exports — it has been expanding fast in recent years. In 1966 it increased by 23 per cent. owing to large Canadian shipments of grain to the USSR and China. Such shipments were reduced by about half last year but, on the other hand, sales from the EEC rose by 26 per cent., those to the USSR expanding by as much as 66 per cent. In all, OECD exports to these areas went up by 7 per cent. in 1967. It is estimated that trade between the centrally-planned economies, which is not included in the preceding table, rose by some 8 per cent. last year, or somewhat faster than in 1966, when the prices of a number of products entering intra-area trade had been lowered.

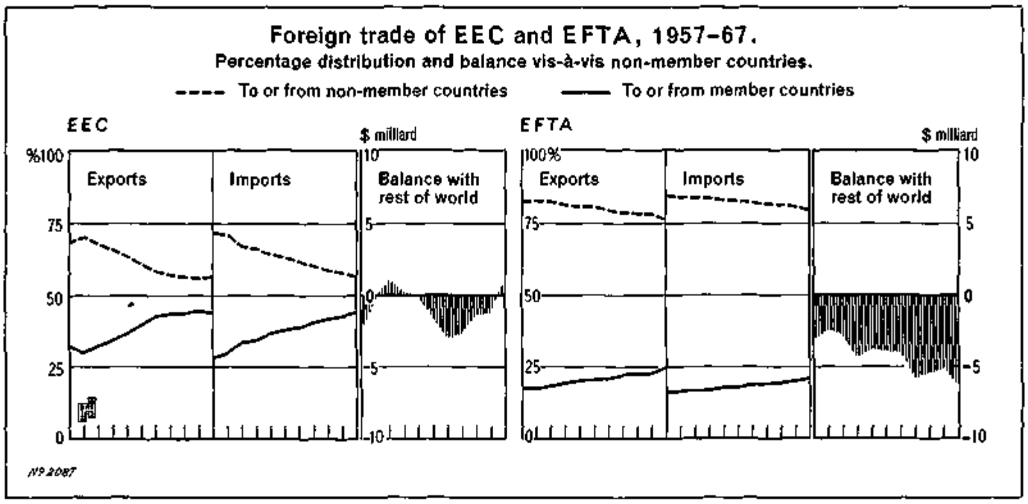
Exports from developing countries showed two divergent trends: an increase of some 10 per cent. in sales from oil-producing countries and a 2 per cent. decline in exports from all other countries. As imports into the latter went up also by 2 per cent., their import surplus, which had totalled $7 milliard in 1966, probably exceeded $8 milliard last year.

A longer-term view of regional trade developments is afforded by the accompanying graphs. Whereas in 1958 the EEC countries' and North America's exports were approximately equal at some $22 milliard, in 1967 the former amounted to $56 milliard and the latter to $42 milliard, so that at the end of the ten-year period the EEC's exports were two and a half times as great, and those from North America not quite twice as great, as at the beginning. The EFTA countries' exports rose by roughly four-fifths, from $16 to 29 milliard. From 1958 to 1967 the share of the EEC in the export total for the three areas expanded from 38 to 44 per cent., while that of North America fell from 35 to 33 per cent. and that of the EFTA from 27 to 23 per cent. The growth trend, based on quarterly adjusted figures at annual



rates, rose more steeply in all three areas from 1963 onwards. In 1967, however, it turned downwards in the EFTA countries.

In 1957, the year before the Rome Treaty came into force, the intra-area trade of EEC countries was already much larger than that of the EFTA countries, the respective totals having been \$7 and 3 milliard. In the EEC it represented roughly a third of the group's total exports, in the EFTA less than a fifth. Ten years later, owing to the higher rate of expansion of intra-area trade in the EEC than in the EFTA, the figures were \$25 and 7 milliard respectively. In 1967 intra-area trade accounted for 45 per cent. of the EEC's exports and 25 per cent. of the EFTA's exports. The EEC's imports from non-member countries increased from \$18 to 31 milliard in the period under review, but their share in the EEC's total imports declined from 70 to 55 per cent. That the EFTA countries' dependence on the outside world remained much greater is illustrated by the fact that, though the expansion in their imports from non-member countries — from \$17 to 28 milliard — was roughly the same as in the case of the EEC, the share of non-member countries in the group's total imports diminished only from 85 to 80 per cent.



In the course of the period 1957–67 the EEC's trade balance vis-à-vis non-member countries went through three distinct phases: an improvement in the late 1950s, when there was a decline in imports, a deterioration up to 1963, owing to rapidly expanding imports and a slow-down in export growth, and continuous improvement thereafter. In 1967 the balance was back into surplus. The EFTA countries, on the other hand, have a structural deficit vis-à-vis non-member countries, which has tended to increase.

The aggregate current account of western European countries shifted from a deficit of \$0.55 milliard to a surplus of \$1.2 milliard last year. The EEC countries' surplus increased from \$1.4 to 3.9 milliard, while the EFTA countries' deficit widened from \$0.7 to 1.7 milliard.

The rise in the EEC surplus was mainly due to a \$2.3 milliard increase in Germany's trade surplus. In addition, the other member countries' combined

Western European countries: Balances of payments.

Countries	Years	Trade balance (f.o.b.)	Services[1]	Current balance	Net capital movements (inflow +)[2] Long-term	Short-term	Overall balance[3]
		in millions of US dollars					
Belgium-Luxemburg. . .	1966	— 360	+ 265	— 95	— 75	+ 60	— 110
	1967	— 125	+ 340	+ 215	— 40		+ 175
France	1966	— 30	+ 70	+ 40	+ 10[4]	+ 290[5]	+ 340
	1967	+ 155	— 200	— 45	+ 75	— 65[5]	— 35
Germany	1966	+ 2,885	— 2,780	+ 105	— 195[4]	+ 540	+ 450
	1967	+ 5,195	— 2,780	+ 2,415	— 900	— 615	+ 900
Italy	1966	— 995[6]	+ 2,400	+ 1,405	— 825[4]	— 20	+ 560
	1967	— 1,120[6]	+ 2,405	+ 1,285	— 925	+ 15	+ 375
Netherlands	1966	— 605	+ 520	— 85	+ 50	— 5	— 40
	1967	— 485	+ 555	+ 70	— 165	+ 155	+ 60
Total EEC	1966	+ 895	+ 475	+ 1,370	— 1,035	+ 865	+ 1,200
	1967	+ 3,620	+ 320	+ 3,940	— 2,465		+ 1,475
Austria.	1966	— 670[6]	+ 480	— 190	+ 35	+ 90	— 65
	1967	— 545[6]	+ 435	— 110	+ 265	+ 50	+ 205
Denmark	1966	— 265	+ 205	— 60	+ 90		+ 30
	1967	— 300	+ 140	— 160	+ 95		— 65
Norway.	1966	— 850[6]	+ 690	— 160	+ 125	+ 40	+ 5
	1967	— 1,020[6]	+ 830	— 190	+ 345	+ 10	+ 165
Portugal	1966	— 340	+ 300	— 40	+ 115	+ 40[7]	+ 115
	1967	— 315	+ 365	+ 50	+ 120	+ 5[7]	+ 175
Sweden	1966	— 315[6]	+ 50	— 265	+ 360		+ 95
	1967	— 175[6]	— 5	— 180	+ 155		— 25
Switzerland.	1966	— 650[6]	+ 770	+ 120	— 135		— 15[8]
	1967	— 595[6]	+ 815	+ 220	— 105		+ 115
United Kingdom	1966	— 410	+ 325	— 85	— 285	— 40	— 410
	1967	— 1,715	+ 375	— 1,340	— 75	+ 550	— 865
Total EFTA . . .	1966	— 3,500	+ 2,820	— 680	+ 435		— 245
	1967	— 4,665	+ 2,955	— 1,710	+ 1,415		— 295
Finland	1966	— 240[6]	+ 30	— 210	+ 50	+ 15	— 145
	1967	— 180[6]	+ 15	— 165	+ 95	— 10	— 80
Greece	1966	— 725[6]	+ 490	— 235	+ 220	+ 40	+ 25
	1967	— 675[6]	+ 485	— 190	+ 170	+ 35	+ 15
Iceland	1966	— 5	— 5	— 10	+ 15	— 5	—
	1967	— 50	—	— 50	+ 20		— 30
Ireland	1966	— 360[6]	+ 315	— 45	+ 120		+ 75
	1967	— 295[6]	+ 325	+ 30	— 10		+ 20
Spain	1966	— 2,000	+ 1,420	— 580	+ 360	+ 15	— 205
	1967	— 1,900	+ 1,320	— 580	+ 460	— 35	— 155
Turkey	1966	— 230[6]	+ 70	— 160	+ 125		— 35
	1967	— 170[6]	+ 70	— 100	+ 115		+ 15
Total "Other" . .	1966	— 3,560	+ 2,320	— 1,240	+ 955		— 285
	1967	— 3,270	+ 2,215	— 1,055	+ 840		— 215
Grand total. . . .	1966	— 6,165	+ 5,615	— 550	+ 1,220		+ 670
	1967	— 4,315	+ 5,490	+ 1,175	— 210		+ 965

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

Note: In converting national currency data for Denmark, United Kingdom, Finland, Iceland, Ireland and Spain into dollars, adjustments have been made for the estimated effects of changes in parities.

trade deficit declined by $0.4 milliard. On the other hand, the EEC's net receipts from services fell by $0.2 milliard. In the BLEU and the Netherlands the current account shifted from deficit to surplus, owing chiefly, in each case, to a reduction in the trade deficit. The current balances of France and Italy deteriorated in comparison with 1966. In France there was a worsening on services account, while in Italy the trade deficit increased. In the first quarter of 1968 the current surplus of EEC countries was almost wholly offset by a long-term capital outflow. Owing, however, to very large unrecorded transactions, the overall balance showed a surplus of some $0.5 milliard.

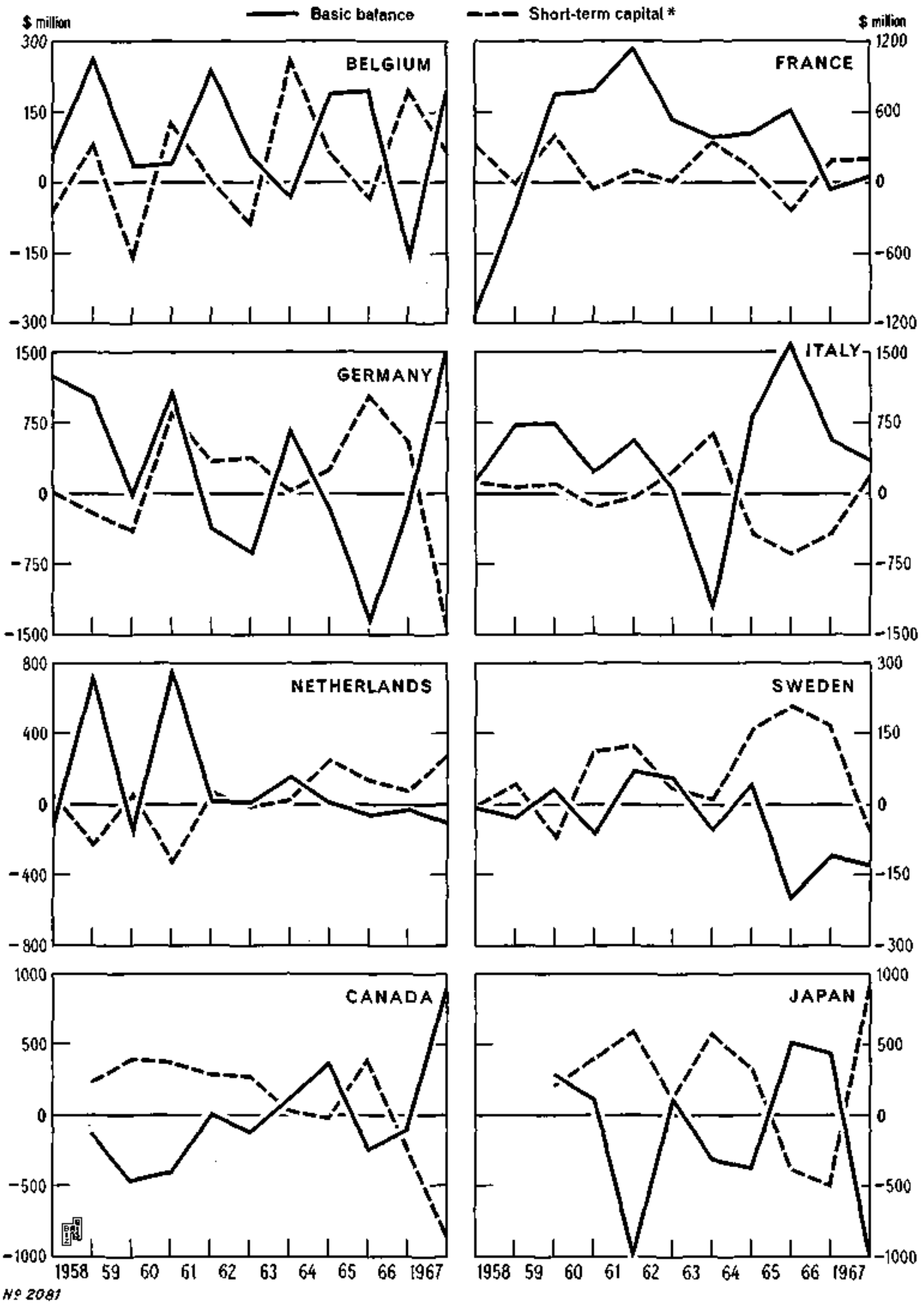
The $1 milliard rise in the deficit of the EFTA countries in 1967 included a deterioration of $1.3 milliard in the UK trade balance (details of the latter are given in Chapter I). This was partly compensated by a $140 million reduction in the trade deficit of the remaining six countries and a rise of $135 million in the whole area's net invisible receipts. Larger current deficits were recorded last year by Denmark and Norway. In the case of Denmark this was primarily due to a fall in receipts from services and in that of Norway to the rapid growth of imports. The remaining four countries showed better results than in 1966. In Austria and Sweden the trade deficit was reduced and in both countries this improvement more than compensated the decline in receipts from services. Portugal's current account shifted from deficit to surplus, mainly owing to higher receipts from workers' remittances. In Switzerland, finally, about half of the larger current surplus was due to an improvement in the trade balance and the remainder to an increase in invisible receipts.

The combined current deficit of the six countries outside the EEC and the EFTA was reduced by $200 million. All, except Iceland, achieved an improvement in their trade account.

In the three groups of countries capital movements had a compensatory effect last year. In the EEC there was a net outflow of $2.5 milliard, most of it representing long-term capital exports from Germany and Italy. The EFTA countries recorded a net inflow of $1.4 milliard, the main recipients having been the United Kingdom, Norway and Austria. The net inflow into the remaining six countries amounted to $0.8 milliard, roughly half of which went to Spain. In all, western Europe recorded a net capital outflow of $210 million, compared with an inflow of $1,220 million in the previous year.

The behaviour of capital movements over the past decade may be seen in more detail for the eight countries represented in the following graph. This shows, on the one hand, the balances on current and long-term capital account, or basic balances, and, on the other, short-term capital movements, including errors and omissions and changes in the net external positions of commercial banks. During the greater part of this period short-term capital movements in most of the eight countries tended to offset the basic balance of payments — partly in response to market forces and partly as a result of central-bank policies. In the first few years, however, short-term capital movements in Belgium, Germany and Italy moved roughly in line with

Basic balances of payments and short-term capital movements.



* Including balancing items and changes in the banks' net external positions.

changes in the basic balance. But this can be explained by some special factors at work at the time. Thus, in 1960 Germany simultaneously recorded a very large basic surplus and, in conjunction with the relatively high domestic interest rates, a substantial short-term capital inflow, mostly to the German banks. During the course of the decade the size of the net short-term capital flows increased in relation to that of the basic balances, and in recent years the flows have been more clearly of a stabilising nature than previously and have helped to limit changes in the official monetary reserves.

France. Over the last three years France's overall balance of payments has swung round from a surplus of $960 million to a small deficit. The change from 1965 to 1966 was largely due to a deterioration of the trade balance and a contraction of the net long-term capital inflow. The turn-round from a surplus of $340 million in 1966 to a deficit of $35 million in 1967 was the result of a shift from surplus to deficit in the services account and from a net inflow to a net outflow in the short-term capital account. The balance of trade, on the other hand, shifted from a small deficit to a surplus of $155 million.

The slowing-down of economic expansion in France and abroad put a curb on both imports and exports. As measured by customs statistics, imports from countries outside the franc area increased by 6 per cent., compared with 17 per cent. in the previous year. Imports of raw materials actually declined by 13 per cent., whereas those of manufactured products rose by 11 per cent. Exports, which had increased by 11 per cent. in 1966, went up by only 5 per cent. last year; those of capital goods, however, increased by 12 per cent. The trade deficit in regard to such countries widened from $905 to 1,080 million. Whereas the import surplus vis-à-vis other EEC countries increased by $440 million, the export surpluses in relation to the EFTA countries and eastern Europe showed gains of $100 and 40 million respectively, mainly on account of larger sales to the United Kingdom and the USSR. In trade with countries belonging to the franc area a $100 million shift took place from deficit to surplus, owing partly to a sharp decline in purchases of Algerian wine. From mid-1967 onwards total exports resumed growing at a faster rate than imports, and in the first quarter of 1968 the trade balance was much closer to equilibrium than twelve months before.

The balance of invisible items, which ever since 1959 had shown a surplus, switched to a deficit of $200 million last year. All major items except investment income showed a deterioration. Government transactions, which had recorded a surplus of $40 million in 1966, shifted to a deficit of $125 million owing to a fall in receipts (as a result of the removal of the NATO headquarters and the departure of US troops) and a rise in French expenditure abroad. A small deficit also appeared on travel account, while net outpayments in respect of remittances, though rising less fast than in the previous year, went up to $360 million.

The net inflow on account of private capital movements was about the same as in 1966, both French investment abroad and foreign investment in

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

Items	1965	1966	1967 Year[2]	1967 1st quarter	1967 2nd quarter	1967 3rd quarter	1967 4th quarter
	in millions of US dollars						
Merchandise trade (f.o.b.)							
Exports	8,265	8,985	10,135	2,355	2,495	2,595	2,650
Imports	7,935	9,015	9,980	2,375	2,500	2,440	2,600
Trade balance	+ 330	— 30	+ 155	— 20	— 5	+ 155	+ 50
Services							
Investment income	+ 85	+ 90	+ 110	+ 30	+ 45	+ 5	+ 30
Travel	— 30	+ 10	— 20	+ 25	+ 75	— 130	— 25
Workers' remittances	— 275	— 330	— 360	— 80	— 90	— 100	— 95
Government transactions	+ 55	+ 40	— 125	—	— 55	— 30	— 50
Other	+ 295	+ 260	+ 195	+ 15	+ 15	+ 70	+ 95
Total	+ 130	+ 70	— 200	— 10	— 10	— 185	— 45
Current balance	+ 460	+ 40	— 45	— 30	— 15	— 30	+ 5
Long-term capital							
Private							
Net French investment abroad	— 175	— 215	— 390	— 45	— 65	— 90	— 170
Net foreign investment in France	+ 535	+ 370	+ 510	+ 90	+ 60	+ 145	+ 160
Total private	+ 360	+ 155	+ 120	+ 45	— 5	+ 55	— 10
Official	— 250[3]	— 145[4]	— 45	— 5	—	— 10	— 25
Total	+ 110	+ 10	+ 75	+ 40	— 5	+ 45	— 35
Balance on current and long-term capital account	+ 570	+ 50	+ 30	+ 10	— 20	+ 15	— 30
Short-term capital, multilateral settlements and adjustments[5]	+ 390	+ 290	— 65	+ 35	+ 150	— 45	— 150
Total balance (= changes in monetary items)	+ 960	+ 340	— 35	+ 45	+ 130	— 30	— 180

[1] Cash balance. [2] The sum of the quarters does not tally with the annual figure, as revisions are included in the total for the year but not in the quarterly figures. [3] Including a debt prepayment of $180 million to the US Export-Import Bank. [4] Including a debt prepayment of $70 million to the United States. [5] Including merchanting transactions, which were formerly recorded partly under "Imports" or "Exports" but chiefly under "Rest of French franc area". The latter heading has been discontinued, since the overall balance, which had previously included overseas territories in the French franc area, is now limited to French territory.

France increasing substantially. The former went up from $215 to 390 million and reflected mainly higher purchases of foreign securities. Security transactions, including for the first time French issues on international markets, also accounted for a large part of the rise from $370 to 510 million in foreign investment in France. With the disappearance of the surplus in the balance of payments, no debt prepayment took place in 1967. As a result the official capital outflow was only $45 million. On short-term capital account, where there had been substantial inflows in previous years, there was a net outflow in 1967, mainly owing to large private gold purchases in the second half of the year.

Germany. Two factors were of primary importance in the development of Germany's balance of payments in 1967: the weakening of domestic demand and the consequent relaxation of monetary policy. The first of these factors produced an increase in the export surplus from $2 to 4.2 milliard, the largest ever recorded. With the deficit on services and unilateral transfers diminishing from $1.9 to 1.8 milliard, the current surplus rose from $0.1 to 2.4 milliard. At the same time the change in domestic monetary conditions led to opposite movements in the capital account. In the long-term sector the net outflow rose from $0.2 to 0.9 milliard, while at short term there was a shift from an inflow of $0.4 milliard to an outflow of nearly the same magnitude.

In 1967 imports decreased by $600 million to $17.5 milliard, or by 3.5 per cent. The decline affected chiefly manufactured products, in particular consumer goods, purchases of which contracted by 13 per cent. Imports of capital goods fell off by 2 per cent., but their share of the German market continued to grow, since domestic sales of capital goods went down by as much as 7 per cent. Good crops cut imports of foodstuffs by nearly 5 per cent. On the other hand, overall purchases of raw materials increased slightly. Finally, imports of defence equipment were 10 per cent. down on the year. Most of the decline in imports occurred in the first part of 1967; with the incipient recovery in the autumn imports began to pick up and in the fourth quarter they exceeded the previous year's level by 4 per cent. In the first quarter of 1968 they were 16 per cent. up on the year while exports were up by 12 per cent.

Exports increased last year by $1.6 milliard to $21.8 milliard, or by 8 per cent., compared with 12.5 per cent. in 1966. The rate of expansion slackened most in relation to the United States — from 25 to 9.5 per cent. In trade with other EEC countries it came down from 16 to 9 per cent. The largest relative gain took place in relation to centrally-planned economies, exports to which rose by 36 per cent. and accounted for 6 per cent. of the year's overall total. Sales to the United Kingdom increased by 11 per cent., while those to most other countries of the EFTA group declined. The growth rate of vehicle exports showed the greatest contraction, viz. from 9.0 to 0.5 per cent. Exports of machinery and consumer goods, which had expanded by some 15 per cent. in 1966, rose by less than 10 per cent. last year.

The deficit on services was reduced from $320 to 235 million. Net expenditure on travel was cut by $115 million, reflecting the impact of the recession on German travel abroad. Net outpayments on investment income account were nearly $100 million greater than in 1966 and net receipts from "other" services increased by $65 million, mostly on account of larger receipts from foreign troops and merchanting trade. The former were compensated by advance payments (registered as a short-term capital outflow) for US deliveries of defence equipment. Unilateral transfers amounted to $1.6 milliard, the same as in 1966. The number of foreign workers fell by over 200,000 in 1967 — as a consequence, remittances dropped by some $90 million. On the other hand, official transfers rose by about the same amount, net

Germany: Balance of payments.[1]

Items	1966	1967 Year	1967 1st quarter	1967 2nd quarter	1967 3rd quarter	1967 4th quarter	1968 1st quarter
	in millions of US dollars						
Merchandise trade							
Exports (f.o.b.)	20,155	21,760	5,190	5,475	5,175	5,920	5,835
Imports (c.i.f.)	18,165	17,545	4,110	4,365	4,225	4,845	4,750
Trade balance	+ 1,990	+ 4,215	+ 1,080	+ 1,110	+ 950	+ 1,075	+ 1,085
Services							
Travel	− 775	− 660	− 115	− 150	− 340	− 55	.
Investment income	− 405	− 500	− 75	− 115	− 165	− 145	.
Other	+ 860	+ 925	+ 165	+ 195	+ 290	+ 275	.
Total	− 320	− 235	− 25	− 70	− 215	+ 75	+ 75
Unilateral transfers							
Workers' remittances	− 630	− 545	− 130	− 130	− 145	− 140	− 110
Other	− 935	− 1,020	− 260	− 280	− 220	− 260	− 270
Total	− 1,565	− 1,565	− 390	− 410	− 365	− 400	− 380
Current balance	+ 105	+ 2,415	+ 665	+ 630	+ 370	+ 750	+ 780
Long-term capital							
Private							
Net German investment abroad	− 630	− 850	− 185	− 185	− 250	− 230	− 455
Net foreign investment in Germany	+ 1,055	+ 300	+ 135	+ 25	+ 120	+ 20	+ 40
Total private	+ 425	− 550	− 50	− 160	− 130	− 210	− 415
Official	− 620[2]	− 350	− 45	− 90	− 70	− 145	− 45
Total	− 195	− 900	− 95	− 250	− 200	− 355	− 460
Balance on current and long-term capital account	− 90	+ 1,515	+ 570	+ 380	+ 170	+ 395	+ 320
Short-term capital							
Private	+ 425	− 395	+ 145	− 70	− 115	− 355	+ 10
Official	− 55	+ 45	− 20	− 65	+ 95	+ 35	+ 45
Total	+ 370	− 350	+ 125	− 135	− 20	− 320	+ 55
Errors and omissions	+ 170	− 265	+ 225	− 215	+ 25	− 300	+ 470
Total balance (= changes in monetary items)	+ 450	+ 900	+ 920	+ 30	+ 175	− 225	+ 845

[1] On a transactions basis. [2] Including a debt prepayment of $195 million to the United States.

payments to the Agricultural Fund of the EEC being nearly $50 million higher than in 1966.

The private long-term capital account shifted from a net inflow of over $400 million in 1966 to a net outflow of $550 million, mainly because of a decline of some $750 million in foreign investment in Germany. The easing of domestic monetary conditions had the biggest effect in the credit sector, where net borrowing of $335 million in 1966 gave way to net repayment of $95 million. In particular, the banks, which had taken in $100 million in

1966, repaid $175 million last year. The liquidation of foreigners' portfolio investment in Germany, which had started in 1966, accelerated last year from $85 to 180 million, since the yields of German fixed-interest securities fell well below those obtainable on Euro-bonds. Foreign direct investment in Germany came down from $835 million in 1966, when it included the $180 million Texaco transaction, to $610 million. Part of this inflow was accounted for by the reinvestment of profits and by the conversion of previous short-term credits. Net long-term German investment abroad rose last year from $630 to 850 million, largely in response to attractive interest rate differentials. The net outflow of long-term official capital came down from $620 to 350 million. In 1966 it had been boosted by an advance debt repayment to the United States of $195 million. In all, the long-term capital account recorded a net outflow of $900 million, compared with one of nearly $200 million in the previous year.

The short-term capital account shifted from a net inflow of $370 million to a net outflow of nearly the same magnitude. German enterprises, which in 1966 had taken up foreign credits to the amount of $430 million, repaid $250 million last year and, in addition, granted $140 million of credits to their customers abroad. Errors and omissions, which reflect to a large extent changes in trade credits, switched over from a substantial surplus to a deficit of $265 million. The overall surplus for 1967, as measured by the changes in monetary items, attained $900 million — twice the figure for 1966.

In the first quarter of 1968 the overall surplus amounted to $845 million, nearly as much as in the first quarter of 1967. The current surplus of $780 million was partly offset by a net long-term capital outflow of $460 million, so that the greater part of the overall surplus was accounted for by the net short-term capital inflow and the positive balancing item, which is normally very big in the first quarter.

Italy. The overall surplus on the Italian balance of payments, after reaching a peak of $1.6 milliard in 1965, fell to $560 million in 1966 and was further reduced to $375 million last year. The trade deficit rose by $125 million and the large private capital outflow, which had been so marked a feature of 1966, gained further momentum. In the first quarter of 1968 the capital outflow amounted to $440 million, while there was a current surplus of $265 million.

Measured on a customs basis, the growth rate of imports slowed down from 16 to 13 per cent. last year and that of exports from 12 to 8 per cent. Imports of fuel and of capital goods led the field with gains of 24 and 19 per cent. respectively, reflecting in the latter case the expansion of investment. Imports of consumer goods went up by only 6 per cent., owing chiefly to a rise in purchases of meat and durable consumer goods. The sluggishness of exports to other EEC countries, due mainly to a 5 per cent. fall in sales to Germany, was partly offset by the continuing strength of demand from the EFTA area and from non-European countries and by the rapid growth of sales to eastern-bloc countries and Yugoslavia.

Italy: Balance of payments.[1]

Items	1966	1967 Year	1967 1st quarter	1967 2nd quarter	1967 3rd quarter	1967 4th quarter	1968 1st quarter
	in millions of US dollars						
Merchandise trade							
Imports (c.i.f.)	8,600	9,290	2,280	2,380	2,245	2,385	2,485
Exports (f.o.b.)	7,605	8,170	1,960	2,060	2,070	2,080	2,345
Trade balance	− 995	− 1,120	− 320	− 320	− 175	− 305	− 140
Services							
Travel	+ 1,200	+ 1,125	+ 145	+ 270	+ 500	+ 210	+ 155
Workers' remittances	+ 730	+ 680	+ 140	+ 185	+ 180	+ 175	+ 145
Transport	+ 410	+ 445	+ 95	+ 110	+ 120	+ 120	+ 115
Other	+ 60	+ 155	− 45	+ 35	+ 130	+ 35	− 10
Total	+ 2,400	+ 2,405	+ 335	+ 600	+ 930	+ 540	+ 405
Current balance	+ 1,405	+ 1,285	+ 15	+ 280	+ 755	+ 235	+ 265
Capital movements							
Long-term							
Private	− 640	− 870	− 290	− 185	− 155	− 240	− 385
Official	− 185[2]	− 55	+ 5	− 50	− 15	+ 5	− 55
Short-term	− 20	+ 15	+ 25	− 5	—	− 5	—
Total	− 845	− 910	− 260	− 240	− 170	− 240	− 440
Total balance (= changes in monetary items)	+ 560	+ 375	− 245	+ 40	+ 585	− 5	− 175

[1] On a cash basis. [2] Including a debt prepayment of $145 million to the United States.

Net receipts from services ceased to rise last year. Workers' remittances and income from travel fell by $50 and 75 million respectively, owing to a deterioration in cyclical conditions abroad and to measures taken by foreign countries. These losses were practically offset by larger receipts from transportation and smaller interest and dividend outpayments.

As regards Italian private capital, there were larger purchases of foreign securities owing to the policy of keeping domestic long-term interest rates relatively low. Direct investment abroad also rose, while credits granted to non-residents declined. The inflow of foreign private capital totalled $215 million, some $45 million less than in 1966. While on portfolio account there was a shift of $160 million from liquidations to net purchases, a turn-round of the same size but in the reverse direction occurred in long-term credits as a result of large-scale repayments by Italian borrowers. The inflow from direct investment and miscellaneous capital transactions fell by $50 million. The net outflow in respect of official capital, which had been boosted by a debt prepayment of $145 million in 1966, was reduced from $185 to 55 million. The above cash balance does not include trade credits; these have grown to large proportions in recent years mainly because of the expansion of Italian exports, which are customarily offered on deferred-payment terms. In each of the last two years the net outflow in respect of trade credits exceeded $500 million.

Netherlands. The overall balance of payments of the Netherlands shifted from a deficit of \$40 million in 1966 to a surplus of \$60 million last year as a result of a smaller trade deficit and increased receipts from invisible transactions.

For 1967 as a whole the growth of imports on a customs basis slowed down from 7.5 to 4 per cent. While imports of raw materials fell by 10 per cent. and those of capital goods decelerated sharply, there was a 10 per cent. rise in food imports notwithstanding good domestic crops of wheat and sugar. Exports continued to expand last year, the rate of growth coming to 8 per cent.; sales of agricultural produce recovered, rising by 10 per cent., while those of machinery and vehicles went up by only 2 per cent. As far as destination is concerned, there was an increase of 7 per cent. in exports to other EEC countries — a slightly faster rate of growth than in 1966 — while those to EFTA countries showed a rise of 8 per cent. after remaining stationary the year before. The growth of exports to this latter group of countries in 1967 reflected mainly a 16 per cent. increase in sales to the United Kingdom. As a result of these movements the trade deficit on a cash basis narrowed from \$605 to 485 million.

Netherlands: Balance of payments.*

Items	1966	1967 Year	1967 1st quarter	1967 2nd quarter	1967 3rd quarter	1967 4th quarter	1968 1st quarter
	in millions of US dollars						
Merchandise trade (f.o.b.)							
Imports	7,050	7,355	1,755	1,845	1,800	1,955	1,950
Exports	6,445	6,870	1,640	1,695	1,700	1,835	1,860
Trade balance	— 605	— 485	— 115	— 150	— 100	— 120	— 90
Services							
Investment income	+ 165	+ 245	+ 45	+ 15	+ 105	+ 80	+ 25
Other	+ 355	+ 310	+ 45	+ 80	+ 80	+ 105	+ 60
Total	+ 520	+ 555	+ 90	+ 95	+ 185	+ 185	+ 85
Current balance	— 85	+ 70	— 25	— 55	+ 85	+ 65	— 5
Capital movements							
Long-term							
Security transactions							
Dutch	+ 95	+ 40	+ 25	— 15	+ 35	— 5	+ 5
Foreign	+ 55	— 45	+ 5	— 20	— 25	— 5	— 30
Banks	—	— 65	—	— 35	— 20	— 10	— 15
Other private capital	— 75	— 75	— 45	— 5	— 30	+ 5	+ 15
Official	— 25	— 20	— 5	—	— 10	— 5	— 5
Total long-term	+ 50	— 165	— 20	— 75	— 50	— 20	— 30
Short-term	— 5	+ 155	— 5	+ 50	+ 40	+ 70	—
Total	+ 45	— 10	— 25	— 25	— 10	+ 50	— 30
Total balance (= changes in monetary items)	— 40	+ 60	— 50	— 80	+ 75	+ 115	— 35

* On a cash basis.

Net income from investment, which in the previous year had shown some decline, rose by $80 million last year. Part of this increase came from interest receipts on foreign issues on the Dutch market and part from higher dividend income, notably from the United States. Receipts from other invisible items continued their downward trend. They declined by $45 million in 1967 owing to a fall in transport receipts, a reduction in remittances as a result of a decline in the number of Dutch border workers employed in Germany, and a further deterioration on travel account.

Measured on a cash basis, the current account shifted from a deficit of $85 million to a surplus of $70 million. On a transactions basis, however, the improvement showed up in a reduction of the deficit from $200 to 100 million. This is a long way off the surplus of some $200 million, equivalent to 1 per cent. of the gross national product, which is aimed at in order to provide development aid.

On long-term capital account there was a net outflow of $165 million in 1967, which was almost wholly offset by short-term movements. Security transactions, which had resulted in an inflow of $150 million in 1966, were approximately balanced last year owing to a rise in purchases of foreign securities — mainly US shares — by Dutch residents. While net sales of foreign securities had amounted to $55 million in 1966, net purchases totalled $45 million last year. Purchases of Dutch securities by non-residents dropped from $95 to 40 million, chiefly as a result of a cut-back on the part of Belgian and Swiss investors. While no foreign issues were floated on the Dutch capital market in 1966, a Fl. 50 million ($14 million) loan was issued last year by the Netherlands Antilles. Net Dutch direct investment abroad went up by $85 million while net long-term borrowing from abroad rose by a similar amount. Long-term transactions by the banks moved from equilibrium to an outflow of $65 million. Total short-term capital transactions, on the other hand, shifted from equilibrium to an inflow of $155 million.

Belgium-Luxemburg Economic Union. The overall payments balance of the BLEU came back to surplus last year, as the trade deficit narrowed from $360 to 125 million. Import growth, as measured by customs statistics, came to an end in 1967 as a result of the slack in the Belgian economy (in particular the high level of stocks) and also of a decline in prices. Exports increased by 3 per cent., compared with 7 per cent. in the previous year. While sales to Germany and the Netherlands actually fell off, exports to France and Italy expanded by 13 and 26 per cent. respectively. Those to eastern Europe continued to grow fast, rising by 30 per cent. Net receipts from invisible items went up from $265 to 340 million in 1967, mainly as a result of increased receipts from transport and government transactions, which more than offset the growing expenditure on foreign travel.

Private capital movements, which had shown a small outflow in 1966, recorded a net inflow of $155 million last year. This shift was due mainly to a rise of foreign direct investment in the BLEU, from $140 to 230 million. Two-thirds of the inflow occurred in the second half of the year. Belgian

Belgium-Luxemburg Economic Union: Balance of payments.

Items	1966	1967 Year	1967 1st quarter	1967 2nd quarter	1967 3rd quarter	1967 4th quarter
	in millions of US dollars					
Merchandise trade						
Imports	5,690	5,800	1,380	1,490	1,370	1,560
Exports	5,330	5,675	1,370	1,465	1,340	1,500
Trade balance	− 360	− 125	− 10	− 25	− 30	− 60
Services						
Merchanting and processing	+ 270	+ 260	+ 70	+ 80	+ 55	+ 55
Travel	− 90	− 130	− 10	− 35	− 75	− 10
Transport	—	+ 35	+ 10	+ 10	+ 5	+ 10
Government transactions	+ 5	+ 80	+ 5	+ 20	+ 25	+ 30
Other	+ 80	+ 95	+ 20	—	+ 40	+ 35
Total	+ 265	+ 340	+ 95	+ 75	+ 50	+ 120
Current balance	− 95	+ 215	+ 85	+ 50	+ 20	+ 60
Capital movements						
Public authorities	− 50	− 140	− 65	− 50	− 45	+ 20
Semi-official*	+ 35	+ 30	+ 35	− 15	+ 15	− 5
Private						
Foreign investment in the BLEU	+ 145	+ 295	+ 50	+ 45	+ 95	+ 105
BLEU investment abroad	− 180	− 150	− 55	− 30	− 10	− 55
Other	+ 10	+ 10	+ 5	—	—	+ 5
Total	− 40	+ 45	− 30	− 50	+ 55	+ 70
Errors and omissions	+ 25	− 85	− 25	+ 45	− 110	+ 5
Total balance (= changes in monetary items)	− 110	+ 175	+ 30	+ 45	− 35	+ 135

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

private investment abroad, on the other hand, declined from $180 to 150 million. As the government repaid part of its foreign debt, the outflow in respect of official capital transactions increased from $50 to 140 million. In aggregate, recorded capital movements shifted from a net outflow of $40 million in 1966 to a net inflow of about the same amount last year. This was offset, however, by a turn-round of $110 million in the errors and omissions item. The first quarter of 1968 closed with a balance-of-payments deficit of $70 million, against a surplus of $30 million in the corresponding quarter of 1967, owing chiefly to a deterioration in the current account.

Austria. Austria's overall balance of payments shifted from a deficit of $65 million in 1966 to a surplus of $205 million last year. This was the result of a substantial reduction in the trade deficit and large-scale borrowing abroad.

The economic pause, coupled with good domestic crops, acted as a curb on imports, which declined by 1 per cent., compared with a rise of 11 per cent. in 1966. Imports of food and raw materials fell by 12 and 9 per cent. respectively, while those of finished consumer goods and chemicals increased by 12 and 10 per cent. In aggregate, imports amounted to $2,365 million last year. Exports went up by $125 million, or 7 per cent., to $1,820 million. More than half of this increase was accounted for by sales to other EFTA countries, exports to the United Kingdom showing a sharp rise of over 40 per cent. There was also a further expansion of exports to eastern European countries. Deliveries to the EEC, on the other hand, declined by 2 per cent., reflecting the contraction of exports to Germany and Belgium. The net result of these movements was a reduction in the trade deficit from $670 to 545 million.

Net receipts from invisible items declined last year from $480 to 435 million, mainly owing to a $30 million decrease on travel account; the latter was due more to rapidly expanding expenditure by Austrian tourists abroad than to a fall in receipts from foreign tourists in Austria. There was also some increase in outpayments on investment income account.

The net long-term capital inflow reached $265 million last year, compared with $35 million in 1966 and a previous peak of $120 million in 1958. Net borrowing by public authorities totalled $115 million — compared with net repayments of $35 million in 1966. In addition, borrowing by the private sector, mostly for electricity and road-building, more than doubled to $150 million. In the first quarter of 1968 the net inflow of long-term capital amounted to $90 million (twice as much as in the corresponding quarter of 1967), which more than compensated the current deficit of $80 million. As there was also an inflow of funds on short-term capital account, the overall balance recorded a surplus of $50 million.

Switzerland. The slowing-down of domestic economic expansion, which had brought about a current surplus of $120 million in 1966, continued last year and, together with mounting invisible receipts, pushed the surplus up to $220 million. The capital account, which for the first time did not include the banks' short-term foreign positions, showed a net outflow of $105 million, and the overall surplus amounted to $115 million.

The trade deficit was reduced for the third year in succession; in 1967 it fell from $650 to 595 million. Imports expanded by only 4 per cent., compared with 7 per cent. in 1966. While purchases of investment goods levelled out after having risen by 10 per cent. in 1966, those of consumer goods went up by 9 per cent., substantially more than in the previous year. Some 40 per cent. of the increase was accounted for by clothing and motor-cars. The growth rate of exports also slowed down, from 10 to 7 per cent. Exports to EEC countries were almost stationary, a 5 per cent. decline in sales to the BLEU, Germany and the Netherlands being offset by increased sales to France and Italy. Exports to the EFTA group, on the other hand, expanded by 18 per cent., those to the United Kingdom rising by as much as 23 per cent. In comparison with the previous year the seasonal contraction of the trade deficit in the fourth quarter was much more pronounced. The deficit amounted to only $45 million, imports having almost ceased to rise, whereas the expansion of exports was accelerating following a stepping-up of sales to Germany. In the first quarter of 1968 imports picked up again and the import surplus rose to $150 million, this being $35 million less than in the corresponding period of 1967.

Net receipts from services are estimated to have gone up from $770 to 815 million in 1967, owing to a growth in receipts from travel (reflecting less an increase in numbers than a rise in expenditure per head) and rising income on capital invested abroad.

On capital account, the net outflow from identified transactions increased from $170 to 400 million, net new foreign issues on the Swiss market having gone up from $100 to 165 million and authorised bank credits to foreigners from $70 to 235 million. At the same time, however, the net inflow from unidentified transactions came to $300 million. This large movement of funds into Switzerland was partly connected with the uncertainty concerning the pound sterling.

Sweden. The continuation of the slower rate of economic growth in 1967 was reflected in both the current account, where the import surplus was reduced, and the capital account, which showed a smaller inflow. Whereas in 1966 there had been a record inflow of both private and official capital, the inflow of private capital declined last year from $130 to 55 million, most of the decrease occurring in the first half of the year. Although the Swedish capital market is still closed to non-resident borrowers, some exceptions were made in 1967 for borrowers from other Scandinavian countries and in the autumn a S.kr. 75 million ($14.5 million) IBRD loan was raised. In the official sector there was a shift from an inflow of $25 million to net repayments of $5 million. Finally, the surplus in the "errors and omissions" item came down from $200 to 100 million. This item, which is structurally positive, is known to represent the counterpart of an undervaluation of services and merchandise receipts, credits granted to shipyards and other trade credits. All of the decline in 1967 seems to be due to a reversal in these other trade credits from a net inflow to a net outflow in the second half of the year, when uncertainties regarding a possible devaluation of the Swedish krona caused import payments to accelerate. This movement appears to have been reversed again in the first quarter of 1968 when the current deficit of $145 million was almost entirely offset by an inflow of funds.

The net surplus in respect of services, which has been shrinking fast ever since the early 1960s, amounted to $50 million in 1966 and practically disappeared last year. This was due chiefly to a further steep rise in net expenditure on foreign travel, which totalled $180 million. Shipping receipts and investment income remained almost unchanged.

The import surplus was reduced from $315 to 175 million, as imports went up by only 2.5 per cent. against a 6 per cent. expansion in exports. Imports of raw materials and food declined by 11 and 1.5 per cent. respectively, reflecting in the first case the slow-down in production growth and in the second good domestic crops. Raw-material exports also declined, but those of manufactured goods expanded by 9 per cent.

Norway. After having been in equilibrium in 1966, Norway's overall payments balance recorded a surplus of $165 million last year; this was due to a large capital inflow and rising freight receipts, which more than offset a deterioration in the trade balance.

Total imports rose by $340 million to $2,770 million. More than half the expansion was accounted for by deliveries of ships; their share went up last year from one-seventh to one-fifth of overall imports. At the same time exports of ships nearly doubled to $210 million, while exports of merchandise went up by 5 per cent. to $1,540 million. Sales of fish and other staple products declined, while those of machinery, iron and steel and paper showed a substantial increase. In the first quarter of 1968 imports of ships were at a particularly low level and the current account recorded a surplus of $25 million. There was also a capital inflow of $30 million.

Shipping receipts rose from $650 to 800 million as a result of the Middle East war. While freight rates had been declining in 1966 and the first half of 1967, the closure of the Suez Canal in early June pushed them upwards. Trip charter rates for Norwegian tankers were three and a half times as high in the June-October period as in the first five months of the year; the upward movement of dry cargo rates, however, was much less sharp. Both sets of rates fell towards the end of the year.

At $190 million, the current deficit last year was only $30 million larger than in 1966. It was more than counterbalanced by a net long-term capital inflow of $345 million. While borrowing by the private sector, mainly shipping companies, expanded from $160 to 260 million, net direct investment in Norway more than doubled to $70 million. Public authorities, on the other hand, stepped up their repayments.

Finland. Measures taken to limit inflationary pressures began to show results in 1966, when the import surplus of $240 million was very little higher than in the previous year. Although the trade deficit came down to $135 million in the first nine months of 1967, compared with $190 million in the corresponding period of 1966, the underlying disequilibrium persisted. Since the restrictive policies pursued so far had been reflected in a decline in investment, a slackening of productive activity and growing unemployment, a further tightening of restrictions did not seem feasible. The markka was therefore devalued by 23.8 per cent. on 12th October 1967. In order to contain pressures on prices and costs and to tax windfall profits, an export levy was introduced on 21st October. It will remain in force until the end of 1969, but the rate of 14 per cent. payable by Finnish exporters will be gradually reduced. It was also decided to speed up tariff reductions in regard to EFTA countries.

Imports remained stationary during the first nine months of 1967 as compared with the corresponding period of 1966. While those of raw materials and investment goods declined by 1 and 3 per cent. respectively, imports of fuels and consumer goods went up by 7 and 3 per cent. Exports increased

Finland: Balance of payments.

Items	January to September 1966	January to September 1967	October to December 1966	October to December 1967	Year 1966	Year 1967
	in millions of US dollars					
Merchandise trade						
Imports (c.i.f.)	1,250	1,250	480	430	1,730	1,680
Exports (f.o.b.)	1,060	1,115	430	385	1,490	1,500
Trade balance	— 190	— 135	— 50	— 45	— 240	— 180
Services						
Transport	+ 75	+ 90	+ 25	+ 15	+ 100	+ 105
Investment income	— 35	— 50	— 10	— 10	— 45	— 60
Other	— 20	— 25	— 5	— 5	— 25	— 30
Total	+ 20	+ 15	+ 10	—	+ 30	+ 15
Current balance	— 170	— 120	— 40	— 45	— 210	— 165
Capital movements						
Long-term	+ 35	+ 80	+ 15	+ 15	+ 50	+ 95
Short-term	+ 60	+ 20	— 45	— 30	+ 15	— 10
Total	+ 95	+ 100	— 30	— 15	+ 65	+ 85
Total balance (= changes in monetary items)	— 75	— 20	— 70	— 60	— 145	— 80

by 6 per cent., owing chiefly to a 30 per cent. rise in sales of metal and engineering products. On the other hand, the exports of the paper industry levelled out, while those of the timber industry and of agricultural produce fell by 4.5 and 10 per cent. respectively. During the same period the terms of trade deteriorated by 5 per cent., owing to a rise in the unit values of imports, and in the fourth quarter they were 9 per cent. less favourable than in the corresponding quarter of 1966. In terms of volume, the last-quarter figures did not yet reflect the impact of the devaluation, since contracts for that period had been concluded previously.

As regards the balance of payments for 1967 as a whole, the deficit in respect of merchandise trade narrowed from $240 to 180 million. On the other hand, higher interest payments to foreign countries caused the surplus on services to contract from $30 to 15 million. Over half of the current-account deficit of $165 million was offset by borrowing from abroad. The net long-term capital inflow increased from $50 to 95 million, most of the rise being accounted for by the issue of three loans (two government loans and one by the Mortgage Bank of Finland) totalling $39 million. Short-term capital movements shifted from a net inflow of $15 million to a net outflow of $10 million.

Denmark. Denmark's overall balance of payments turned last year from a surplus of $30 million to a deficit of $65 million. The change was due entirely to a deterioration in the current balance, which recorded a deficit of $160 million, compared with one of $60 million in 1966. Two-thirds of the deterioration represented a fall in receipts from services.

Imports, on a customs clearance basis, rose by 6 per cent. in both 1966 and 1967, while the export growth rate declined from 6 to 4 per cent. There was, however, an improvement in the course of last year, the trade deficit in the first half giving way to a small surplus in the second. Imports, which had increased quickly in response to heavy demand pressures and also in anticipation of the coming into force of the value added tax on 3rd July, slackened in the second half of the year, whereas exports, which had shown little increase in the first half, recovered markedly. For the year as a whole exports of manufactured products, excluding ships, expanded by 10 per cent., while those of agricultural products were 5 per cent. down on 1966, owing partly to a further implementation of common agricultural policies in the EEC countries and partly to lower export prices. Net receipts from invisibles declined from $205 to 140 million, reflecting a deterioration in all items. The travel account, which normally shows a surplus, shifted to a deficit, as expenditure of Danish tourists abroad rose much more than receipts from foreign tourists in Denmark. Net receipts from shipping and government transactions declined and outpayments in respect of interest and dividends rose.

The net capital inflow amounted to nearly $100 million in each of the last two years. Whereas the public sector's repayments had exceeded its new borrowing in 1966, in 1967 net borrowing amounted to $15 million. The net inflow on direct investment account was somewhat lower than in 1966, as Danish investment abroad increased more than foreign investment in Denmark.

Despite the improvement in exports in the second half of 1967, the Danish krone was devalued on 21st November, by 7.9 per cent.

Ireland. Ireland's trade deficit, which had recorded a peak of $425 million in 1965, came down to $360 million in 1966 and about $300 million last year. Whereas in the greater part of 1966 imports were kept down by restrictive domestic measures, an expansionary policy prevailed last year. In spite of it, imports went up by only 5 per cent., which seems to be mainly attributable to the fact that the recovery was concentrated in residential building and public investment — sectors in which the import element is relatively small — as well as to a decline in import prices. The growth of exports, on the other hand, accelerated from 11 to 17 per cent., a large share of the rise being accounted for by increasing sales of meat. In absolute values, imports amounted to $1,050 million in 1967 and exports to $755 million. Net receipts from services, at $325 million, were only $10 million up on 1966, and the current balance shifted from a deficit of $45 million to a surplus of $30 million. While in 1966 there had been a capital inflow of $120 million, of which well over half was due to large-scale government borrowing and to the change in ownership of a private bank, last year no government borrowing took place. In all, there was a small net capital outflow.

Because of its very close ties with the UK economy, the Irish pound was devalued in line with sterling on 18th November 1967.

Spain. In 1967, for the third year in succession, Spain's basic balance of payments recorded a deficit. However, at $120 million, it was $100 million less than in the previous year. This improvement was due entirely to a rise in the net long-term capital inflow to $460 million, which reflected an increase in direct investment, mostly from the United States, a substantial rise in portfolio investment and larger credits from the US Export-Import Bank.

Owing to a slow-down in domestic economic activity and to a slight increase in export receipts, the import surplus was reduced by $100 to 1,900 million. This improvement was entirely offset, however, by lower net invisible receipts. As registered by customs statistics, imports, at $3.5 milliard, were two and a half times as large as exports; after expanding by 19 per cent. in 1966, they declined slightly last year. Imports of semi-manufactured products and raw materials showed decreases of 12 and 11 per cent. respectively, and purchases of foodstuffs declined by 6 per cent., owing partly to larger domestic supplies of meat. Imports of investment goods were virtually stable, while fuel imports went up by 23 per cent. and those of consumer goods by 9 per cent. Exports, which had expanded by nearly a third in 1966, rose by 10.5 per cent. last year. Apart from a decline in sales of ships and lorries, all groups of products shared in the expansion.

The number of foreign tourists visiting Spain went up by 3.5 per cent. last year, compared with an increase of 21 per cent. in 1966. The number from France, which accounts for half the total, and from Germany declined. Arrivals from all other countries went up, those from the United Kingdom by 10 per cent. But travel receipts, following an increase of 13 per cent. in 1966, registered a decline, which is reflected in the fall in net receipts from services proper by $70 million to $870 million. Income in respect of workers' remittances also declined, by $30 million to $450 million, reflecting the lull in economic activity in the main countries of emigration.

As the current balance continued to be in deficit and Spain's exchange reserves were declining, the peseta followed sterling's example by devaluing by 14.3 per cent. against the dollar on 20th November. In support of the devaluation a stabilisation programme was announced which included a price and wage freeze until the end of 1968 and rises of up to 50 per cent. in taxes on luxury goods. Following these measures the import surplus in the first quarter of 1968 was substantially reduced and the overall deficit was brought down to $65 million, compared with $150 million in the first quarter of 1967.

Portugal. Whereas the inflow of long-term capital was virtually the same in the last two years, Portugal's current balance improved by $90 million to a surplus of $50 million in 1967. The trade deficit was reduced by $25 million to $315 million and receipts from invisibles went up by $65 million to $365 million, owing chiefly to a $50 million rise in private remittances. Net travel receipts increased by only $10 to 185 million, despite a rise of some 30 per cent. in the number of foreigners entering the country. In fact, there was a slight decline in gross receipts, but this was more than compensated by a fall in Portuguese travel expenditure abroad.

Owing to a marked slow-down in industrial activity and to higher agricultural output, imports as measured by customs statistics remained stationary last year. Those from outside the escudo area — which account for nearly nine-tenths of the total — actually fell by 2 per cent., while those from the overseas territories increased by 5 per cent. Imports of machinery and transport equipment declined by 6 per cent. and those of cereals by 23 per cent. On the other hand, imports of livestock and animal products roughly doubled. As regards exports, those to countries outside the escudo area — which represent three-quarters of the total — went up by 8 per cent., an expansion of 25 per cent. in sales to the EFTA contrasting with a small decline in those to the EEC. Exports to the overseas territories went up by nearly one-fifth. The total export growth, most of which occurred in the second half of the year, partly reflected higher prices for a small number of products such as table wines, cotton yarns and cloth, wolfram ores and machinery. As import prices remained stable, the terms of trade improved by 8 per cent. over the previous year.

At $120 million, the net medium and long-term capital inflow was slightly larger than in 1966. In the public sector increased borrowing from abroad — about half of which was to finance shipbuilding — was more than offset by bigger repayments. The net inflow of short-term capital, including the balance of overseas territories with third countries, was $35 million smaller than in 1966, mainly on account of advance import payments.

Canada. The easing of domestic demand pressures and the foreign exchange benefits of the World Fair in Montreal combined to make the 1967 balance-of-payments result the best in Canada since the war. The basic balance turned from a $110 million deficit in 1966 into a $890 million surplus and the current-account deficit fell from $1,050 to 390 million, its lowest level since 1952. The merchandise trade surplus grew from $325 to 550 million.

After rapidly expanding throughout 1965 and 1966, both imports and exports flattened out in the first nine months of 1967 but showed signs of recovery towards the end of the year. This renewed upturn was particularly pronounced in the case of exports, which benefited from the cyclical revival of the US economy and from the strikes in the US copper and automobile industries. For 1967 as a whole, exports rose by 10 per cent. and imports by 8 per cent. Wheat deliveries actually fell by $330 million, chiefly owing to smaller shipments to the USSR and China, and exports of other farm products and of fish and forestry products showed hardly any increase. Exports of metals and minerals, on the other hand, went up by $300 million, mainly as a result of larger sales of copper and petroleum. But the biggest factor behind the $1,005 million increase in total exports (on a customs clearance basis) was a rise of $925 million, or 40 per cent., in deliveries of manufactured goods other than metals and chemicals. About 75 per cent. of this was attributable to exports of automotive products, which benefited from

Canada: Balance of payments.

Items	1966	1967[1] Year	1st quarter	2nd quarter	3rd quarter	4th quarter
	in millions of US dollars					
Merchandise trade (f.o.b.)						
Exports	9,670	10,635	2,700	2,705	2,480	2,750
Imports	9,345	10,085	2,520	2,585	2,515	2,465
Trade balance	+ 325	+ 550	+ 180	+ 120	− 35	+ 285
Services						
Investment income	− 750	− 800	− 170	− 220	− 220	− 190
Travel	− 60	+ 395	− 5	+ 155	+ 215	+ 30
Other	− 565	− 535	− 125	− 180	− 100	− 130
Total	−1,375	− 940	− 300	− 245	− 105	− 290
Current balance	−1,050	− 390	− 120	− 125	− 140	− 5
Long-term capital						
Net new Canadian issues abroad	+ 890	+ 880	+ 255	+ 145	+ 195	+ 285
Transactions in outstanding Canadian securities	− 225	− 35	− 55	− 35	+ 20	+ 35
Transactions in foreign securities	− 390	− 320	− 50	− 50	− 115	− 105
Direct investment	+ 635	+ 450	+ 85	+ 125	+ 110	+ 130
Other	+ 30	+ 305	+ 50	+ 50	+ 70	+ 135
Total	+ 940	+1,280	+ 285	+ 235	+ 280	+ 480
Balance on current and long-term capital account	− 110	+ 890	+ 165	+ 110	+ 140	+ 475
Short-term capital[2]	+ 255	− 540	− 475	− 55	+ 140	− 150
Total balance (= changes in monetary items)	+ 145	+ 350	− 310	+ 55	+ 280	+ 325

[1] Quarterly data in the current balance are seasonally adjusted. [2] Including the balancing item.

the US-Canadian agreement signed in 1965. Such products were responsible also for over 60 per cent. of the \$745 million rise in total imports. The dominant factor behind the contraction in the deficit on invisibles from \$1,375 to 940 million was the \$455 million improvement in net travel receipts, which was largely due to the 1967 World Fair and the various other centennial year activities.

Net receipts on long-term capital account went up by \$340 million to \$1,280 million, despite a \$185 million contraction in net foreign direct investment in Canada and a slight decline in net new Canadian bond issues abroad. These reductions were more than offset by a \$260 million improvement in the balance of transactions in foreign and outstanding Canadian securities, and by a \$275 million rise in the surplus on "other" long-term capital movements. The gains in the latter item stemmed mainly from repayments of credits extended in connection with earlier wheat exports and from foreign bank lending to Canadian corporations. The increase in long-term capital inflows has been influenced by the new Canadian Bank Act and the relatively high long-term interest rates prevailing in Canada. The decline in net direct investment in Canada was accounted for entirely by the United States;

investments by other countries nearly doubled, but still represented only one-fifth of the total at the end of 1967. The $1 milliard improvement in the basic balance of payments was to a large extent offset by a shift in the balance of short-term capital movements from a $255 million surplus in 1966 to a $540 million deficit. The net official reserve position and that of the Canadian banks together strengthened by $350 million.

Japan. Japan's basic balance of payments shifted from a surplus of $440 million in 1966 to a $990 million deficit. This sharp deterioration was essentially the result of the somewhat unusual coincidence of strengthening boom conditions within Japan and economic slow-down in most other industrial countries. Consequently, the growth of Japan's imports accelerated from 14.5 per cent. in 1966 to 23 per cent., whereas, owing to both weakening foreign demand and domestic capacity shortages, that of exports declined from 15.5 to 6 per cent. The trade surplus narrowed from $2,275 million in 1966 to $1,160 million. In the first quarter of 1968, however, the situation began to improve again; the monetary and fiscal restraint measures taken in the second half of 1967 contributed towards a flattening-out of imports, while exports resumed their upward trend.

On a customs clearance basis, practically the whole of the 1967 increase in exports was accounted for by machinery and equipment; as a result the share of this item in total exports increased from 38 to 42 per cent. Exports of textiles, in contrast, declined by 3 per cent. Imports of capital goods went

Japan: Balance of payments.[1]

Items	1966 Year	1966 1st half	1966 2nd half	1967 Year	1967 1st half	1967 2nd half
	in millions of US dollars					
Merchandise trade (f.o.b.)						
Exports	9,640	4,380	5,260	10,230	4,720	5,510
Imports	7,365	3,560	3,805	9,070	4,400	4,670
Trade balance	+2,275	+ 820	+1,455	+1,160	+ 320	+ 840
Services						
Transport	− 610	− 320	− 290	− 820	− 365	− 455
Investment income	− 185	− 95	− 90	− 175	− 85	− 90
Government[2]	+ 440	+ 195	+ 245	+ 475	+ 220	+ 255
Other	− 670	− 325	− 345	− 830	− 440	− 390
Total	−1,025	− 545	− 480	−1,350	− 670	− 680
Current balance	+1,250	+ 275	+ 975	− 190	− 350	+ 160
Long-term capital	− 810	− 285	− 525	− 800	− 365	− 435
Balance on current and long-term capital account	+ 440	− 10	+ 450	− 990	− 715	− 275
Short-term capital[3]	− 120	+ 45	− 165	+ 420	+ 225	+ 195
Total balance (= changes in monetary items)	+ 320	+ 35	+ 285	− 570	− 490	− 80

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

up by 29 per cent. and those of raw materials (which account for about 70 per cent. of total imports) by 26 per cent., while consumer goods imports, i.e. mainly foodstuffs, rose by only 8 per cent.

The deficit on invisible items widened by $325 million to $1,350 million, nearly two-thirds of the increase being accounted for by larger transport payments, and the total current account shifted from a $1,250 million surplus to a $190 million deficit. In comparison with that in earlier boom periods, this deficit could be considered very moderate. However, Japan has in recent years turned into a large-scale net exporter of long-term capital; despite the tightening of domestic credit policy, net long-term capital exports in 1967, at $800 million, were virtually as high as in 1966. Net foreign purchases of Japanese securities went up by $95 million, but this increase was to a considerable extent offset by larger long-term trade credits, extended mainly in connection with industrial equipment exports. In 1967 net trade credits accounted for 63 per cent. of the total net long-term capital outflow. Short-term capital movements, on the other hand, responded to the tightening of the monetary reins. Including the balancing item, but excluding changes in the banks' external positions, a $120 million outflow in 1966 was succeeded by a $420 million inflow in 1967. This turn-round, however, offset only part of the deterioration of the basic balance of payments, and the overall balance recorded a deficit of $570 million, the highest since 1961.

IV. GOLD, RESERVES AND FOREIGN EXCHANGE.

Gold production, markets and reserves.

In 1967 world gold production, the upward trend of which had slowed down markedly during the two preceding years, registered its first decline since 1953. Total output (excluding the USSR, other eastern European countries, mainland China and North Korea) fell from 41.2 to 40.3 million ounces. While the main reason for the change in trend during the past few years is to be found in the performance of the South African industry, last year's decline in total output was about equally shared among the three leading western producers.

World gold production.

Countries	1929	1940	1946	1953	1963	1964	1965	1966	1967
	weight, in thousands of fine ounces								
South Africa . .	10,412	14,046	11,927	11,941	27,432	29,137	30,540	30,869	30,531
Canada	1,928	5,333	2,849	4,056	4,003	3,835	3,608	3,274	2,962
United States .	2,059	4,870	1,575	1,958	1,454	1,456	1,705	1,803	1,471
Australia	427	1,644	824	1,075	1,024	964	878	916	815
Ghana	208	886	586	731	921	865	755	684	763
Japan.	335	867	40	258	433	460	519	555	676
Philippines . . .	163	1,121	1	481	376	426	437	453	490
Colombia	137	632	437	437	325	365	319	281	260
Mexico	655	883	420	483	238	210	216	214	175
Total listed .	16,324	30,282	18,659	21,420	36,206	37,718	38,977	39,049	38,145
Other countries[1]	2,016	7,178	2,771	2,840	2,534	2,452	2,163	2,151	2,140
Estimated world total[1] .	18,340	37,460	21,430	24,260	38,740	40,170	41,140	41,200	40,285
	in millions of US dollars								
Value of estimated world total at $35 per fine ounce .	640[2]	1,310	750	850	1,355	1,405	1,440	1,440	1,410

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

In South Africa, output went down by 340,000 ounces, or slightly over 1 per cent. South Africa's share of western production, however, continued to rise and amounted to 76 per cent. of the total. In the two next most important producing countries — Canada and the United States — the 1967 fall in production was relatively much larger. Owing to rising costs and declining reserves of ore, Canadian gold output had already gone down from 4 to 3.3 million ounces between 1963 and 1966. In 1967 it fell to just under 3 million ounces. US production was down by 330,000 ounces; the main reason was the protracted strike in the copper-mining industry, about one-third of US gold output being a by-product of copper mining. Last year's fall in US production came after two years in which output had risen from 1.5 to 1.8 million ounces, following the opening of a new gold-mine in Nevada. Output from all other western producers, taken together, showed a slight increase in 1967. The main changes were a fall of 100,000 ounces in Australian production and increases of about the same size in both Ghana and Japan.

A feature of developments in the South African gold-mining industry in 1967 was that output from the newer goldfields stopped rising. This was because the increase in the total of ore milled was offset by a decline in its average gold content. With mining costs continuing to creep upwards, total profits from the new mining areas for the first time showed a reduction. Looking at developments over the past few years, between 1962, when the opening-up of new goldfields reached its climax, and 1967 the older mines reduced the scale of their milling operations by 31 per cent. However, as their average gold yield increased somewhat, output from these mines fell by only 25 per cent., from 6.1 to 4.6 million ounces. Average profits per ounce of gold declined over this five-year period from $6.9 to 3.7, while total profits went down from $42 to 17 million.

Operating results of the South African gold-mining industry.[1]

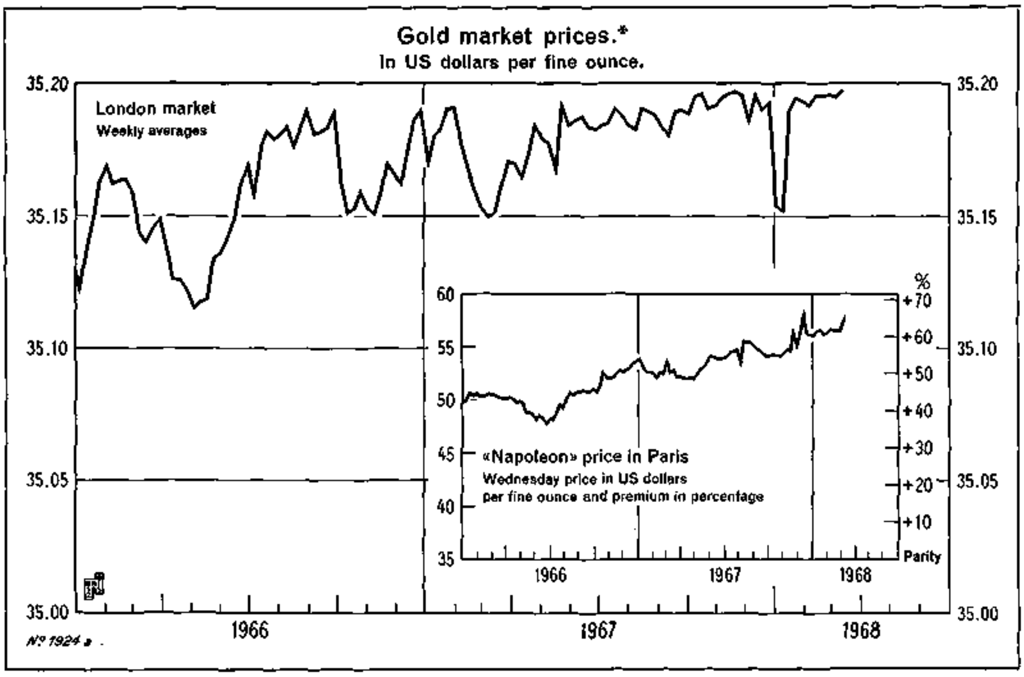
Years	Ore milled	Average gold yield per ton	Total production	Total profits[2]	Average profit per ounce[2]
	in millions of tons	in dwt.[3]	in millions of ounces	in millions of dollars	in dollars
1962 Old mines[4]	30.6	4.02	6.1	41.9	6.9
New mines[5]	40.2	9.08	18.3	343.5	18.8
1963 Old mines	28.6	4.06	5.8	36.5	6.3
New mines	45.0	9.13	20.5	382.5	18.7
1964 Old mines	26.7	4.13	5.5	33.1	6.0
New mines	48.2	9.34	22.5	414.1	18.4
1965 Old mines	24.8	4.24	5.3	26.5	5.0
New mines	51.1	9.48	24.3	427.1	17.6
1966 Old mines	22.1	4.37	4.8	21.9	4.6
New mines	52.8	9.49	25.1	431.4	17.2
1967 Old mines[6]	21.2	4.32	4.6	17.0	3.7
New mines	53.9	9.31	25.1	413.3	16.5

[1] Members of the South African Chamber of Mines and primary gold producers only (about 97 per cent. of total South African production). [2] Including profits from uranium. [3] One dwt. (pennyweight) is one-twentieth of an ounce, equal to 1.555 grammes. [4] East Rand, Central Rand. [5] Evander Area, Far West Rand, Klerksdorp, Orange Free State. [6] Estimates.

In the newer mining areas the scale of operations expanded by about one-third, from 40.2 to 53.9 million tons of ore milled, and total output from 18.3 to 25.1 million ounces. Although the average gold return per ton of ore milled rose only slightly, the decline in average profits from $18.8 to 16.5 per ounce was very much smaller in percentage terms than in the older mines, and total profits, despite their 1967 decrease, expanded by over 20 per cent., from $340 to 410 million.

In the first quarter of 1968 South African gold output exceeded its level of a year earlier by about 155,000 ounces. This was due to the coming into operation of two new mines.

The very substantial gap between new gold supplies and total market demand for the metal in 1967, which produced a decline of \$1,600 million in western gold reserves during the year, has already been described on pages 38–40 of this Report. Although non-monetary demand for gold did not reach huge proportions until after the devaluation of sterling, it was strong throughout most of 1967. And this meant that the London market gold price was rather close to its effective upper limit of \$35.20 an ounce for much of the year, particularly from the end of May onwards.



* The London market quotations stop in mid-March 1968, when the market was temporarily closed and the operations of the gold pool terminated.

At the beginning of 1967 the fixing price was just above \$35.17½. And during the second half of January it went up over \$35.19 because of renewed talk about a possible increase in the official price of gold. Then followed the only period of any length in 1967 during which relatively calm conditions prevailed in the market. From \$35.19¼ in early February, the fixing price declined to below \$35.15 at the end of the month and again on certain days during the first half of March. At this time, and indeed throughout the first half of the year, market supplies of new gold were larger than usual, since South Africa was selling, in addition to its current production, quite substantial amounts of gold from its reserves.

Quotations began to rise again during the latter part of March and demand continued at a high level during April, partly because of the political difficulties in Greece. By the end of April the fixing price was above \$35.18½. For a brief interval conditions then became quieter again; but the unpegging of the dollar price of silver on 18th May, followed by the outbreak of the Middle East crisis, gave a new stimulus to demand. From then on until the crisis in November, market demand for gold remained persistently high; and in addition during the third quarter of the year South Africa's balance of payments moved from deficit into surplus, thus curtailing market supplies. The fixing price therefore remained within rather narrow limits, mostly between $35.18 and just below $35.20. And the same was true during the period between the devaluation of sterling and the closing of the London market on 15th March — except for a short interval in early January 1968 when the announcement of new balance-of-payments measures by the US Government brought quotations down below $35.14 for a few days.

While the very high level of demand for gold in the bullion market during 1967 led to heavy selling by the gold pool, in the gold coin market there was a considerable further increase in the price of those coins that are no longer minted. The premium of the Napoleon, for example, over its gold content rose from 48½ per cent. at the end of March 1967 to 61½ per cent. at the end of the year, and further to 64½ per cent. immediately before the closing of the London gold market in March 1968. By the middle of May the premium over the market ingot price was 55 per cent.

The London market reopened on 1st April 1968 with gold bullion quoted at $38 an ounce. Later that same week quotations were down to $36.95, from which point they soon rose again to $38. In the last week of the month they began to rise further and by late May the market price was $41.50 an ounce.

As already mentioned, western gold reserves fell by $1,600 million in 1967. At the end of the year they stood at $41,580 million. Countries' official gold stocks were reduced by $1,420 million to $39,480 million, and spot gold holdings of international monetary institutions by $180 million to $2,100 million.

The decline in countries' total gold stocks during 1967 was concentrated on the United States and the United Kingdom. Total net US gold sales for the year were $1,170 million, of which (in addition to $50 million's worth from current domestic output) $160 million went to domestic industrial users. Total net US sales to foreign countries were $1,030 million. The bulk of this was accounted for by net sales to the United Kingdom of $880 million; and these included the US share of the gold pool's loss for 1967. Excluding transactions with the United Kingdom, therefore, total net US gold sales to foreign countries were only $150 million, compared with $690 million in 1966 and $1,470 million in 1965. In other words, countries' conversions of dollars into gold at the US Treasury in 1967 were the smallest for many years.

The United Kingdom's gold loss for 1967 was $650 million, most of which occurred during the last quarter of the year. As well as contributing its share to the gold pool's sales, the United Kingdom also sold gold to meet its payments deficit.

In continental western Europe gold reserves went up by $125 million during 1967. This was more than accounted for, however, by an increase of

World gold reserves.

Countries or areas	Changes in 1965	Changes in 1966	Changes in 1967	Holdings at end-1967
	in millions of US dollars			
United States	−1,665	− 570	−1,170	12,065
United Kingdom	+ 130	− 325	− 650	1,290
Continental western Europe	+2,300	+ 250	+ 125	21,060
of which				
Austria	*+ 100*	*—*	*—*	*700*
Belgium	*+ 105*	*− 35*	*− 45*	*1,480*
France	*+ 980*	*+ 530*	*− 5*	*5,235*
Germany	*+ 160*	*− 120*	*− 65*	*4,225*
Italy	*+ 300*	*+ 10*	*− 15*	*2,400*
Netherlands	*+ 70*	*− 25*	*− 20*	*1,710*
Portugal	*+ 55*	*+ 70*	*+ 55*	*700*
Spain	*+ 195*	*− 25*	*—*	*785*
Switzerland	*+ 315*	*− 200*	*+ 250*	*3,090*
Other	*+ 20*	*+ 45*	*− 30*	*735*
Canada	+ 125	− 105	− 30	1,015
Japan	+ 25	—	+ 10	340
Latin America	− 80	− 70	+ 15	1,000
Middle East	+ 5	− 55	+ 95	820
Other Asia	+ 35	− 25	+ 60	710
Other Africa	− 115	+ 210	+ 105	880
of which				
South Africa	*− 150*	*+ 210*	*− 55*	*585*
Other countries	− 15	+ 5	+ 20	300
Total for all countries	+ 745	− 685	−1,420	39,480
International institutions	− 530	+ 635	− 180	2,100
of which				
BIS	*− 510*	*+ 135*	*− 200*	*−625*
European Fund	*+ 20*	*− 15*	*− 10*	*45*
IMF	*− 40*	*+ 515*	*+ 30*	*2,680*
Grand total	+ 215	− 50	−1,600	41,580

$260 million in gold swaps between the Swiss National Bank and the BIS, as a result of which Switzerland's gold reserve at the end of 1967 was $250 million higher than a year earlier. Excluding the effects of these swaps, continental countries' gold reserves would have gone down by $135 million during the year. Countries participating actively in the gold pool all showed losses — though in the case of Italy and Switzerland these were reduced by gold purchases of $85 and 30 million respectively from the US Treasury. On the other hand, Portugal added $55 million to its gold reserves.

Elsewhere in the world, countries' gold reserves went up by $275 million. Despite sales of $150 million to the United States, Canada's reserve declined by only $30 million; and in most other areas gold reserves showed some increase. Middle Eastern gold reserves went up by $95 million, of which Kuwait accounted for $70 million. And other African countries' holdings rose by $105 million. In this group, Algeria's reserve went up by $150 million, while South Africa's official gold stock fell by $55 million. During the course of the year South Africa's balance of payments turned round quite sharply from deficit to surplus, its gold reserve declining by $170 million in the first six months and then rising by $115 million in the second half of the year. There was little change in Latin America, where purchases of $55 million by Mexico were to a large extent offset by Peruvian sales of $45 million.

International institutions' gold holdings declined by $180 million in 1967. In particular, the negative spot position of the BIS went up by $200 million, the main factor being the increase in swaps with the Swiss National Bank to which reference has already been made. The gold stock of the International Monetary Fund showed a small rise of $30 million, after deduction of an amount of $20 million deposited with the US Treasury. The European Fund's gold holdings, on the other hand, went down by $10 million during the year as a result of increased lending in gold to members of the European Monetary Agreement.

According to preliminary estimates, western gold reserves declined by a further $1,460 million in the first quarter of 1968. The stocks of the active members of the gold pool were reduced by $2,045 million, of which the United States accounted for $1,360 million and Switzerland for a further $485 million. The fall in the Swiss National Bank's gold reserve included a substantial reduction of its gold swaps with the BIS, whose negative spot gold position fell by $280 million. South Africa's gold reserve went up by $160 million during the quarter.

International Monetary Fund.

Fund operations. The lending operations of the IMF during 1967 were on a much smaller scale than in either of the two preceding years. Member countries' gross drawings declined from $1,448 million in 1966 to $835 million last year. At the same time total repurchases rose from $721 to 1,329 million, so that the net total of outstanding drawings fell by $494 million during the year to just under $4.5 milliard. At the end of 1967 three countries accounted for some 60 per cent. of total outstanding drawings: the United Kingdom with $1.5 milliard, the United States with $0.8 milliard and India with $0.5 milliard.

An outstanding feature of the Fund's operations in 1967 was the reduction of $902 million in the United Kingdom's debt. In May 1967 the United Kingdom repaid $405 million, representing that part of its $1 milliard drawing made in December 1964 which had been financed by recourse to the GAB. The repayment was made in the same currencies and the same amounts as had been borrowed from the other GAB members on that occasion and the Fund used the proceeds to pay off the corresponding GAB loans. In November 1967 the United Kingdom made a second repayment of $250 million. In addition, the UK position in the Fund was improved during 1967 by $247 million through other countries' drawings of sterling.

The US debt to the IMF was also reduced during 1967, by $114 million. This came about entirely through other members drawing US dollars on the Fund.

International Monetary Fund: Drawings and repurchases in 1967.

Countries or areas	Drawings	Repurchases	Net drawings
	In millions of US dollars		
United States	—	114[1]	− 114
United Kingdom	—	902[2]	− 902
Europe excluding United Kingdom	336	46[3]	291
of which			
Finland	*94*	—	*94*
Spain	*166*	—	*166*
Turkey	*27*	*19*	*8*
Yugoslavia	*45*	*12*	*33*
Latin America	123	184[4]	− 61
of which			
Argentina	—	*48*	*− 48*
Chile	*10*	*25*	*− 15*
Colombia	*71*	*37*	*34*
Others	376	84	292
of which			
Ceylon	*26*	*4*	*22*
Ghana	*25*	*7*	*18*
India	*90*	*8*	*82*
Iraq	*40*	—	*40*
New Zealand	*89*	—	*89*
Philippines	*28*	—	*28*
Total	835	1,329	− 494

[1] Repurchases by other members' drawings. [2] Including repurchases by other members' drawings, $247 million. [3] Including repurchases by other members' drawings, $12 million. [4] Including repurchases by other members' drawings, $35 million.

In the rest of Europe apart from the United Kingdom there were net drawings of $291 million during the year. The principal transactions were a drawing of $166 million by Spain in January — equivalent to the whole of its gold tranche and super-gold tranche position — and a series of drawings, totalling $94 million in all, by Finland. The remainder of the Fund's membership drew a net total of $231 million; New Zealand accounted for $89 million of this and India for a further $82 million.

Although the Fund's net lending to member countries declined during the year, there was at the same time a very substantial increase, from $365 to 1,804 million, in the amounts which it made available under stand-by arrangements for possible future drawings. This was almost entirely accounted for by the $1.4 milliard stand-by concluded with the United Kingdom in November 1967 immediately after the devaluation of sterling. Should the United Kingdom make full use of this facility, the Fund has arranged to obtain $400 million of the currencies that would be needed by selling gold and $525 million by use of the GAB.

Another feature of the Fund's 1967 operations was the greater diversity of currencies used in drawings. Altogether twenty-one different currencies were drawn during the year, five of them for the first time. The principal currency used for drawings in 1967 was the pound sterling, with $247 million, and this was followed by the US dollar with $114 million. Other currencies were used in rather small amounts, the next largest net amount drawn being $35 million in Australian dollars. Excluding the US dollar and sterling, the

Fund's net use of Group of Ten currencies declined by $573 million during the year. However, as $405 million of this amount was used to repay GAB loans, the Fund's holdings of these currencies did not increase much.

During the first quarter of 1968 member countries' gross drawings on the Fund totalled $826 million, almost as much as in the whole of the preceding year. The main transactions were drawings of $426 million by Canada and $200 million by the United States. The latter's gold tranche position, however, increased by $57 million during the quarter, other countries drawing a total of $263 million in US dollars, of which Canada accounted for $201 million. Total repurchases amounted to $514 million, so that net drawings for the quarter came to $312 million.

Special drawing rights. During the period under review substantial progress was made towards establishing a new facility for special drawing rights (SDRs) in the Fund. At their 1967 annual meeting, held in Rio de Janeiro, the Governors of the Fund received and approved an outline of the proposed new facility, which represented the outcome of four years' discussion both in the Fund and in the Group of Ten. The Governors instructed the Executive Directors of the Fund to convert the outline into a legal document, taking the form of amendments to the Fund's Articles of Agreement, for submission by end-March 1968. This work was in fact completed in April 1968, when the proposed amendments were transmitted to member governments for their consideration and approval. Shortly before this, in March 1968, the Finance Ministers and central-bank Governors of the Group of Ten had met in Stockholm to settle certain outstanding questions relating to the SDR scheme. The French Government reserved its position on the compromise agreement reached in Stockholm, partly because in its view the proposed amendments to the Fund Agreement do not adequately reflect the provisions of the outline that had been agreed upon in Rio and partly because the problems which it considers fundamental were not examined.

The proposed new special drawing rights will be in principle distinct, both as regards accounting and in their purpose, from Fund members' existing drawing rights arising out of quota subscriptions. The latter are available to countries for obtaining short to medium-term, mostly conditional, loans in individual cases of balance-of-payments difficulty. SDRs, on the other hand, will be allocated simultaneously across the board to all participating countries for the purpose of helping to meet the longer-term needs of the monetary system as a whole for increased international liquidity. Decisions to allocate SDRs will be taken, on the basis of proposals from the Fund's Managing Director, by a majority of not less than 85 per cent. of the total voting power. Individual allocations will be pro rata to countries' Fund quotas.

Countries will be able to use all their SDRs automatically to meet balance-of-payments financing needs, but with the proviso (subject to possible later revision) that during the first five-year period of operation of the scheme no country's average net use of its allocations of SDRs may exceed 70 per cent. of its cumulative allocations. In other words, if, say, during the first three years a country were to use 75 per cent. of its allocations, it would in the following two years have to reconstitute its holdings of SDRs to the extent necessary to bring its average holdings over the whole period up to at least 30 per cent. of its cumulative allocations. Transfers of SDRs will, with certain exceptions, be subject to guidance by the IMF. The object of this is to promote over time a "balanced distribution" of holdings among participants. The basic rule in this connection will be that the Fund directs SDRs to countries whose balances of payments and gross reserve positions are "sufficiently strong". Participants' obligations to accept SDRs from other participants will be limited to an amount equal to twice their cumulative allocations.

Amongst other provisions of the SDR scheme, the following may be mentioned:

1. The unit of value of SDRs will be equivalent to the existing gold content of the dollar. In other words, "debtor" and "creditor" positions in SDRs (i.e. holdings that are less than or in excess of cumulative allocations) will be the equivalent of debts and claims in gold.

2. A moderate uniform rate of interest will be paid on countries' holdings of SDRs in excess of their cumulative allocations. Countries whose holdings of SDRs are less than the total of their cumulative allocations will pay interest on the difference.

3. There are certain exceptions to the principle that the operations of the SDR facility are to be kept distinct from the existing operations of the Fund. For instance, participants will be able to use SDRs to repay Fund drawings, as well as for the payment of charges arising out of such drawings. And the Fund, for its part, will be able to use SDRs in order to replenish its holdings of members' currencies, provided that this does not raise any member's holdings of SDRs above its holding limit.

Reform of the Fund. As well as adopting the outline of the SDR scheme, the Governors of the Fund, at their Rio meeting, also called on the Fund Board to consider possible improvements in the existing rules and practices of the Fund. And they instructed the Board to submit to them their agreed recommendations in this field simultaneously with the full text of the SDR scheme. This work, too, was concluded in April 1968 and its outcome, which takes the form of further amendments to the Fund Agreement, transmitted to the Governors together with the text of the proposed SDR facility. Among the main reforms of the Fund's existing rules and practices recommended by the Board of Executive Directors are the following:

1. To increase to 85 per cent. of the Fund's total membership the voting majorities required for deciding on (a) future general increases in quotas, (b) changes in the form of payment of quota subscriptions on the occasion of general quota increases, (c) a uniform change in par values, and

(d) in the event of (c) a waiver of the principle of maintaining the gold value of the Fund's assets.

2. Improvement of the status of gold tranche and super-gold tranche positions. Countries' access to their gold tranches will be made legally automatic, and a fixed rate of interest will be paid on super-gold tranche positions.

3. Modification of the procedure for appealing against interpretations of the Articles of Agreement by the Board of Executive Directors. A standing Committee on Interpretation of the Board of Governors will be set up to advise on disputes between the Fund and any of its members. The Committee's decisions will be binding on the Fund, unless rejected by an 85 per cent. majority of the Board of Governors.

Official reserves and other monetary movements.

Global reserves. Gross global reserves, defined as the sum of countries' gross official holdings of gold and foreign exchange plus their IMF reserve positions, went up by $1,580 million in 1967. This was about $200 million more than the increase recorded for 1966. The outstanding feature of the 1967 figures is the change that occurred in the composition of global reserves. Gold reserves fell by $1,420 million and IMF reserve positions by $580 million, while gross exchange reserves rose by $3,580 million. This unprecedented increase occurred despite the fact that the dollar value of sterling reserves (other than those which represent the counterpart of short-term assistance to the United Kingdom) was reduced as a result of the devaluation of the pound.

Over 80 per cent. of the 1967 increase in total gross exchange reserves, or $3,080 million, was accumulated by Group of Ten countries. This was considerably more than in the six preceding years put together and it came about as a result of special transactions, for the most part international credit operations, the purpose of which was to finance the payments deficits of the United States and the United Kingdom. The following items may be mentioned:

1. The increase of $1,810 million in the exchange reserves of the non-reserve Group of Ten countries included a rise of $1.3 milliard in their holdings of dollars under swaps with the US authorities, together with an addition of $470 million to their holdings of non-marketable US Government securities.

2. The increase of $1,025 million in the United States' foreign exchange reserves included a rise of just on $200 million in the Federal Reserve System's holdings of Deutsche Mark, mostly resulting from swap drawings by the BIS, as well as one of $545 million in its holdings of sterling, which presumably represents the counterpart of short-term assistance to the Bank of England. In addition, the US Treasury's sterling holdings went up by about $400 million.

3. The increase of $245 million in the United Kingdom's exchange reserves includes $490 million transferred from the Treasury's dollar portfolio, $250 million borrowed from central banks to repay the IMF in November 1967, and a loan of just over $100 million from Swiss commercial banks. In addition, the Bank of England took short-term assistance from foreign monetary authorities.

Changes in global reserves of countries.

Areas and years	Gold	Foreign exchange	Fund reserve positions	Total gross	Total net*
	in millions of US dollars				
All countries					
1966	− 685	+ 1,365	+ 685	+ 1,365	+ 960
1967	− 1,420	+ 3,580	− 580	+ 1,580	− 1,690
Group of Ten					
1966	− 835	+ 900	+ 380	+ 445	+ 245
1967	− 1,740	+ 3,080	− 480	+ 860	− 2,005
Other developed countries					
1966	+ 300	− 140	+ 140	+ 300	+ 210
1967	− 20	+ 75	− 125	− 70	− 85
Less-developed countries					
1966	− 150	+ 605	+ 165	+ 620	+ 505
1967	+ 340	+ 425	+ 25	+ 790	+ 400
Group of Ten, excluding United States and United Kingdom					
1966	+ 60	− 60	+ 920	+ 920	+ 680
1967	+ 80	+ 1,810	− 575	+ 1,315	+ 1,355
United States					
1966	− 570	+ 540	− 540	− 570	+ 225
1967	− 1,170	+ 1,025	+ 95	− 50	− 3,395
United Kingdom					
1966	− 325	+ 420	—	+ 95	− 660
1967	− 650	+ 245	—	− 405	+ 35

* Equals the gross figures, net of changes in official liabilities to non-residents (where available) and in liabilities to the International Monetary Fund.

Note: In 1966 net global reserves are shown as having gone up by $960 million, although countries' total gold reserves declined by $685 million. This was because (a) most of the $885 million transferred from the UK Treasury's dollar portfolio to the UK reserves in February 1966 had been added to the reserve liabilities of the United States in 1965; and (b) large amounts of dollar reserves were placed in the Euro-dollar market in 1966.

These figures show that the growth of global reserves in 1967 depended on special transactions. Had they not taken place, the international payments situation would have been quite different.

The net change in global reserves should correspond exactly to the change in countries' total gold reserves. This is because, except for gold, all reserve assets held by a given monetary authority have as their counterpart equal liabilities of some other monetary authority. In fact, however, according to available statistics net global reserves declined by $1,690 million in 1967, which is $270 million more than the fall that occurred in countries' total gold reserves. The main reason for this discrepancy is that official dollar reserves placed in the Euro-dollar market, where they do not figure amongst the official liabilities of the United States, declined in 1967. Leaving on one side their imperfections, the statistics show that there was a substantial decline in net global reserves during 1967, due to the sales of gold to the market by the gold pool. The figures for the first quarter of 1968, when they are available, will show a similar development.

Turning to the area break-down of last year's change in net global reserves, developments in Group of Ten countries and in some other developed countries are discussed later in this chapter. In the less-developed areas of the world, total net reserves went up by $400 million in 1967. These countries' gold and exchange reserves rose by $330 and 180 million respectively, whilst their net IMF positions declined by $110 million.

Latin American reserves went up by $300 million, the main feature of which was a gain of $385 million by Argentina. This occurred following the devaluation of the peso in March 1967, which formed part of a general stabilisation programme supported by substantial foreign credits. Brazil's reserves, on the other hand, fell by $175 million. Elsewhere in Latin America there were gains of $95 million in Venezuela and $50 million in Colombia. In the Middle East total net reserves went up by $405 million. Iran, Israel, Jordan, Kuwait and Saudi Arabia all recorded gains ranging from $65 to 85 million. Asian countries outside the Middle East, on the other hand, registered a net decline of $90 million in reserves. Within this group, Korea's reserves went up by $120 million and those of Taiwan and Thailand by $100 and 85 million respectively. These relatively large increases were probably linked to US expenditure arising out of the Vietnam war. On the other hand, Malaysia's reserves went down by $155 million — the dollar value of its sterling assets being reduced as a result of the devaluation of sterling — and those of the Philippines by $95 million. In addition, there were losses ranging from $35 to 55 million in Burma, Ceylon, India and Pakistan. Lastly, in Africa other than the Middle East total net reserves fell by $215 million. Nigeria's reserves declined by $105 million and those of Ghana by $80 million, while Libya gained $45 million.

United States. The US balance-of-payments deficit, measured both on the official reserve transactions and on the liquidity basis, showed a very considerable increase in 1967. And its financing consisted almost entirely of a massive build-up of liabilities to foreigners. That is to say, the total of official reserve assets was almost unchanged, taking the year as a whole. But within the very slight decrease of $50 million that occurred, there was a considerable shift in the composition of US reserves. The gold stock declined by $1,170 million, largely as a result of sales through the gold pool; but practically the whole of this was statistically offset by increases of $1,025 and 95 million respectively in official holdings of convertible foreign exchange and in the IMF gold tranche position. A good part of the increase in official exchange holdings consisted of sterling acquired as the counterpart of drawings by the United Kingdom on its swap facility with the Federal Reserve Bank of New York.

United States: External monetary movements.

Items	1966	1967 Year	1967 1st quarter	1967 2nd quarter	1967 3rd quarter	1967 4th quarter	1968 1st quarter
	in millions of US dollars (+ = increase in assets, decrease in liabilities)						
Reserves	− 570	− 50	−1,025	+ 420	+ 375	+ 180	− 905
of which							
Gold	*− 570*	*−1,170*	*− 50*	*− 15*	*− 90*	*−1,015*	*−1,360*
Foreign exchange	*+ 540*	*+1,025*	*−1,005*	*+ 425*	*+ 460*	*+1,145*	*+ 400*
IMF gold tranche position	*− 540*	*+ 95*	*+ 30*	*+ 10*	*+ 5*	*+ 50*	*+ 55*
Liabilities to official foreigners	+ 795	−3,350	− 255	−1,110	− 415	−1,570	.
of which							
Liquid	*+1,595*	*−2,075*	*+ 80*	*− 550*	*− 280*	*−1,325*	*+1,360*
Non-liquid	*− 800*	*−1,275*	*− 335*	*− 560*	*− 135*	*− 245*	.
Balance on official reserve transactions basis	+ 225	−3,400	−1,280	− 690	− 40	−1,390	.
less							
Non-liquid liabilities to official foreigners	− 800	−1,275	− 335	− 560	− 135	− 245	.
Total change in official liquid position	+1,025	−2,125	− 945	− 130	+ 95	−1,145	.
plus							
Liabilities to non-official foreigners	−2,385	−1,450	+ 710	− 95	−1,305	− 760	− 690
Balance on liquidity basis	−1,360	−3,575	− 235	− 225	−1,210	−1,905	.

The contrast between 1966 and 1967 was particularly marked on the official reserve transactions basis, where a small surplus of $225 million was converted into a deficit of $3,400 million. This change, of course, partly reflected the deterioration of the balance of payments in 1967. But in addition, the official reserve transactions balance for 1966 had been especially favourable, since tight monetary conditions in the United States in that year had produced a rise of nearly $2.5 milliard in liabilities to non-official foreigners. The official reserve transactions deficit for 1967 was essentially financed through an increase of $3,350 million in liabilities to official foreigners. Liquid liabilities rose by $2,075 million, nearly two-thirds of which occurred in the last quarter of the year. In particular, European countries' dollar reserves increased, owing to shifts by private holders out of dollars into national currencies and gold following the devaluation of sterling. In addition, non-liquid liabilities to official foreign holders increased by $1,275 million. Foreign official agencies invested about $1 milliard in long-term time deposits or certificates of deposit in US banks, as well as adding $440 million to their holdings of non-liquid Roosa bonds.

On the liquidity basis, the payments deficit widened between 1966 and 1967 from $1,360 to 3,575 million. And, apart from the rise of $2,075 million in liquid liabilities to official foreigners, it was financed by an increase of $1,450 million in liabilities to non-official foreigners.

The pattern of US monetary movements varied considerably during the course of 1967, to a large extent in relation to changes in the position of sterling. In the first quarter US banks were returning funds to the Euro-dollar market and there was a big reflux of money to London. These developments produced a reduction of $710 million in liabilities to non-official foreigners and a fall of $1,005 million in official exchange holdings, the latter including the repayment of all outstanding UK swap drawings on the United States. In the second quarter, when sterling began to come under pressure again, US official exchange holdings went up by $425 million.

In the third quarter there was a large liquidity deficit, covered by an increase of $1,305 million in private dollar balances. Much of this rise represented a movement out of sterling and it was partly financed by further UK swap drawings, US official exchange holdings going up by $460 million. The last-quarter figures reflected pressure on both reserve currencies, as well as the deterioration in the balance of payments. Official liabilities rose by $1,570 million, to a considerable extent because of sales of dollars by private holders following the devaluation of sterling. Total private dollar holdings nevertheless went up by $760 million, indicating that the movement out of sterling was greater than that out of the dollar. Pressure on the pound was intense in the period just before the change in parity and further substantial drawings by the Bank of England on its swap facility with the Federal Reserve accounted for much of the rise of $1,145 million in official exchange holdings. As a result of this rise, US reserves went up by $180 million during the quarter, despite the large reduction in the gold stock.

Full details of US monetary movements in the first quarter of 1968 are not yet available. The gold stock declined by $1,360 million, while official holdings of foreign exchange went up by $400 million and the IMF gold tranche position by $55 million.

The increase in US liquid liabilities to official holders during 1967 included a rise of $1.5 milliard in foreign monetary authorities' holdings of dollars under swaps with the US authorities. At the end of 1966 total US drawings on the Federal Reserve's swap facilities had amounted to $280 million and by February 1967 these had all been paid off. From May onwards, however, the US authorities began to draw again in substantial amounts on these facilities and by late December their total drawings stood at the record figure of $1,790 million. Of this amount, $650 million was in Swiss francs, $500 million in Italian lire, $350 million in Deutsche Mark, $170 million in Dutch florins and $120 million in Belgian francs. With the exception of those on Italy, where the balance of payments was in quite heavy surplus during the second half of 1967, most of the drawings were made to meet inflows of dollars into the countries concerned either at the time of the Middle East crisis or immediately after the sterling devaluation. By early March 1968 Federal Reserve drawings on the network had been reduced to $555 million.

During 1967 and early 1968 the Federal Reserve's swap network was increased, in five stages, from a total of $4.5 milliard at the end of 1966 to nearly $9.4 milliard in March 1968. Three more central banks — those of

Federal Reserve System swap arrangements.

Facilities with	December 1966	March 1968
	in millions of US dollars	
Austria	100	100
Belgium	150	225
BIS	400	1,600
Canada	500	1,000
Denmark	—	100
France	100	100
Germany	400	1,000
Italy	600	750
Japan	450	1,000
Mexico	—	130
Netherlands	150	400
Norway	—	100
Sweden	100	250
Switzerland	200	600
United Kingdom	1,350	2,000
Total	4,500	9,355

Denmark, Mexico and Norway — joined the network. And in addition, all the previously existing facilities, except those with the Austrian National Bank and the Bank of France, were increased substantially.

United Kingdom. The change in the external monetary position of the United Kingdom that came about during 1967 essentially reflected the pressures on sterling that built up to the devaluation in November. These pressures derived from the £320 million balance-of-payments deficit and from a substantial run-down of sterling balances. Some idea of the size of this run-down may be gleaned from the fact that total net sterling balances, excluding those of official holders outside the sterling area (the movements in which were very considerably influenced by central-bank assistance), fell by £295 million over the year.

As in 1966, therefore, the official financing requirement was considerably larger than the overall payments deficit. So far as the pattern of official financing is concerned, in terms of sterling, the reserves fell by £190 million, including the use of £205 million from the Treasury's dollar portfolio; the debt to the IMF was reduced by £320 million; and official liabilities denominated in foreign currencies rose by £180 million. The balance of these three items is a loss of £50 million. And the remainder of the official financing required came from central-bank assistance in forms that resulted in an increase in the sterling balances of official holders outside the sterling area. These balances rose during the year by £580 million. This amount, however, comprises not only the net increase in assistance to which there was a sterling counterpart — including the writing-up of this counterpart following the change in parity — but also the movements that occurred in other official sterling balances held outside the sterling area.

United Kingdom: External monetary movements.

Items	1966	1967 Year	1967 1st quarter	1967 2nd quarter	1967 3rd quarter	1967 4th quarter
	in millions of £ sterling (+ = increase in assets, decrease in liabilities)					
Official assets	− 280	− 190	+ 55	− 150	− 35	− 60
of which						
Reserves	*+ 35*	*+ 15*	*+ 55*	*− 150*	*− 35*	*+ 145*
Use of dollar portfolio	*− 315*	*− 205*	*—*	*—*	*—*	*− 205*
Account with IMF	+ 5	+ 320	+ 20	+ 165	+ 5	+ 130
Official UK liabilities in non-sterling currencies	− 15	− 180	+ 15	—	—	− 195
Sterling liabilities to official holders in non-sterling area (net)	− 295	− 580	+ 440	− 55	− 430	− 535
Other sterling liabilities (net)	+ 160	+ 295	− 205	+ 90	+ 225	+ 185
of which						
to sterling-area holders	*+ 5*	*+ 150*	*− 80*	*+ 115*	*+ 65*	*+ 50*
to non-official non-sterling-area holders	*+ 170*	*+ 125*	*− 135*	*− 30*	*+ 150*	*+ 140*
to international organisations	*− 15*	*+ 20*	*+ 10*	*+ 5*	*+ 10*	*− 5*
Liabilities of UK banks in foreign currencies (net)	+ 160	− 15	− 140	+ 20	+ 30	+ 75
Liabilities in overseas sterling-area currencies (net)	+ 45	− 25	− 10	− 15	+ 25	− 25
Miscellaneous capital	+ 75	− 45	− 10	− 40	− 20	+ 25
*Exchange adjustments**	—	*+ 100*	—	—	—	*+ 100*
Overall balance	− 145	− 320	+ 165	+ 15	− 200	− 300

* The net total of contra entries, arising from the revaluation in sterling terms of official monetary or banking assets and liabilities denominated in gold and overseas currencies and of the sterling counterpart of drawings on central-bank facilities, or included to account for the fact that the pre-devaluation forward commitments of the Exchange Equalisation Account are recorded as being settled on maturity at the new parity.

The year can be divided into two broad phases. The first of these lasted for most of the first six months and during its course the external monetary position improved very substantially. In the first quarter alone there was a payments surplus of £165 million, an inflow of £140 million through the Euro-currency market and a rise of £205 million in total net sterling balances, excluding those of official holders outside the sterling area. This permitted not only the repayment of all outstanding short-term drawings on central-bank facilities — except for a small amount drawn on the Basle arrangement of June 1966 which is linked to changes in sterling balances — but also a rise of £55 million in reserves.

This favourable phase continued, with diminishing momentum, well into the second quarter. And although the trend was decisively reversed from late May onwards, the overall balance for the quarter was still just on the right side, by £15 million. However, as there was a reduction of £90 million in total sterling balances other than those of official holders outside the sterling area, some official financing was required for the quarter as a whole. On the liabilities side, the debt to the IMF was reduced by £165 million, chiefly as a result of a £145 million repayment in May; and, in addition, Switzerland was repaid £28 million borrowed at the time of the 1964 Fund drawing. At the same time, however, reserves fell by £150 million and there was some increase in short-term assistance. The outstanding drawings on the June 1966 Basle arrangement were paid off, but this was more than offset by fresh drawings of £80 million on the swap facility with the Federal Reserve System.

From the middle of the year onwards the situation deteriorated progressively. The third-quarter payments deficit was £200 million; and on top of this there was a further fall of £225 million in total net sterling balances other than those of official holders outside the sterling area, together with some outflow of funds to the Euro-currency market. Adverse seasonal factors help to account for the size of both the overall deficit and the reduction in sterling balances. The latter, however, were also affected by the flight of funds that had begun at the time of the Middle East crisis. Official financing relied mainly on short-term assistance, sterling liabilities to official holders outside the sterling area going up by £430 million. The reserves fell by £35 million during the quarter.

The external monetary statistics for the final quarter of the year were, of course, affected by the devaluation. In particular, non-sterling monetary assets and liabilities were revalued in terms of sterling, the sterling counterpart of drawings on central-bank facilities was increased following the change in parity and the settlement of official forward exchange commitments entered into before devaluation is recorded as having taken place at the new parity. Taken together, these adjustments reduce the adverse balance of monetary movements for the quarter by £100 million. Despite these adjustments the overall deficit of £300 million was considerably higher than in the previous quarter. And the financing burden placed on the monetary authorities was greater than that, since total net sterling balances other than those of official holders outside the sterling area fell by a further £185 million — giving a total decline of £500 million since the end of the first quarter — and in addition there was a £75 million outflow through the Euro-currency market.

The means employed by the authorities to meet their financing requirements during the quarter were various. In the first place, the reserves (despite the increase in their sterling value brought about by the devaluation) fell by £60 million, including the use of the remaining £205 million from the Treasury's dollar portfolio. Secondly, official liabilities expressed in foreign currencies rose by £195 million. This rise was composed of three elements: a loan of Sw.fr. 450 million from three Swiss commercial banks; deposits of $125 million under facilities with overseas central banks; and a central-bank loan of $250 million made available through the BIS. This third loan was used to repay the outstanding obligations on the United Kingdom's 1964 Fund drawing, which accounts for most of the £130 million reduction in the total debt to the Fund. Thirdly, there was further recourse to central-bank facilities with a counterpart in an increase in the official sterling balances of the non-sterling area. The total of these balances showed the very large rise of £535 million during the quarter. But it needs to be remembered that this rise includes the writing-up of those balances already outstanding at the time of devaluation which represented the counterpart of assistance.

The foreign trade accounts point to a large balance-of-payments deficit in the first quarter of 1968. And, in addition, sterling came under heavy pressure during the March gold crisis. Full details of the first-quarter monetary movements are not yet available. There was little change in the reserves, which in fact rose by £11 million; and the major item was a rise of £350 million in net external sterling liabilities. Of this amount, £245 million accrued to non-sterling-area countries, presumably to a considerable extent as the counterpart of assistance.

Continental western Europe. Owing mainly to the slackening of economic activity, the combined external surplus of continental western Europe (considering changes in the net foreign position of Swiss commercial banks, information on which is not available for 1966, as part of the capital account) rose between 1966 and 1967 from $1.1 to 1.9 milliard. These figures, however, overestimate the extent of the change that took place between the two years, since in 1966 these countries had made debt prepayments (to which there was no counterpart in 1967) of $0.4 milliard to the US Government. The biggest individual change between the two years was the increase in Germany's surplus from $450 to 900 million. In addition, there were marked improvements in the balances of payments of Austria, Belgium, Norway and, to a lesser extent, the Netherlands. On the other hand, France's surplus disappeared and Italy's was much reduced.

The change in the economic situation in a number of continental countries brought with it an easing of monetary conditions. Not surprisingly, therefore, part of these countries' external surplus was financed by an outflow of bank funds. In fact, the combined net foreign liabilities of the commercial banks in these countries (excluding Switzerland) decreased considerably more than in 1966 — by $430 million as compared with $105 million. In Germany alone exports of money by the banks amounted to $805 million and financed almost 90 per cent. of the overall surplus. In Italy, on the other hand, the banks reduced their net foreign position, by $180 million, for the first time since 1963. The 1967 change in the continental banks' combined net foreign positions would have been much larger than it actually was but for the international monetary crisis in the last quarter of the year. This led to substantial inflows of funds through the banking systems in certain countries. The net foreign assets of Swiss commercial banks were reduced by $500 million, and the net liabilities of French banks increased by over $400 million, in the last quarter of 1967. And had it not been for special swap arrangements between the Deutsche Bundesbank and the German commercial banks, the end-year net influx of money through the latter would have been much larger than it was.

To a considerable extent, therefore, it was the international monetary crisis of November/December 1967 that caused the combined net official monetary assets of the continental countries to rise by half as much again as they had in 1966. Within the total rise of $1,460 million for the year, gold and foreign exchange reserves went up by $2,175 million, whilst IMF and

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

Countries	End of year	Gold and foreign exchange (net)	Net IMF and GAB position	Total official assets (net)	Commercial banks (net)	Total foreign assets (net)	Changes (+ = increase in assets, decrease in liabilities): Total official assets	Changes: Commercial banks
		in millions of US dollars						
Austria	1966	1,225	100	1,325	− 145	1,180	+ 20	− 85
	1967	1,365	115	1,480	− 95	1,385	+ 155	+ 50
Belgium	1966	2,120	370	2,490	− 705	1,785	+ 35	− 145
	1967	2,410	330	2,740	− 780	1,960	+ 250	− 75
Denmark	1966	510	70	580	− 25	555	+ 10	+ 20
	1967	440	60	500	− 10	490	− 80	+ 15
Finland	1966	140	30	170	− 90	80	− 120	− 25
	1967	170	− 65	105	− 105	—	− 65	− 15
France	1966	5,655	985	6,640	− 155	6,485	+ 385	− 45
	1967	6,090	885	6,975	− 525	6,450	+ 335	− 370
Germany	1966	7,240	1,255	8,495	− 580	7,915	+ 350	+ 100
	1967	7,540	1,050	8,590	225	8,815	+ 95	+ 805
Greece	1966	250	25	275	5	280	+ 25	—
	1967	260	25	285	10	295	+ 10	+ 5
Iceland	1966	50	5	55	− 10	45	+ 5	− 5
	1967	25	—	25	− 10	15	− 30	—
Ireland	1966	490	—	490	240	730	+ 85	− 10
	1967	425	10	435	315	750	− 55	+ 75
Italy	1966	4,235	885	5,120	195	5,315	+ 170	+ 390
	1967	4,830	845	5,675	15	5,690	+ 555	− 180
Netherlands	1966	2,030	415	2,445	− 45	2,400	+ 40	− 80
	1967	2,260	355	2,615	− 155	2,460	+ 170	− 110
Norway	1966	480	45	525	− 40	485	+ 55	− 50
	1967	610	50	660	− 10	650	+ 135	+ 30
Portugal	1966	1,100	20	1,120	110	1,230	+ 115	—
	1967	1,240	20	1,260	145	1,405	+ 140	+ 35
Spain	1966	1,040	165	1,205	—	1,205	− 205	—
	1967	1,050	—	1,050	—	1,050	− 155	—
Sweden	1966	845	165	1,010	135	1,145	+ 55	+ 40
	1967	680	140	820	300	1,120	− 190	+ 165
Switzerland	1966	3,685	—	3,685	45	3,730	− 15	.
	1967	3,860	—	3,860	− 15	3,845	+ 175	− 60
Turkey	1966	25	− 20	5	.	.	− 35	.
	1967	40	− 20	20	.	.	+ 15	.
Total	1966	31,120	4,515	35,635	−1,065[1]	34,565[1]	+ 975	+ 105[2]
	1967	33,295	3,800	37,095	− 695[1]	36,380[1]	+1,460	+ 370[1]
Canada	1966	2,230	450	2,680	355	3,035	− 280	+ 425
	1967	2,275	435	2,710	675	3,385	+ 30	+ 320
Japan	1966	1,735	320	2,055	− 515	1,540	− 65	+ 385
	1967	1,760	240	2,000	−1,030	970	− 55	− 515

[1] Sixteen countries. [2] Fifteen countries.

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

GAB positions declined by $715 million. This was a completely different pattern of changes from 1966, when almost 90 per cent. of the rise in official monetary assets was in the form of IMF and GAB positions. The principal reason for last year's decline in the Fund reserve positions of continental countries was that the United Kingdom made repayments to the Fund in these countries' currencies, totalling $575 million.

The outstanding feature of official monetary movements in these countries during 1967 was the increase of $2,050 million in their foreign exchange reserves. Virtually the whole of this is accounted for by the Common Market countries, each of which added substantially to its exchange reserves. The increase in total continental exchange reserves included rises of $1,290 million in dollars held under swaps with the US authorities and of $270 million in holdings of US Government non-marketable securities denominated in European currencies. Continental gold reserves went up by $125 million during the year. The components of this movement have already been described on pages 113–114.

Full details of external monetary movements in continental European countries during the first quarter of 1968 are not yet available. Their combined net official assets, however, declined by $500 million. The gold crisis reduced their gold reserves by $965 million, at the same time causing their foreign exchange reserves, contrary to the normal seasonal pattern, to rise by $145 million. In addition, these countries added $320 million to their net IMF positions, chiefly because of the Canadian and US drawings on the Fund.

Germany. Among the continental countries, Germany had easily the largest payments surplus in 1967. At $900 million, it was exactly twice as big as in the preceding year and it included a deficit of $225 million in the fourth quarter. By far the greater part of the 1967 surplus was financed through exports of money by the banks totalling $805 million, so that net official monetary assets only rose by $95 million. In the official monetary sector the gold reserve declined by $65 million as a result of Germany's contribution to the gold pool's sales; and the IMF and GAB position went down by $205 million during the year, chiefly owing to UK repayments to the Fund. The foreign exchange reserves, on the other hand, rose by $145 million and other net official monetary assets by $220 million. The latter figure includes $250 million of DM Roosa bonds purchased under an agreement with the US Government for offsetting the foreign exchange costs of US forces stationed in Germany.

The changes in the German commercial banks' foreign position during 1967 present a number of interesting features. The total net outflow during the first nine months of the year was $1,110 million, of which $820 million occurred in the first quarter. The most striking feature of the banks' money exports during the first three quarters of the year, however, was the extent to which they took place in Deutsche Mark. In the second and third quarters, Germany: Changes in the banks' foreign position.

Items	1967 Year	1967 January–September	1967 October–December	1968 January–March
	in millions of US dollars (+ = increase in assets, decrease in liabilities)			
Assets	+ 1,100	+ 1,025	+ 75	+ 435
of which				
in domestic currency	*+ 465*	*+ 570*	*— 105*	*+ 275*
in foreign currencies	*+ 635*	*+ 455*	*+ 180*	*+ 160*
Liabilities	— 295	+ 85	— 380	+ 25
of which				
in domestic currency	*— 335*	*+ 30*	*— 365*	*+ 25*
in foreign currencies	*+ 40*	*+ 55*	*— 15*	*—*
Total net position	+ 805	+ 1,110	— 305	+ 460

when the banks' foreign exchange assets rose by only \$75 million, their DM claims on non-residents went up by \$410 million. Part of this increase took the form of DM credits to foreign customers, which might have been expected to rise at a time when Germany was running a substantial external surplus; but in addition the banks placed quite substantial amounts on deposit with foreign banks during this period. And one reason why they did so was that, early in July, the Bundesbank began to widen the spread between its buying and selling rates for the dollar. This forced the banks to take exchange cover for their exports of money in the form of dollars, thereby raising the cost of forward cover and reducing the net return on their dollar investments abroad. As a result, they began to change the form of their money exports from dollars to Deutsche Mark, and in July alone their DM claims on non-residents rose by \$210 million.

In the last quarter of 1967 there was, as usual, an inflow of money through the banks. But whereas in earlier years this had come about through repatriation of funds employed abroad, in 1967 it took the form of an increase of \$380 million in foreign liabilities. And of this amount, \$365 million represented a rise in DM liabilities to non-residents. The reason for this sudden rise in foreigners' DM balances is no doubt to be found in the international monetary disturbances which occurred at that time. Also contrary to the usual seasonal pattern, the banks' foreign exchange assets rose by \$180 million during the final quarter of 1967. This was made possible by the special swap facilities offered by the Bundesbank to the commercial banks from late November onwards. These facilities were offered to the banks in order to counteract the large-scale liquidation of their dollar assets which had begun earlier in the month. Altogether the Bundesbank sold a net amount of \$630 million of dollars to the banks under these special swap arrangements during the quarter.

Following its temporary lapse into deficit during the last quarter of 1967, the German balance of payments showed a surplus of \$845 million in the first quarter of 1968 — almost as large as in the corresponding quarter of 1967. Official monetary assets rose by \$385 million, despite a fall of \$255 million in the gold reserve as a result of the gold rush that culminated in the termination of the gold pool arrangements. The exchange reserves went up by $430 million. The IMF gold tranche position also rose, by $80 million, and other official assets by $130 million, including the purchase of a $125 million Roosa bond. The banks' net foreign position increased by $460 million over the quarter, almost entirely through a rise in gross assets. The Bundesbank's special swaps with the commercial banks, after declining to $420 million at the end of February, rose by $440 million during the course of March.

The biggest increases in continental countries' official monetary assets during 1967 occurred in those countries — Italy, Belgium, the Netherlands and Switzerland — where, contrary to what happened in Germany, there were inflows of funds through the banks in addition to a surplus on the balance of payments.

Italy. In Italy the overall surplus for the year was $375 million and the banks' net foreign assets declined by $180 million. Net official monetary assets therefore showed a rise of $555 million. Within the official monetary sector the pattern of movements was the same as in Germany. The gold reserve fell, though only by $15 million, since Italy purchased $85 million of gold from the US Treasury towards the end of the year; and the IMF and GAB position was reduced by $40 million. Foreign exchange reserves and other official monetary assets increased by $610 million, of which $485 million was accounted for by a rise in dollars held under swaps with the Federal Reserve System.

The pattern both of the balance of payments and of the financing items changed completely between the first and second halves of the year. During the first six months there was an overall deficit of $205 million and this was more than covered by a reduction of $250 million in the banks' net foreign assets. In the latter half of the year, however, there was a substantial surplus of $580 million, all of which was concentrated in the seasonally favourable third quarter. Although the banks added $70 million to their net foreign position during these six months, that still left $510 million to be financed by the official sector. Practically the whole of the inflow of dollars to the reserves was absorbed by Federal Reserve drawings totalling $500 million on the swap facility with the Bank of Italy.

Italy's overall balance for the first quarter of 1968 showed a deficit of $175 million. The gold and exchange reserves fell by $210 million, mainly through a reduction of the swap with the Federal Reserve, while the net IMF position increased by $50 million.

Belgium. In Belgium the balance-of-payments surplus for 1967 was $175 million and the official monetary assets rose by $250 million, the difference being accounted for by an increase of $75 million in the banks' net foreign liabilities. The pattern of changes in official monetary assets was the same as in Germany and Italy. The gold reserve declined by $45 million and the IMF and GAB position by $40 million, while other assets went up by $335 million. This figure includes a rise of $105 million in official holdings of dollars under the swap arrangement with the Federal Reserve, as well as net purchases of Roosa bonds for $30 million.

In the first quarter of 1968 there was an *overall deficit of $60 million*, and net official assets declined by $70 million. The gold stock was reduced by $60 million and the National Bank's portfolio of export acceptances (which had shown a rise of $100 million in the last quarter of 1967) by $55 million. The net IMF position, on the other hand, went up by $30 million.

Netherlands. Whereas in Italy and Belgium it was the balance-of-payments surplus that accounted for the greater part of the increase in reserves during 1967, in the Netherlands the main factor was the rise in the banks' net foreign liabilities. This amounted to $110 million and, together with the overall surplus of $60 million, brought about an increase of $170 million in official monetary assets. The pattern of official monetary movements for the year as a whole was the same as in a number of other continental countries, and for the same reasons. The gold reserve and the IMF and GAB position declined by $20 and 60 million respectively, whilst the foreign exchange reserves went up by $250 million.

During the first half of 1967 the balance of payments was in deficit to the extent of $130 million, and its financing was more than covered by an increase of $160 million in the net foreign liabilities of the banks. The exchange reserves, after falling by $50 million during the first quarter, rose by $100 million between end-March and end-June. In the second half of the year the balance of payments turned into surplus, and during the third quarter this was almost entirely financed by a reduction of $70 million in the banks' net foreign liabilities. In the last quarter, when the surplus was $115 million, the exchange reserves went up by $180 million, but the gold reserve and the net IMF position were both reduced. At the end of the year the exchange reserves of the Nederlandsche Bank included an amount of $296 million held under swaps with the US authorities, of which $170 million was with the Federal Reserve and $126 million with the US Treasury.

In the first quarter of 1968 there was an overall deficit of $35 million. In addition, the banks reduced their net foreign liabilities by $25 million, so that official monetary assets fell by $60 million. Within the official monetary sector there were some quite substantial changes during the quarter. The first-line reserves of gold and convertible foreign exchange fell by $270 million, of which gold accounted for $55 million; on the other hand, the net IMF position rose by $125 million and other net official assets by $85 million, the latter including the purchase of a guilder-denominated Roosa bond for the equivalent of $65 million.

Switzerland. Switzerland's net official monetary assets rose by $175 *million*, as a result of an overall balance-of-payments surplus of $115 million and a reduction of $60 million in the commercial banks' net foreign position. The gold reserve went up by $250 million through swaps with the BIS, while other assets declined by $75 million. As usual, however, the annual figures conceal large changes in the pattern of monetary movements which occurred in the course of the year as a result of seasonal window-dressing operations by the Swiss commercial banks, and these fluctuations were exaggerated in 1967 by the disturbances in foreign exchange markets.

The unwinding of end-year operations in January, even though partly offset by fresh commercial bank swaps with the central bank over the end of March, dominated the first quarter, when the commercial banks' net creditor position improved by $305 million and there was a fall of $225 million in official assets. As the March swaps matured in April there was a further large outflow of funds through the banks, but this was reversed by interest rate factors in May and, more decisively, by the Middle East crisis in June, which came just before the normal half-year demand for Swiss franc liquidity. Over the quarter as a whole official monetary assets went up by $65 million. During the third quarter interest rates in the Euro-dollar market induced large placements of funds abroad by the commercial banks and their net external position improved by $200 million. Since this coincided with seasonal strength in the overall balance of payments, however, net official assets declined by only $55 million. The last three months of the year saw a further very heavy flow of funds, partly seasonal and partly in connection with the unrest in the gold and foreign exchange markets. Mainly through an increase in foreign liabilities, the commercial banks' net position declined by $500 million, while official assets went up by $395 million.

In the first two months of 1968, when there were substantial money exports through the commercial banks, official assets fell by $495 million. In March, however, the renewal of tension in the gold and exchange markets caused them to increase by $75 million.

France. The balance of payments for the year 1967 showed a small deficit of $35 million, the first recorded since the stabilisation of the franc in 1958. In the external monetary sector there was a large increase of $370 million in the banks' net foreign liabilities, practically offset by a rise of $335 million in net official assets. The principal changes in the official monetary sector were a reduction of $100 million in the IMF and GAB position — entirely due to the UK repayment to the Fund in May 1967 — and a rise of $365 million in the exchange reserves.

During the first six months of the year the balance of payments was in surplus to the extent of $175 million. And this was almost entirely covered by a reduction of $170 million in the banks' net foreign liabilities. In the second half of the year, however, the overall position showed a deficit of $210 million; but since the banks' net foreign liabilities went up by $535 million, the official sector had a surplus of $325 million, which corresponded broadly to the rise in exchange reserves. The inflow of funds through the banks was essentially the result of the growing international monetary unrest. During the fourth quarter alone it amounted to $415 million, for the most part taking the form of switching out of dollars into francs.

Sweden. For the year 1967 there was a small balance-of-payments deficit of $25 million. External monetary movements showed a substantial shift of assets from the official to the banking sector, practically all of which occurred towards the end of the year. During the first nine months there was an overall surplus of $100 million and this was rather more than covered by an increase in the banks' foreign positions. Then, in the last quarter, there was a deficit of $125 million. At the same time the banks' net foreign assets went up by a further $55 million, so that net official monetary assets fell by $180 million. A good part of the last-quarter deficit was due to doubts about the maintenance of the exchange parity following the devaluation of sterling. These doubts gave rise to advance payments by Swedish residents to foreign suppliers, and to withdrawals of foreign deposits from Swedish banks. With the help of some tightening of credit policy, the crisis was over by the end of the year, and in the first quarter of 1968 the external balance was about in equilibrium. The banks reduced their net foreign assets by $75 million, which brought about a corresponding rise in the reserves.

Austria. The external monetary counterpart of the payments surplus of $205 million recorded for 1967 is mainly to be found in an increase in official monetary assets. The exchange reserves went up by $140 million and the IMF and GAB position by $15 million. The remainder of the surplus was covered by a decline of $50 million in the net foreign liabilities of the commercial banks. During the first quarter of 1968 there was a further surplus of $50 million but net official assets declined by $70 million. The difference is accounted for by an increase, largely seasonal, of $120 million in the banks' net foreign positions.

Other European countries. In *Spain* the balance-of-payments deficit declined to $155 million in 1967 and it was entirely financed by a drawing of $165 million on the IMF. The gold and exchange reserves actually showed a small rise of $10 million over the year as a whole. During the first quarter of 1968, however, they declined by $75 million. *Portugal's* balance-of-payments surplus, on the other hand, went up from $115 million in 1966 to $175 million in 1967. The 1967 surplus was covered to the extent of $35 million by an increase in the banks' foreign assets and for the rest by additions to reserves. The latter included a rise of $55 million in the gold reserve.

Norway's balance of payments also improved between 1966 and 1967, from about equilibrium to a surplus of $165 million. The exchange reserves went up by $130 million and the banks' net foreign liabilities were reduced by $30 million. *Denmark* had an overall payments deficit of $65 million in 1967, practically all of which occurred during the first half of the year. The reserves went down by $120 million during the first ten months of the year, since in addition to the payments deficit there was an increase of $65 million in the banks' foreign positions. These were subsequently reduced by $45 million in November and December, when the reserves rose by about the same amount. *Finland* had an overall deficit of \$80 million in 1967. This was more than covered by drawings of \$95 million on the IMF; and as, in addition, the banks' foreign position was reduced by \$15 million, the gold and exchange reserves went up by \$30 million. The balance of payments improved substantially in the first quarter of 1968, as a result of which Finland's reserves rose by \$100 million.

Canada. The \$350 million balance-of-payments surplus was largely financed through an increase of \$320 million in the net short-term foreign assets of the commercial banks; net official monetary assets therefore rose by only \$30 million over the year. The gold reserve fell by \$30 million, after sales equivalent to \$150 million to the US Treasury, and the net IMF position also showed a small decline. But these movements were more than offset by increases in official foreign exchange reserves and in other official monetary assets. Both the overall surplus and the increase in reserves would have been rather larger but for Canadian Government purchases from US residents of its own and of IBRD securities. These totalled \$60 million, compared with \$175 million the year before. The purpose of these transactions was to hold Canada's gold and US dollar reserves plus its net creditor position in the IMF below the limit of \$2,550 million agreed with the US authorities in return for Canadian exemption from the US interest equalisation tax.

Canada: External monetary movements.

Items	1966	1967					1968
		Year	1st quarter	2nd quarter	3rd quarter	4th quarter	1st quarter
	in millions of US dollars (+ = increase in assets, decrease in liabilities)						
Net official assets	− 280	+ 30	− 35	− 55	+ 70	+ 50	− 815
of which							
Gold	*− 105*	*− 30*	*+ 35*	*− 15*	*+ 35*	*− 85*	*− 40*
Foreign exchange	*− 325*	*+ 60*	*− 70*	*− 15*	*+ 15*	*+ 130*	*+ 15*
Net IMF and GAB position . . .	*+ 95*	*− 15*	*+ 20*	*− 20*	*+ 5*	*− 20*	*− 435*
Other (net)	*+ 55*	*+ 15*	*− 20*	*− 5*	*+ 15*	*+ 25*	*− 355*
Banks' net position	+ 425	+ 320	− 280	+ 110	+ 215	+ 275	+ 105
Overall balance	+ 145	+ 350	− 315	+ 55	+ 285	+ 325	− 710

In the first quarter of 1968 there was a sudden reversal in Canada's overall balance of payments, to a deficit of \$710 million. As well as seasonal factors, there were substantial capital movements provoked by the US balance-of-payments measures. At the same time there was an outflow of \$105 million through the commercial banks, so that net official assets declined by \$815 million. \$426 million was drawn on the IMF and in addition substantial use was made of Canada's swap facility with the Federal Reserve Bank of New York. As a result of these borrowings, plus a further gold sale equivalent to \$50 million to the US Treasury, foreign exchange reserves rose by \$15 million during the quarter. In April the situation improved and net official monetary assets increased by \$230 million.

Japan. Between 1966 and 1967 the overall balance of payments moved from a $320 million surplus to a deficit of $570 million. This deterioration of $890 million was matched by the change in the commercial banks' net position, which, after an improvement of $385 million in 1966, worsened by $515 million last year. In both years, therefore, net official assets declined by about $60 million. However, in contrast to 1966, the decline in 1967 was in Japan's IMF position, other net official assets increasing by $25 million. In the first quarter of 1968 the balance of payments continued in deficit, to the extent of $250 million; most of this was covered by a further rise of $205 million in the net foreign liabilities of the banks.

Foreign exchange markets.

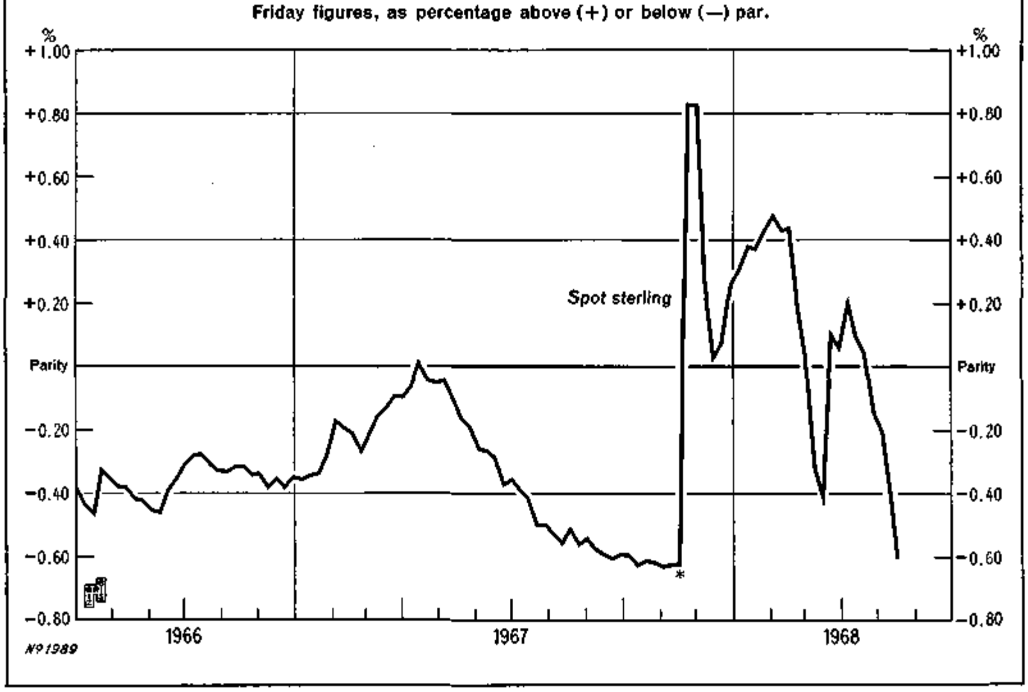
In the foreign exchange markets the period under review was among the most disturbed since the war. The outbreak of the Middle East crisis at the beginning of June 1967 brought both the reserve currencies under some strain. And from then onwards there was sustained and growing pressure on the pound, which led to the devaluation on 18th November. Coming at a time when the persistent US payments deficit was running at a rather high level, the devaluation of sterling focused attention on the situation of the other reserve currency. The dollar then came immediately under very heavy pressure in the exchange market and there was a large movement of funds into major continental European currencies. At the same time there was some general switching out of currencies into gold. In these circumstances, market expectations of possible radical changes in the international monetary structure tended at times to override normal commercial dealing or interest arbitrage movements.

Concerted official intervention, together with reassurances that the gold parity of the dollar would be maintained, helped to restore more orderly market conditions by the end of December. And in the new year the announcement of further balance-of-payments measures by the US Government and the seasonal reflux of funds from the Continent were temporary stabilising factors. In March the final instalment of the gold crisis produced market disturbances comparable to those which had followed the devaluation of sterling. By the end of the month, however, tension had again lessened and during April conditions were favourably affected by the prospect of peace talks on Vietnam as well as by progress towards a tax increase in the United States. Markets then became unsettled again during May and the situation seems bound to remain somewhat unstable until tangible evidence is forthcoming of better equilibrium in international payments.

Apart from the Swiss franc and the Deutsche Mark, the main continental currencies strengthened considerably during the course of 1967 up to the time of the sterling devaluation. The Swiss franc and the Deutsche Mark, on the other hand, had eased against the dollar in the third quarter. Following the devaluation of sterling, all major continental currencies were strong until nearly the end of the year. They eased noticeably with the seasonal outflow of funds after the turn of the year, became temporarily much firmer during the March 1968 gold crisis, and then tended to ease again. In mid-May the French franc came under pressure, while the Deutsche Mark and Swiss franc strengthened appreciably.

Sterling. As funds flowed back to London in the first four months of 1967, the spot dollar rate improved from \$2.79 at the beginning of the year to just above parity in mid-April. From May onwards until devaluation, however, sterling weakened progressively under the influence of the various factors enumerated on pages 5–6 of Chapter I. By end-June the spot rate was down to \$2.79, in early September it went below \$2.78½ and from mid-October onwards it was being held at around \$2.78¼. In addition, the three-month forward discount on the dollar widened between mid-year and devaluation from under ½ per cent. per annum to 1¾ per cent.

Sterling quotations for the US dollar.
Friday figures, as percentage above (+) or below (—) par.



* New parity as from 18th November.

The change in parity on 18th November found sterling very heavily oversold. And when the market reopened for business the need to cover more extreme short positions at once sent the spot rate to the new ceiling of \$2.42, where it remained for the rest of the month. Early in December, however, the rate began to fall rather abruptly and, although selling was not heavy, by mid-month quotations were hardly above the new parity of \$2.40. This was the consequence partly of the heavy demand for gold and partly of fears that the devaluation might not be supported by adequate measures of domestic restraint. With official support now withdrawn from the forward market, the three-month forward discount on the dollar rose to nearly 5 per cent. per annum — considerably in excess of the interest differential in favour of sterling.

Towards the end of the year sterling strengthened in both the spot and forward markets and this improvement continued into January. The spot rate was assisted by anticipation of radical cuts in public-sector expenditure, although these aroused some disappointment when actually announced, and by demand from the market for sterling to close out maturing forward contracts. By early February it had improved to around $2.41\frac{1}{8}$ and the three-month forward discount had fallen to below 3 per cent. per annum. There still remained, however, a sizable adverse interest arbitrage margin, despite lower interest rates in the Euro-dollar market.

This calmer spell was abruptly terminated by market reaction to the publication on 21st February of central-government expenditure estimates for the forthcoming financial year. The spot rate fell sharply to $2.40½ and with a revival of unrest in the gold and foreign exchange markets early in March there were heavy sales of sterling. Spot sterling was not allowed to fall below $2.39, but the three-month forward discount rose to over 10 per cent. per annum at one point, which no doubt tended to increase spot sales. The statement issued in Washington by central-bank governors on 17th March helped to ease the tense situation in foreign exchange markets and the announcement of additional international support for the United Kingdom's reserves specifically favoured sterling. This was followed two days later by the British budget, which went beyond the market's expectation in imposing restraint on private domestic demand. The spot rate rose briefly to $2.40½, but from early April onwards it began to decline again and by late May stood at $2.38½. In the forward market, although the discount declined considerably from its mid-March peak, sterling remained weak.

Swiss franc. In accordance with the usual seasonal pattern, the Swiss franc eased against the dollar at the beginning of 1967 and for most of the first four months of the year the spot rate stood at about Sw.fr. 4.33. But in late April, with domestic interest rates rather firm in contrast to the general downward trend in other centres, it appreciated to Sw.fr. 4.31½, at which point the Swiss National Bank intervened in the market, and at the same time the forward premium on the dollar temporarily ran off. The spot rate then remained at that level until the end of June. The outbreak of war in the Middle East touched off a large inflow of funds and, although this did not last beyond the armistice, the mid-year liquidity needs of the Swiss banks prevented any reversal of the inflow from developing.

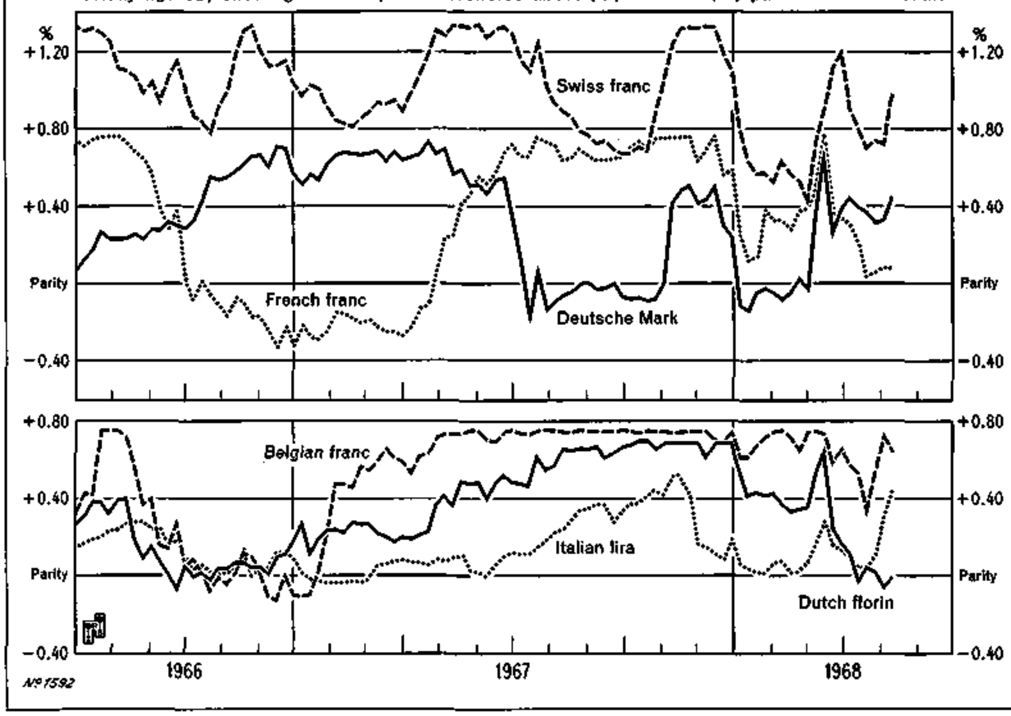
After the end of June domestic interest rates declined and in July the official discount rate was lowered. Short-term capital flowed abroad and the spot quotation eased to over Sw.fr. 4.34 by the end of August and stayed at about that level until late in October, while the forward rate went to a sizable premium.

In October money-market conditions tightened and the spot rate began to rise again. Anticipation of sterling devaluation added impetus to this movement and on 17th November, the day before the devaluation, the rate was at Sw.fr. 4.31½. However, it was the subsequent confusion that set off a really large demand for the franc. This coincided with the usual end-year operations of the Swiss banks; but its independent influence is seen both in the fact that they covered their liquidity needs on this occasion mostly through outright sales of foreign exchange to the National Bank, rather than on a swap basis, and in a rise in the premium for forward francs, which led the central bank, acting on behalf of the US authorities, to sell $65 million of francs in the forward market.

Just before the end of the year the Swiss franc began to ease, and an outflow of funds in the new year brought the spot rate to over Sw.fr. 4.35 in late February — its lowest level for many years. This outflow occurred despite a three-month forward premium of the franc which ranged up to 3 per cent. per annum, reflecting the wide international interest rate differentials that existed at this time. With the recurrence of gold speculation in mid-March, however, the Swiss franc strengthened sharply in both spot and forward markets. Quotations eased again during April but by end-May the spot rate against the dollar had appreciated to Sw.fr. 4.29¾.

European quotations for the US dollar.

Friday figures, showing the European currencies above (+) or below (—) par on the US dollar.



Deutsche Mark. Despite very substantial exports of money by the German commercial banks, the payments surplus kept the spot rate against the dollar close to its upper limit during most of the first four months of 1967. In May, however, under the influence of the continued outflow of short-term funds, the Deutsche Mark began to ease in the spot market. At the same time the three-month forward quotation went up from about parity with the spot rate to a premium of 1 per cent. per annum.

In July the Bundesbank, in order to discourage the export of bank liquidity, widened the margin between its spot buying and selling rates for the US dollar from ½ Pfennig to 2½ Pfennig. By increasing the possibility of exchange loss on short-term foreign currency investments, this raised the cost of forward cover — the forward premium of the Deutsche Mark going up from just above 1 per cent. to over 1½ per cent. per annum by mid-month. At the same time the spot rate, which had appreciated a little in June for the same reasons as the Swiss franc, declined sharply to just below par on the dollar. Quotations then fluctuated rather narrowly around these levels until early November.

A substantial inflow of funds into Germany then began and by 17th November the spot rate against the dollar had strengthened to nearly DM 3.98. This was followed by a rise in the forward premium of the Deutsche Mark to over 3 per cent. per annum by 24th November. The central bank then began to offer dollars to the banks on a short-term swap basis at well below market rates. This encouraged the retention of dollar investments as well as the re-export of money previously repatriated. Demand for the Deutsche Mark strengthened again in mid-December, but as market conditions settled down around the turn of the year a very heavy outward movement of funds developed. The forward premium, no longer effectively restrained by official intervention, again rose briefly to 3 per cent. per annum and then declined in line with interest rates in the Euro-dollar market, while the spot rate fell some way below its dollar parity, despite large purchases in the market by the Federal Reserve Bank in order to repay earlier swap drawings. The situation changed during March, when the Deutsche Mark, like all other major continental European currencies, strengthened abruptly — the spot rate appreciating from DM 3.99 to 3.97 and the three-month forward premium on the dollar rising from 2 to 3½ per cent. per annum. The Bundesbank again offered the banks facilities for short-term dollar swaps at favourable rates. By early May spot quotations had eased to DM 3.98½ but later in the month the Deutsche Mark strengthened to near its upper limit against the dollar.

French franc. The spot rate on the dollar, which had declined considerably during the latter months of 1966, remained below par during the first quarter of 1967, with quotations around Fr.fr.4.95. During April and May, however, the franc strengthened rapidly under the influence of tight bank liquidity; and the Middle East crisis brought a further improvement in the spot rate, which by the end of June was close to the upper limit of Fr.fr. 4.90. And, despite the emergence of a deficit in the balance of payments in the second half of the year, quotations remained at that level for almost the rest of the year. This was because the deficit was more than covered by substantial inflows of funds through the banks. In November alone the inflow to the reserves was $335 million.

From the middle of December 1967 onwards the franc was noticeably less firm until the revival of gold speculation in March. By early May the spot rate had declined again to just above its dollar parity; and near the end of the month, as a result of the social disturbances in France, it went to its lower limit against the dollar.

Other European currencies. Both the *Belgian franc* and the *Dutch florin* strengthened from around parity with the dollar at the end of 1966 to near their upper intervention points for nearly the whole of the second half of 1967. In both cases this was associated with a return of the balance of payments into surplus during the year. The upward pressure on the exchange rates was reinforced during the last quarter by sizable inflows of short-term capital. As happened elsewhere, nervousness in the wake of the sterling devaluation expressed itself also in a strengthening of forward quotations against the dollar, which, after showing a small discount for most of 1967, rose to a premium of around 2 per cent. per annum in November. Since end-1967 the Belgian franc has remained rather firm, except for a short period in April 1968. The Dutch florin, on the other hand, had gone below par on the dollar by early May 1968.

During 1967 quotations for the *lira* against the dollar moved in much the same way as those for the Belgian franc and Dutch florin. The spot rate, which had fluctuated rather narrowly around the parity during most of the first half of the year, rose by about 0.5 per cent. between mid-June and November. To a large extent this reflected the seasonally favourable balance of payments in the third quarter, but demand for the lira remained strong in the period immediately before the sterling devaluation. Late in November the seasonal weakening of the balance of payments began to make itself felt and by early 1968 the spot rate against the dollar had fallen to the parity level. The lira strengthened again during the March gold crisis and in early May the spot rate was about 0.4 per cent. above par.

During the first nine months of 1967 the spot rate for the *Swedish krona* against the dollar moved broadly in line with the seasonal pattern of the balance of payments. Quotations rose from just below the parity at the beginning of the year to 0.4 per cent. above par by mid-May, subsequently weakening a little in the third quarter. Following the devaluation of the pound, the krona came under heavy pressure — Sweden's exchange reserves declined by $115 million in November 1967 — and the spot rate on the dollar went down a little below par. The pressure was effectively halted by a tightening of credit policy which included a 1 per cent. increase in the official discount rate. The krona promptly recovered to well above par, but towards the end of February 1968 it fell back to near the dollar parity.

Canadian dollar. Apart from seasonal weakness early in the year, there was strong demand for the Canadian dollar during most of 1967. The spot rate appreciated steadily during the summer months and by October had reached its upper limit of US \$0.93¼. The trend began to change after the devaluation of sterling; and the US balance-of-payments measures announced on 1st January 1968 touched off large withdrawals of funds to the United States, bringing the Canadian dollar under heavy pressure. The spot rate in terms of US dollars went just below US \$0.92 in mid-January and substantial support had to be given by the Bank of Canada. Following action by both the Canadian and US authorities the pressure eased somewhat in February. There was a further heavy outflow of funds during the March gold crisis, but the Canadian dollar subsequently recovered to US \$0.92¼ at the end of the month and by early May it had risen strongly to US \$0.92¾.

Other exchange developments.

Contrary to what happened in 1949, the devaluation of the pound sterling by 14.3 per cent. on 18th November 1967 did not give rise to a realignment of the exchange parities of any other major countries. It was, nevertheless, followed by devaluations of twenty-five other currencies. The majority of these parity changes were in the smaller sterling-area countries, whose economic and financial links with the United Kingdom remain particularly strong. More remarkable is the fact that the larger overseas sterling-area countries chose to appreciate against sterling. In the case of India there had already been a 36 per cent. devaluation in June 1966 and Ghana had devalued by 30 per cent. in July 1967. So far as the others are concerned, however, adherence to the existing parity indicates the diversification of the external economic relationships of countries like Australia, South Africa, Pakistan, Malaysia and parts of East and West Africa which has occurred since 1949. Three sterling-area countries, New Zealand, Ceylon and Iceland, devalued by more than the United Kingdom, reflecting their own balance-of-payments difficulties, which were likely to be aggravated by the devaluation of the pound.

Outside the sterling area only Spain and Israel devalued to the same extent as sterling. Denmark followed the pound part of the way down, and the pataca in Macao was also devalued modestly, maintaining its parity with the Hong Kong dollar.

Apart from the extension of direct balance-of-payments controls in the United States, described in Chapter I, the other major exchange developments during the period under review mainly involved exchange rate adjustments. In Finland it was decided in October 1967 that to restore the Finnish competitive position without a rate change would entail excessive sacrifice in terms of unemployment. After an interval of ten years, therefore, the markka was devalued on 12th October 1967 by 23.8 per cent. to a new US dollar parity of F.mk. 4.19997. In Hungary, from the beginning of 1968, the rate of

Currency devaluations in November 1967.

Country	Currency	Units per US $		Devaluation, in percentages	New parity effective as from
		Old parity	New parity		
Sterling-area countries					
Bermuda	Pound	0.35714	0.41667	*14.29*	18th November 1967
British Honduras	Dollar	1.42857	1.66667	*14.29*	18th November 1967
Ceylon	Rupee	4.76190	5.95237	*20.00*	21st November 1967
Cyprus	Pound	0.35714	0.41667	*14.29*	20th November 1967
East Caribbean	Dollar	1.71429	2.0	*14.29*	18th November 1967
Falkland Islands	Pound	0.35714	0.41667	*14.29*	18th November 1967
Fiji*	Pound	0.39643	0.43542	*8.95*	26th November 1967
Gambia	Pound	0.35714	0.41667	*14.29*	21st November 1967
Gibraltar	Pound	0.35714	0.41667	*14.29*	18th November 1967
Guyana	Dollar	1.71429	2.0	*14.29*	20th November 1967
Hong Kong*	Dollar	5.71429	6.06061	*5.71*	22nd November 1967
Iceland	Króna	43.0	57.0	*24.56*	27th November 1967
Ireland	Pound	0.35714	0.41667	*14.29*	18th November 1967
Jamaica	Pound	0.35714	0.41667	*14.29*	21st November 1967
Malawi	Pound	0.35714	0.41667	*14.29*	20th November 1967
Malta	Pound	0.35714	0.41667	*14.29*	19th November 1967
Mauritius and Seychelles	Rupee	4.76190	5.55556	*14.29*	18th November 1967
New Zealand	Dollar	0.71919	0.89286	*19.45*	20th November 1967
Sierra Leone	Leone	0.71429	0.83333	*14.29*	21st November 1967
South Yemen	Dinar	0.35714	0.41667	*14.29*	18th November 1967
Trinidad and Tobago	Dollar	1.71429	2.0	*14.29*	22nd November 1967
United Kingdom	Pound	0.35714	0.41667	*14.29*	18th November 1967
Non-sterling-area countries					
Denmark	Krone	6.90714	7.50	*7.90*	21st November 1967
Israel	Pound	3.0	3.50	*14.29*	19th November 1967
Macao	Pataca	5.71429	6.06061	*5.71*	27th November 1967
Spain	Peseta	60.0	70.0	*14.29*	20th November 1967

* After revaluation.

exchange for convertible currencies applied to non-commercial transactions was raised from Frt. 24 = US $1 to Frt. 30. It seems probable that this was associated with domestic price reforms introduced at the same time.

In Latin America the devaluations of the Brazilian cruzeiro in February and of the Argentine peso in March 1967 were followed later in the year by downward adjustments of the Peruvian sol and the Uruguayan peso, as well as by a further 16 per cent. devaluation of the cruzeiro in December.

After seven years during which the effective parity had remained at Soles 26.82 = US $1, the Peruvian central bank withdrew its support for the exchange rate at the end of August 1967. It was led to this as a result of reserve losses brought about by a rising external deficit and a flight of capital from the country. Early in October a dual exchange rate system was introduced. Exporters must surrender foreign exchange receipts to the central bank in return for dollar certificates. Since their introduction the rate for exchange certificates has been held at Soles 38.7 = US $1, giving an effective devaluation of some 30.7 per cent. For non-trade items there is a free exchange market.

In Uruguay, the peso was devalued by 50 per cent. on 6th November 1967 to a new official rate of Pesos 199 = US $1. This followed three smaller devaluations earlier in the year. In April 1968 the official rate was further devalued to Pesos 249 = US $1.

Elsewhere in Latin America, the free rates for the Chilean escudo and the Colombian peso depreciated substantially against the dollar during the period under review.

In the rest of the world, there were currency devaluations in Mali and the Congo. On 5th May 1967 the Mali franc was devalued by 50 per cent., the official rate being changed from Francs 246.8 to Francs 493.7 = US $1. In the Congo, a new monetary unit, the Zaire, replaced the Congo franc on 23rd June 1967, at the rate of 1,000 Congo francs per Zaire. At the same time there was a $66^2/_3$ per cent. devaluation and the official rate of exchange was fixed at Zaire 1 = US $2.

On 31st May 1968 exchange control was temporarily reintroduced in France. Transfers from the French franc accounts of residents of France to those of non-residents are no longer freely allowed and must in all cases take place through authorised banks. Furthermore, residents of France may no longer acquire assets abroad, or hold means of foreign payment in France, without official authorisation. Permission is also required for the export from France, by or on behalf of residents, of all means of payment or securities, as well as for all imports and exports of gold.

V. THE EURO-CURRENCY MARKET.

The flow of Euro-currency credit through the banks of the eight reporting European countries continued to expand rapidly in 1967. Its dollar component, which had already increased from about $10 milliard to over $13 milliard in the course of 1966, may be estimated to have gone up further to about $16 milliard at the end of 1967. In contrast to 1966, however, the impetus behind the growth did not derive primarily from the demand side. The domestic economic slack and the related ease in credit conditions in several European countries, as well as confidence movements out of sterling, led at times to substantial increases in the supply of Euro-dollar funds. On the other hand, the international political and currency tensions occasionally both heightened the demand for Euro-dollars and led to major withdrawals. As a result, periods of relative ease alternated with periods of tightening market conditions; whereas in 1966 the trend of interest rates had been rather uniformly upwards, 1967 saw substantial fluctuations.

The pattern of new lending was also somewhat more differentiated than in 1966. In that year, with the liquidity squeeze, US residents, mainly banks, had absorbed roughly three-quarters of the new funds in the market, while about one-quarter had gone to outside countries other than the United States; lending to end-users within the reporting area had shown very little change. In 1967 US residents seem to have borrowed only about one-quarter of the new funds in the market; over one-half went to other outside countries and there was a sizable increase in lending to end-users within the reporting area.

Another feature of 1967 was the greater rôle played by official monetary institutions in stabilising the market. At the time of the Middle East crisis and on various occasions during the fourth quarter the BIS activated its dollar swap line with the Federal Reserve and invested the proceeds in the Euro-dollar market. In late November the Deutsche Bundesbank began to offer the commercial banks dollar swaps at preferential rates and did not, as on some earlier occasions, limit the use of dollars held under these facilities to the acquisition of US Treasury bills. Finally, the central banks of Belgium, the Netherlands and Switzerland co-operated with the US monetary authorities to support the dollar in the forward markets. With the help of these official evening-out operations the Euro-currency market continued in 1967 and the first quarter of 1968 to play its rôle as a truly international money and credit market.

Total foreign positions. Before discussing the Euro-currency statistics in detail, it may be helpful as background to look at the reporting banks' total foreign short-term positions. Two main features emerge. Firstly, except in the case of Germany, the banks' external positions in their domestic currencies are substantially smaller than those in foreign currencies. This is true even of the United Kingdom, whose currency is widely used for financing international

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

Countries	End of month	Liabilities: Domestic currency	Liabilities: Foreign currencies	Assets: Domestic currency	Assets: Foreign currencies	Net position: Domestic currency	Net position: Foreign currencies	Net position: Total
		in millions of US dollars						
Belgium-Luxemburg	1966 December	400	1,640	140	1,240	− 260	− 400	− 660
	1967 March	390	1,580	170	1,190	− 220	− 390	− 610
	June	440	1,730	170	1,270	− 270	− 460	− 730
	September	460	1,840	190	1,310	− 270	− 530	− 800
	December	490	1,950	190	1,480	− 300	− 470	− 770
France	1966 December	820	1,960	230	2,460	− 590	500	− 90
	1967 March	900	1,870	290	2,360	− 610	490	− 120
	June	900	1,900	290	2,480	− 610	580	− 30
	September	980	2,260	310	2,740	− 670	480	− 190
	December	1,070	2,590	290	2,850	− 780	260	− 520
Germany	1966 December	1,490	390	760	540	− 730	150	− 580
	1967 March	1,280	320	920	920	− 360	600	240
	June	1,360	340	1,180	1,000	− 180	660	480
	September	1,460	330	1,330	990	− 130	660	530
	December	1,830	350	1,230	1,170	− 600	820	220
Italy	1966 December	440	2,520	190	2,730	− 250	210	− 40
	1967 March	460	2,250	200	2,320	− 260	70	− 190
	June	510	2,270	170	2,220	− 340	− 50	− 390
	September	470	2,600	200	2,560	− 270	− 40	− 310
	December	550	2,920	200	2,940	− 350	20	− 330
Netherlands	1966 December	440	1,120	320	1,200	− 120	80	− 40
	1967 March	480	1,000	330	1,080	− 150	80	− 70
	June	510	1,120	300	1,120	− 210	—	− 210
	September	490	1,190	300	1,240	− 190	50	− 140
	December	520	1,120	290	1,200	− 230	80	− 150
Sweden	1966 December	180	310	60	550	− 120	240	120
	1967 March	160	320	70	530	− 90	210	120
	June	180	310	60	620	− 120	310	190
	September	200	350	80	690	− 120	340	220
	December	190	270	100	630	− 90	360	270
Switzerland	1966 December	1,810	2,230	1,390	2,690	− 420	460	40
	1967 March	1,910	2,280	1,600	2,940	− 310	660	350
	June	2,170	2,510	1,610	3,360	− 560	850	290
	September	2,170	2,660	1,700	3,610	− 470	950	480
	December	2,450	2,800	1,750	3,480	− 700	680	− 20
United Kingdom . .	1966 December	5,610	8,360	3,530	8,460	−2,080	100	−1,980
	1967 March	6,050	8,550	3,570	8,250	−2,480	− 300	−2,780
	June	6,180	9,060	3,740	8,820	−2,440	− 240	−2,680
	September	5,720	10,010	3,700	9,860	−2,020	− 150	−2,170
	December	4,770	10,390	3,270	10,480	−1,500	90	−1,410
Total	1966 December	11,190	18,530	6,620	19,870	−4,570	1,340	−3,230
	1967 March	11,630	18,170	7,150	19,590	−4,480	1,420	−3,060
	June	12,250	19,240	7,520	20,890	−4,730	1,650	−3,080
	September	11,950	21,240	7,810	23,000	−4,140	1,760	−2,380
	December	11,870	22,390	7,320	24,230	−4,550	1,840	−2,710
Canada	1966 December	510	2,160	60	2,970	− 450	810	360
	1967 March	560	2,060	70	2,630	− 490	570	80
	June	510	2,260	70	2,890	− 440	630	190
	September	510	2,190	70	3,030	− 440	840	400
	December	540	2,400	60	3,560	− 480	1,160	680
Japan	1966 December	320	2,840	—	3,260	− 320	420	100
	1967 March	320	3,100	—	3,210	− 320	110	− 210
	June	330	3,410	—	3,360	− 330	− 50	− 380
	September	350	3,450	—	3,490	− 350	40	− 310
	December	370	3,740	—	3,700	− 370	− 40	− 410

* The figures in this table are partly based on different series from those used in the rest of this chapter and are therefore not strictly comparable with them.

trade. Taking the eight European countries as a whole, domestic currency at the end of 1967 accounted for only about one-third of the banks' total external liabilities and for less than one-quarter of their assets. In the case of Canada and Japan the domestic currency component was even smaller. Secondly, without exception, the net external positions in domestic currency were negative. In Canada, Germany, Sweden and Switzerland, however, the net external liabilities in domestic currency were generally more than offset by net external assets in foreign currencies. Only in the case of Belgium and the United Kingdom were the net positions in foreign currencies predominantly negative.

As regards the main movements in the course of 1967, the total external assets of the reporting European banks went up by about $5.1 milliard and liabilities by $4.5 milliard. Most of these increases occurred in the foreign currency component. The modest contribution of the domestic currency component was due partly to foreign holders shifting out of sterling; the UK banks' external liabilities in sterling declined by $840 million, while those in foreign currencies expanded by $2,030 million. On the other hand, as regards Switzerland, the increase in the banks' domestic currency liabilities exceeded that in their foreign currency liabilities, and in the case of the German banks a substantial rise in domestic currency liabilities contrasted with a decline in those in foreign currencies.

External positions in foreign currencies. On the Euro-currency market proper the external liabilities of the reporting European banks in dollars, Deutsche Mark, Swiss francs, sterling, French francs, Dutch florins and Italian lire expanded by altogether $3,810 to 22,120 million and their assets by $4,530 to 24,440 million. The increases were slightly smaller than in 1966, when assets and liabilities had risen by $4,140 and 4,760 million respectively, but were still very large by any standard.

As regards the currency composition, over 85 per cent. of the increase in liabilities was in dollars and less than 15 per cent. in the other six reported currencies. Dollar liabilities expanded by $3,260 million, or $110 million less than in 1966. The second largest increase was in Deutsche Mark liabilities, which went up by $700 million, whereas those in French francs, after a $460 million advance in 1966, contracted by $430 million. This smaller use of French francs was chiefly due to the fact that the Belgian banks, in contrast to 1966, shifted their foreign borrowing on behalf of the Belgian Treasury from French francs into other currencies, mainly into Deutsche Mark. At 84 per cent., the share of dollars in the growth of assets was considerably smaller than in 1966, when, owing to the strong demand for Euro-dollars from the US banks, it amounted to 94 per cent. As regards the other reported currencies, the picture was about the same as on the liabilities side. The largest expansion was in Deutsche Mark assets, whereas French franc assets contracted. Sterling assets, after a $180 million fall in 1966, went up by $70 million, but the whole of this increase occurred in the first half of 1967; the second half saw a $470 million decline, part of which represented the effect of devaluation.

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

Countries	End of month	US dollars		Other currencies[1]		Total		
		Liabil-ities	Assets	Liabil-ities	Assets	Liabil-ities	Assets	Net
		in millions of US dollars						
Belgium-Luxemburg	1966 December	670	740	940	440	1,610	1,180	— 430
	1967 March	680	680	840	460	1,520	1,140	— 380
	June	750	730	970	490	1,720	1,220	— 500
	September	790	800	1,030	460	1,820	1,260	— 560
	December	890	980	1,050	470	1,940	1,450	— 490
France[2]	1966 December	1,330	1,860	630	600	1,960	2,460	500
	1967 March	1,170	1,620	700	740	1,870	2,360	490
	June	1,020	1,660	880	820	1,900	2,480	580
	September	1,290	1,780	970	960	2,260	2,740	480
	December	1,700	1,890	890	970	2,590	2,860	270
Germany	1966 December	330	400	50	120	380	520	140
	1967 March	260	760	50	130	310	890	580
	June	270	790	60	190	330	980	650
	September	250	810	70	160	320	970	650
	December	280	1,030	50	110	330	1,140	810
Italy	1966 December	1,930	2,090	590	640	2,520	2,730	210
	1967 March	1,640	1,690	610	640	2,250	2,330	80
	June	1,640	1,670	630	550	2,270	2,220	— 50
	September	1,820	1,980	780	580	2,600	2,560	— 40
	December	2,140	2,260	780	680	2,920	2,940	20
Netherlands	1966 December	790	550	350[3]	510[3]	1,140	1,060	— 80
	1967 March	690	470	330[3]	600[3]	1,020	1,070	50
	June	730	480	390[3]	610[3]	1,120	1,090	— 30
	September	780	600	400[3]	580[3]	1,180	1,180	—
	December	810	650	300[3]	480[3]	1,110	1,130	20
Sweden	1966 December	190	330	140	200	330	530	200
	1967 March	210	300	100	200	310	500	190
	June	210	320	90	270	300	590	290
	September	230	440	120	220	350	660	310
	December	170	350	90	260	260	610	350
Switzerland[4]	1966 December	1,890	2,780	210	440	2,100	3,220	1,120
	1967 March	1,920	2,780	260	500	2,180	3,280	1,100
	June	2,100	3,280	310	650	2,410	3,930	1,520
	September	2,260	3,310	310	680	2,570	3,990	1,420
	December	2,430	3,520	310	610	2,740	4,130	1,390
United Kingdom . .	1966 December	7,590	7,310	680	900	8,270	8,210	— 60
	1967 March	7,760	6,960	700	1,020	8,460	7,980	— 480
	June	8,130	7,650	790	890	8,920	8,540	— 380
	September	9,070	8,520	790	1,020	9,860	9,540	— 320
	December	9,560	9,190	670	990	10,230	10,180	— 50
Total	1966 December	14,720	16,060	3,590	3,850	18,310	19,910	1,600
	1967 March	14,330	15,260	3,590	4,290	17,920	19,550	1,630
	June	14,850	16,580	4,120	4,470	18,970	21,050	2,080
	September	16,490	18,240	4,470	4,660	20,960	22,900	1,940
	December	17,980	19,870	4,140	4,570	22,120	24,440	2,320
Canada	1966 December	2,150	2,890	10[5]	80[5]	2,160	2,970	810
	1967 March	2,040	2,550	20[5]	80[5]	2,060	2,630	570
	June	2,250	2,810	10[5]	80[5]	2,260	2,890	630
	September	2,170	2,950	10[5]	80[5]	2,180	3,030	850
	December	2,400	3,510	10[5]	70[5]	2,410	3,580	1,170
Japan	1966 December	2,550	2,870	300	380	2,850	3,250	400
	1967 March	2,820	2,890	280	310	3,100	3,200	100
	June	3,130	3,000	290	340	3,420	3,340	— 80
	September	3,180	3,120	290	350	3,470	3,470	—
	December	3,490	3,340	260	340	3,750	3,680	— 70

[1] Sterling, Swiss francs, Deutsche Mark, Dutch florins, French francs, Italian lire. [2] Positions vis-à-vis banks only. [3] Sterling, Swiss francs, Deutsche Mark only; including French francs as from March 1967. [4] Including Euro-currency assets of the BIS. [5] All other currencies, but mainly sterling.

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

Countries	End of month	US dollars		Other currencies[1]		Total		
		Liabil-ities	Assets	Liabil-ities	Assets	Liabil-ities	Assets	Net
		in millions of US dollars						
Belgium-Luxemburg	1966 December	560	560	620	110	1,180	670	— 510
	1967 March	560	460	490	110	1,050	570	— 480
	June	590	490	550	100	1,140	590	— 550
	September	610	540	640	120	1,250	660	— 590
	December	730	700	720	160	1,450	860	— 590
France[2]	1966 December	1,230	1,270	430	360	1,660	1,630	— 30
	1967 March	1,010	1,130	400	420	1,410	1,550	140
	June	940	1,220	480	400	1,420	1,620	200
	September	1,130	1,350	440	550	1,570	1,900	330
	December	1,480	1,360	580	600	2,060	1,960	— 100
Germany	1966 December	260	260	20	10	280	270	— 10
	1967 March	200	630	20	20	220	650	430
	June	190	630	20	20	210	650	440
	September	210	680	30	10	240	690	450
	December	240	680	20	10	260	690	430
Italy	1966 December	1,700	1,870	390	390	2,090	2,260	170
	1967 March	1,440	1,520	330	310	1,770	1,830	60
	June	1,480	1,480	350	250	1,830	1,730	— 100
	September	1,670	1,750	420	330	2,090	2,080	— 10
	December	1,990	2,010	450	420	2,440	2,430	— 10
Netherlands	1966 December	720	470	220[3]	170[3]	940	640	— 300
	1967 March	610	370	200[3]	170[3]	810	540	— 270
	June	640	380	240[3]	230[3]	880	610	— 270
	September	690	500	240[3]	250[3]	930	750	— 180
	December	740	520	170[3]	270[3]	910	790	— 120
Sweden	1966 December	160	240	60	50	220	290	70
	1967 March	160	220	60	40	220	260	40
	June	190	250	50	60	240	310	70
	September	210	310	50	60	260	370	110
	December	150	250	50	80	200	330	130
Switzerland[4]	1966 December	1,750	2,300	130	140	1,880	2,440	560
	1967 March	1,760	2,280	170	140	1,930	2,420	490
	June	1,920	2,760	190	190	2,110	2,950	840
	September	2,050	2,850	210	210	2,260	3,060	800
	December	2,120	2,990	190	240	2,310	3,230	920
United Kingdom . .	1966 December	6,640	3,830	.	.	.	.	.
	1967 March	6,730	3,710	.	.	.	.	.
	June	7,170	4,330	.	.	.	.	.
	September	8,060	4,380	.	.	.	.	.
	December	8,180	5,120	.	.	.	.	.
Total	1966 December	13,020	10,800	.	.	.	.	.
	1967 March	12,470	10,320	.	.	.	.	.
	June	13,120	11,540	.	.	.	.	.
	September	14,630	12,360	.	.	.	.	.
	December	15,630	13,630	.	.	.	.	.
Canada	1966 December	1,450	930	—[5]	40[5]	1,450	970	— 480
	1967 March	1,320	930	10[5]	40[5]	1,330	970	— 360
	June	1,520	1,080	10[5]	40[5]	1,530	1,120	— 410
	September	1,540	980	10[5]	40[5]	1,550	1,020	— 530
	December	1,620	1,300	—[5]	30[5]	1,620	1,330	— 290
Japan	1966 December	610	790	70	230	680	1,020	340
	1967 March	720	770	60	180	780	950	170
	June	850	790	60	190	910	980	70
	September	960	800	70	210	1,030	1,010	— 20
	December	990	830	60	190	1,050	1,020	— 30

[1] Sterling, Swiss francs, Deutsche Mark, Dutch florins, French francs, Italian lire. [2] Positions vis-à-vis banks only. [3] Sterling, Swiss francs, Deutsche Mark only; including French francs as from March 1967. [4] Including Euro-currency assets of the BIS. [5] All other currencies, but mainly sterling.

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

Items	1965	1966	1967	Total amount outstanding at the end of 1967
	in millions of US dollars			
Reporting European banks				
Liabilities				
Dollars	+ 1,710	+ 3,370	+ 3,260	17,980
Other currencies*	+ 250	+ 770	+ 550	4,140
of which				
Sterling	*— 40*	*— 20*	*+ 90*	*800*
Swiss francs	*+ 110*	*+ 290*	*+ 180*	*1,400*
Deutsche Mark	*+ 100*	*+ 100*	*+ 700*	*1,670*
French francs	*+ 30*	*+ 460*	*— 430*	*160*
Total	+ 1,980	+ 4,140	+ 3,810	22,120
Assets				
Dollars	+ 2,590	+ 4,470	+ 3,810	19,870
Other currencies*	+ 520	+ 290	+ 720	4,570
of which				
Sterling	*+ 40*	*— 180*	*+ 70*	*870*
Swiss francs	*+ 80*	*+ 170*	*+ 180*	*1,110*
Deutsche Mark	*+ 300*	*+ 30*	*+ 630*	*2,050*
French francs	*+ 40*	*+ 320*	*— 210*	*240*
Total	+ 3,110	+ 4,760	+ 4,530	24,440
Canadian banks				
Liabilities	— 210	— 240	+ 250	2,410
Assets	— 600	+ 190	+ 610	3,580
Japanese banks				
Liabilities	+ 180	— 60	+ 900	3,750
Assets	+ 390	+ 250	+ 430	3,680

* Sterling, Swiss francs, Deutsche Mark, Dutch florins, French francs, Italian lire.

On balance, the dollar maintained its dominant position in the Euro-currency market and at the end of December accounted for 81 per cent. of both liabilities and assets. With a market share of 8 per cent., the Deutsche Mark ranked second; it was followed at some distance by the Swiss franc. Positions in sterling were only half as large as those in Deutsche Mark. The positions in the other three reported currencies were quite small. The use of Deutsche Mark and Swiss francs in 1967 was encouraged by the relatively easy monetary conditions in Germany and Switzerland and by the high forward premiums of the two currencies. The relative importance of sterling, on the other hand, has declined in recent years as a result of the United Kingdom's external payments difficulties.

The Canadian and Japanese banks' gross external foreign currency positions, which are, however, only partly of a Euro-currency nature, expanded appreciably in 1967. The Canadian banks' assets went up by $610 million and their liabilities by $250 million. The resultant $360 million widening in their external net asset position, about half of which was vis-à-vis the United States, represented the counterpart of a $440 million increase in their net foreign currency liabilities vis-à-vis residents. Most of this occurred during the last quarter of 1967, when both the relatively large forward discount on the Canadian dollar and the high interest rates in the Euro-dollar and US money markets enabled the Canadian banks to offer very attractive yields on foreign currency deposits, which are not subject to the non-interest-bearing cash reserve requirement that applies to Canadian dollar deposits. The development in the Japanese banks' external positions was influenced by the tightening of domestic credit conditions and the easing, in the light of the balance-of-payments deficit, of the official guide-lines with respect to the banks' Euro-currency borrowing. Liabilities, which had declined by $60 million in 1966, went up by $900 million and assets by $430 million. However, $530 million of the increase in liabilities and virtually all of the expansion in assets was vis-à-vis the United States.

The growth of the Euro-dollar market. The geographical pattern of the increase in the reporting European banks' external dollar positions in 1967 was quite different from that in 1966. Liabilities vis-à-vis countries outside the reporting group, which had accounted for only about 38 per cent. of the increase in total liabilities in 1966, were responsible for 56 per cent. of the overall growth in 1967. To a large extent this increased importance of outside countries as a source of Euro-dollars was due to the development of the position vis-à-vis North America. The expansion in liabilities towards the United States accelerated from $320 million in 1966 to $670 million and those towards Canada from $100 to 240 million. In particular, the large inflow from the United States, the major part of which took place during the fourth quarter, is somewhat surprising. The 1966 increase was to a considerable extent the result of the depositing of funds raised by US corporations in the Euro-bond market in advance of needs; and in the preceding year US residents had not been significant suppliers of Euro-dollar funds. The large fourth-quarter inflow in 1967 may have been stimulated by the high Euro-dollar rates ruling at that time and by expectations of a further tightening of the US balance-of-payments restraint measures. Also, the bulk of the increase in liabilities to Canada occurred during the last quarter of 1967. Liabilities to outside countries other than the United States and Canada went up by $930 million, or $80 million more than in 1966. Here larger increases were recorded mainly vis-à-vis "Other western Europe" and eastern Europe.

Liabilities to countries inside the reporting area expanded by $1,420 million, or $680 million less than in 1966. The slow-down occurred principally vis-à-vis three countries. Despite the pronounced easing of Swiss liquidity conditions, liabilities towards Switzerland, after a $850 million advance in 1966, went up by only $290 million. The difference is mainly attributable to developments in the last quarter of the two years. In the fourth quarter of 1966 there were large end-of-year placements both by the BIS and the Swiss National Bank and an increase of about $80 million in Euro-dollar deposits by the Swiss private sector. In the last quarter of 1967, however, the Swiss private sector withdrew some $300 million from the market in response to the international currency crisis, and the fourth-quarter increase in combined placements by the BIS and the Swiss National Bank was only about half

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

Items	Liabilities				Assets			
	Changes in			Amount outstanding at the end of 1967	Changes in			Amount outstanding at the end of 1967
	1965	1966	1967		1965	1966	1967	
	in millions of US dollars							
Outside area								
Other western Europe	+ 50	+ 240	+ 310	1,400	+ 290	+ 220	+ 330	1,220
Eastern Europe	+ 30	+ 70	+ 110	470	+ 80	+ 130	+ 100	770
Canada	— 320	+ 100	+ 240	900	+ 250	— 50	+ 120	740
Japan	+ 10	—	+ 20	70	+ 70	+ 160	+ 360	1,030
Latin America	+ 110	+ 120	+ 110	950	+ 90	+ 70	+ 310	760
Middle East	+ 170	+ 150	+ 120	1,120	+ 60	+ 20	+ 120	310
Other	+ 110	+ 270	+ 260	1,380	+ 150	+ 120	+ 310	700
Total	+ 160	+ 950	+ 1,170	6,290	+ 990	+ 670	+ 1,650	5,530
United States	+ 110	+ 320	+ 670	2,360	+ 190	+ 2,260	+ 960	6,230
Total outside area	+ 270	+ 1,270	+ 1,840	8,650	+ 1,180	+ 2,930	+ 2,610	11,760
Inside area								
Belgium	+ 70	+ 300	+ 150	790	+ 50	+ 90	+ 90	550
France	+ 290	+ 200	+ 180	1,220	+ 170	+ 190	+ 230	1,130
Germany	+ 50	+ 50	+ 550	790	—	+ 110	— 160	320
Italy	+ 620	+ 270	+ 80	1,590	+ 190	+ 120	+ 120	1,310
Netherlands	+ 30	+ 120	+ 100	510	+ 140	+ 200	+ 20	590
Sweden	+ 20	+ 20	+ 30	180	+ 70	+ 20	+ 20	200
Switzerland	+ 490	+ 850	+ 290	2,870	+ 130	+ 210	+ 110	780
United Kingdom	— 130	+ 290	+ 40	1,380	+ 660	+ 600	+ 770	3,230
Total inside area	+ 1,440	+ 2,100	+ 1,420	9,330	+ 1,410	+ 1,540	+ 1,200	8,110
Grand total	+ 1,710	+ 3,370	+ 3,260	17,980	+ 2,590	+ 4,470	+ 3,810	19,870

as large as in 1966 (see also page 154). As a result, the reporting European banks' liabilities to Switzerland went up by only $20 million in the last quarter of 1967, after expanding by as much as $700 million in the corresponding period of 1966. The bulk of the $290 million increase that occurred in 1967 as a whole reflected mainly the re-export by the Swiss banks of funds which had accrued to them during the Middle East crisis.

The expansion in liabilities to the United Kingdom slowed down from $290 million in 1966 to $40 million, indicating that in 1967 there was on balance virtually no flow of Euro-dollar funds through the UK banks to the other reporting European banks. Liabilities to Italy went up by $80 million, or $190 million less than in 1966. Their slower growth was partly due to the fact that, unlike in the preceding two years, there was no further major increase in the amount of dollars obtained by the Italian banks under swaps with the Italian Exchange Office.

On the other hand, the increase in liabilities towards Germany accelerated from $50 million in 1966 to $550 million last year. Despite the $630 million of dollars obtained by the German banks in November and December through swaps with the Bundesbank, only \$60 million of the 1967 rise in the other reporting banks' liabilities to Germany took place during the last quarter of the year. This partly reflects the fact that these swap dollars in large measure simply took the place of funds previously withdrawn by the German banks themselves. Moreover, the German banks used a part of the swap dollars for purchases of US money-market paper, and these did not add to the supply of Euro-dollar funds.

To turn to the uses side, assets vis-à-vis the United States — the \$2,260 million increase in which had been the main feature of 1966 — went up by \$960 million last year. About \$200 million of this rise, moreover, represented the purchases of US money-market paper by German banks just referred to; as in 1966, the remainder chiefly reflected Euro-dollar market borrowing by US banks. The much smaller Euro-dollar market recourse of US banks consequent upon their easier liquidity positions improved conditions for other types of borrowers. In fact, claims on other outside countries went up by \$1,650 million, i.e. about two and a half times as much as in 1966. This greater expansion was widespread; the largest increase, however, occurred as regards the Japanese banks. Moreover, assets vis-à-vis Canada, which had contracted by \$50 million in 1966, went up by \$120 million.

Claims on countries inside the reporting area increased by \$1,200 million, or \$340 million less than in 1966. The slow-down was particularly pronounced in the positions vis-à-vis Germany, the Netherlands and Switzerland, all three countries experiencing slackening economic growth in 1967 and a substantial easing of domestic liquidity conditions. Vis-à-vis Germany there was actually a turn-round from a \$110 million rise in 1966 to a \$160 million decline in 1967. As in past years, the largest increase in claims (\$770 million) was on the United Kingdom; this reflected principally the flow of Euro-dollar funds from the other reporting European banks through the UK banks to outside countries.

Net size of the Euro-dollar market. The table on page 152 indicates the main directions of the Euro-dollar flows but does not pretend to show the actual volume of credit channelled through the market. On the one hand, the figures are inflated by a substantial amount of redepositing between banks and by certain positions which have little connection with Euro-currency activity; on the other hand, the figures do not, for example, include the foreign currency positions vis-à-vis residents, nor can they fully reflect dollars obtained or employed through swaps out of or into the domestic currency or third currencies. The following table provides an estimate of the size of the Euro-dollar market after approximate allowance has been made for these various factors. The methods used for arriving at these estimates were described in the Thirty-sixth Annual Report. For the sake of clarity, however, some further comments may be added. Briefly, the table presents estimates of the amount of Euro-dollar credit channelled through the banks of the eight European countries contributing to the Euro-dollar statistics. It does not include the flow of Euro-dollar credits which, on their way from the original supplier to

Estimated size of the Euro-dollar market.

Items	Sources 1965	Sources 1966	Sources 1967	Uses 1965	Uses 1966	Uses 1967	Net 1965	Net 1966	Net 1967
	end-year figures, in milliards of US dollars								
Outside area									
United States	0.8	1.1	1.7	1.8	4.1	4.8	+ 1.0	+ 3.0	+ 3.1
Other countries	4.2	5.1	6.3	3.2	3.9	5.6	− 1.0	− 1.2	− 0.7
Total	5.0	6.2	8.0	5.0	8.0	10.4	—	+ 1.8	+ 2.4
Inside area									
Official monetary institutions	2.2	2.8	3.1	—	—	—	− 2.2	− 2.8	− 3.1
Non-residents other than banks	1.0	1.5	1.9	0.6	0.8	0.7	− 0.4	− 0.7	− 1.2
Non-bank residents, plus swaps out of or into domestic or third currencies*	1.8	2.5	3.0	4.4	4.2	4.9	+ 2.6	+ 1.7	+ 1.9
Total	5.0	6.8	8.0	5.0	5.0	5.6	—	− 1.8	− 2.4
Total net size of market	10.0	13.0	16.0	10.0	13.0	16.0	—	—	—

* Excluding swaps carried out under special arrangements with official monetary institutions but including, under "Uses", the reporting banks' own use of Euro-dollars for liquidity purposes and window-dressing operations (temporary switching out of dollars into domestic currency).

the end-users, do not go through at least one of the banks of these countries at some stage. On the other hand, the figures do include credit flows which take the form of dollars for only part of their course. For example, funds accepted by the UK banks in the form of dollars and re-lent in the form of Deutsche Mark or sterling are included on both the sources and the uses side of the table. To some extent, therefore, these estimates contain positions that in the other tables appear under "Other currencies".

Thus delimited, the Euro-dollar market may be estimated to have expanded by about \$3 milliard to \$16.0 milliard in the course of 1967. Including the other reported currencies, the increase might be put at around \$3.5 milliard and the total size of the market at something over \$19 milliard at the end of 1967. As to the sources of the \$3 milliard increase, about \$1.8 milliard came from outside the reporting area, \$0.6 milliard of which from US residents. Of the \$1.2 milliard growth in the supply from within the reporting area, about \$0.3 milliard stemmed from official monetary institutions, essentially those dollars transferred by the Deutsche Bundesbank on a swap basis to the German banks which were used by them for placements in the Euro-dollar market. The BIS's Euro-dollar placements also showed some increase compared with 1966, and there was a slight rise (\$40 million) in the volume of dollars placed by the Italian Exchange Office on a swap basis with the Italian commercial banks. On the other hand, the Swiss National Bank, which had made large Euro-dollar deposits at the end of 1966, was not in the market to any great extent at the end of 1967. The main reason for this was that, in view of the international currency situation, the Swiss banks did not, as in the preceding years, cover their end-year requirements by temporarily placing dollars on a swap basis with the Swiss National Bank but mainly by outright sales of dollars. The \$0.4 milliard increase in the supply from "non-residents other than banks" largely derived from bigger continental European deposits with the UK banks. The remaining $0.5 milliard rise chiefly reflected an increase in dollar deposits received by the banks from their own residents.

On the uses side, about $2.4 milliard of the new funds in the market went to outside countries. One of the principal reasons why the estimated $0.7 milliard increase in claims on the United States is smaller than that shown in the table on page 152 is that the swap dollars used by the German banks for purchases of US money-market paper have been excluded. End-uses of Euro-dollars within the reporting area may be estimated to have gone up by about $0.6 milliard in 1967. However, lending by banks to non-bank residents of the reporting area other than residents of their own individual countries declined by about $0.1 milliard, mainly owing to reduced credit demand from German residents. On the other hand, lending to residents within the reporting banks' own countries and/or swaps into the domestic currency or third currencies are estimated to have increased by some $0.7 milliard after an apparent downward trend in 1966. The difference between the two years is chiefly explained by the tendency of the banks in 1966 to reduce the total amount of swapping out of dollars into the domestic currency or third currencies, the most important example being a $430 million switch-back by the UK banks, mainly out of sterling, into dollars. In 1967, by contrast, with demand for dollars by US banks much slacker than in 1966 and with confidence factors also favouring such a movement, there seems to have been a substantial amount of switching out of dollars (into currencies other than sterling). Moreover, in the case of one or two countries there was also an appreciable increase in outright dollar lending to residents in 1967.

With regard to net positions, there was a further modest increase in lending to the United States in 1967 and a continued rise in borrowing from within the reporting area. In contrast to 1966, however, the net supply of Euro-dollars from outside countries other than the United States contracted by $0.5 milliard. From the point of view of growth of the market, therefore, the main feature of 1967 was a net flow of funds from within the reporting area to outside countries other than the United States — mainly Japan and Latin America — and, to a smaller extent, also to the United States.

Changes in individual countries' foreign positions. The increase in the UK banks' external foreign currency liabilities slowed down from $2,470 million in 1966 to $1,960 million in 1967 and the growth in their assets from $2,870 to 1,970 million. The UK banks' share in the total expansion of the market, though still very large, was thus considerably less than in 1966. This slowdown, which in view of the movement by foreign holders out of sterling into Euro-currencies may sound somewhat paradoxical, was partly the result of the reduced amount of new borrowing by US banks from their branches in London. Nevertheless, at the end of 1967 these branches still accounted for well over half of the UK banks' external dollar positions. Another reason for the more moderate rate of expansion was a certain amount of shifting out of

External positions in foreign currencies of reporting European banks.

Banks of	Liabilities		Assets		Net positions		
	Dollars	Other reported cur-rencies*	Dollars	Other reported cur-rencies*	Dollars	Other reported cur-rencies*	Total
	changes from end-1966 to end-1967, in millions of US dollars						
Belgium-Luxemburg . . .	+ 220	+ 110	+ 240	+ 30	+ 20	— 60	— 60
France	+ 370	+ 260	+ 30	+ 370	— 340	+ 110	— 230
Germany	— 50	—	+ 630	— 10	+ 680	— 10	+ 670
Italy	+ 210	+ 190	+ 170	+ 40	— 40	— 150	— 190
Netherlands	+ 20	— 50	+ 100	— 30	+ 80	+ 20	+ 100
Sweden	— 20	— 50	+ 20	+ 60	+ 40	+ 110	+ 150
Switzerland	+ 540	+ 100	+ 740	+ 170	+ 200	+ 70	+ 270
United Kingdom	+ 1,970	— 10	+ 1,880	+ 90	— 90	+ 100	+ 10
Total change	+ 3,260	+ 550	+ 3,810	+ 720	+ 550	+ 170	+ 720

* Sterling, Swiss francs, Deutsche Mark, French francs, Dutch florins, Italian lire.

Euro-currencies into gold and precautionary withdrawals of Euro-dollar deposits in connection with the sterling crisis. The fact that the slow-down in assets growth was more pronounced than that in liabilities must be seen against the background of the large amount of outward switching that took place in 1966. In 1967 the UK banks switched about $90 million out of dollars into the other reported currencies, whereas their overall net position in foreign currencies remained virtually unchanged. Of the $1,970 million rise in the UK banks' dollar liabilities, $430 million was vis-à-vis the United States and $230 million vis-à-vis Canada. Liabilities to German residents went up from $120 to 450 million. On the assets side, the largest changes were a rise of $580 million vis-à-vis US residents and one of $370 million vis-à-vis Japan; claims on Germany declined by $130 million.

The confidence factors which contributed to the slow-down in the growth of the UK banks' external foreign currency positions tended to accelerate the growth in the Swiss banks' positions. Whereas these had shown virtually no change in 1966, the external foreign currency liabilities of the Swiss banks went up by $640 million last year and their assets by $910 million. The resultant $270 million improvement in the net position was partly due to somewhat larger Euro-currency placements by the BIS, but more than half seems to have represented a re-employment of flight money which had entered Switzerland mainly in connection with the war in the Middle East. In relation to the ease of domestic liquidity conditions and to the large Swiss franc inflows, however, the net export of foreign currency funds by the Swiss banks was rather modest. One reason for this is that, as a result of weakening confidence, the forward rate movements left little room for covered interest arbitrage movements out of Swiss francs.

Of the reporting European banks, the German ones, owing to the Bundesbank's policy of active monetary ease and to the lack of domestic credit outlets, showed the largest change in their net positions. Their external liabilities in foreign currencies declined by $50 to 330 million, while their assets advanced by $620 to 1,140 million. The whole of the resultant $670 million increase in net assets was in dollars. As in the case of Switzerland, the banks' Euro-currency placements were, however, at times limited by the conditions ruling in the forward markets. Taking 1967 as a whole, the forward cover for the $630 million expansion in the banks' external dollar assets was in actual fact provided at preferential rates by the Bundesbank. Despite the unwinding of the banks' end-year operations and a further $230 million increase in the Bundesbank's swap commitments, the first quarter of 1968 saw only a $110 million expansion in dollar assets. The German banks, however, shifted a substantial amount of funds out of New York into the Euro-dollar market; claims on US residents declined by $160 million, while those on the United Kingdom went up by $230 million.

The development of the French banks' foreign positions was also influenced by the international currency tensions. In contrast to the Swiss case, the greater part of the rise in the French banks' external liabilities took place in the foreign currency component. Moreover, about three-fifths of the $630 million increase in external foreign currency liabilities was in dollars, whereas almost the whole of the $400 million rise in assets occurred in the other reported currencies. As a result, the $230 million decline in the banks' overall net positions was composed of a $340 million decrease in net dollar assets and a $110 million rise in other net foreign currency assets. The deterioration in the banks' external dollar positions seems to have occurred mainly in November, when they not only recorded a large increase in their dollar liabilities but at the same time reduced their dollar assets. Of the $410 million rise in dollar liabilities in the fourth quarter, $170 million was vis-à-vis Italy, $100 million vis-à-vis the United Kingdom, another $100 million vis-à-vis Germany and $50 million vis-à-vis the United States.

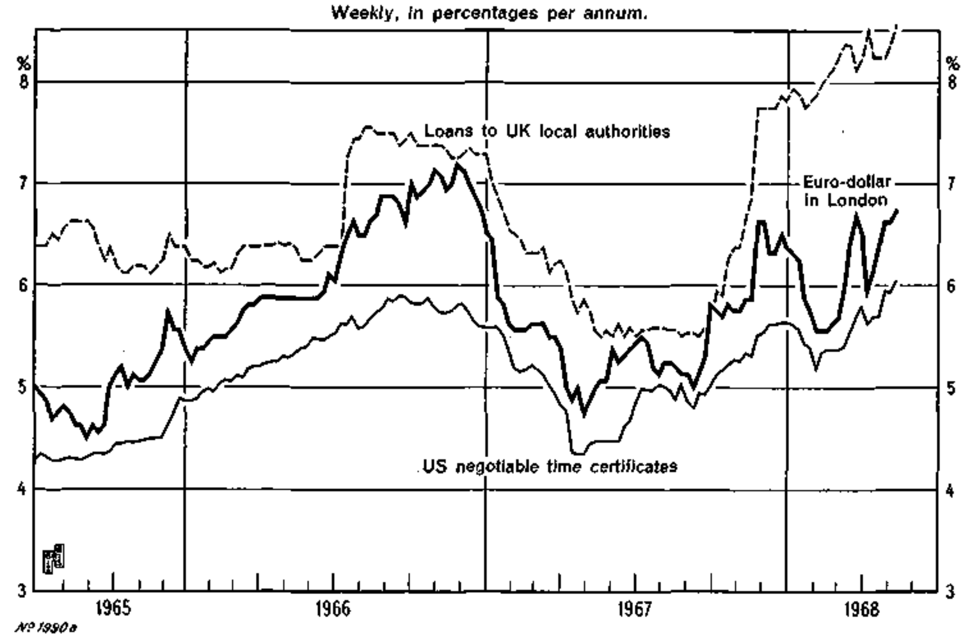
The development of the Italian banks' positions reflected the strengthening of domestic credit demand and the somewhat easier conditions during part of the year on the Euro-currency market. External foreign currency liabilities rose by $400 million and the net position, after improving by $590 and 320 million in 1965 and 1966 respectively, declined by $190 to 20 million. Foreign currency claims on residents went up by $190 to 2,170 million and there were substantial shifts in the currency composition of this total: credits extended to residents in dollars and French francs contracted by $500 and 150 million respectively, whereas those in Deutsche Mark and Swiss francs expanded by $680 and 140 million respectively. The explanation is that, as a result of the widening of the forward discount of the dollar against these two currencies, the Italian banks were able to offer substantially lower interest rates on funds switched out of dollars into these currencies than on outright dollar credits.

In the case of the Netherlands and Sweden, where general cyclical developments were similar to those in Germany, though less pronounced, the reporting banks, like Germany's, both reduced their external foreign currency liabilities and strengthened their foreign currency assets. Consequently, the net position of the Dutch banks improved by \$100 million and that of the Swedish banks by \$150 million.

The growth in the Belgian-Luxemburg banks' external foreign currency positions slowed down in comparison to 1966 but was still quite substantial, liabilities going up by \$330 million and assets by \$270 million. The whole of the resultant \$60 million decline in the net position was in foreign currencies other than the dollar. Net liabilities in Deutsche Mark expanded from about zero to \$370 million, while those in French francs fell by \$330 million. At the end of 1967 Belgium was the only country within the reporting group whose banks showed a major net negative position in foreign currencies. This is explained mainly by the financing requirement of the Belgian Treasury, which does its foreign borrowing partly through the Belgian banks. If net claims on residents are included, the Belgian banks at the end of 1967 had a net asset position in foreign currencies of about \$60 million.

Interest rate developments. In the Euro-currency market 1967 came in like a lamb and went out like a lion. The relaxation of monetary restraint in the United States and in several European countries, together with the usual seasonal factors, led to a pronounced easing in market conditions in the second half of December 1966 and the first four months of 1967. US banks made substantial repayments on their Euro-dollar borrowings and German banks, faced with stagnating credit demand at home, placed funds in the market on a large scale. As a result, the three-month Euro-dollar rate in London declined from its peak of over 7 per cent. in early December to $4^3/_4$ per cent. at the end of April. The premium over three-month US

Three-month rates of interest in London and New York.
Weekly, in percentages per annum.



bank certificates of deposit in New York, which had exceeded 1 per cent. throughout most of the last quarter of 1966, narrowed to about three-eighths of 1 per cent.

The decline in interest rates was accompanied by a stagnation in the market volume; in January there was the usual sharp seasonal contraction and the subsequent three months brought little change either way. With the covered interest arbitrage margins throughout most of this period in favour of sterling, the UK banks in the first quarter of 1967 used a large part of the reflux of funds from US banks and from lending for end-year purposes for placements in UK money-market paper; their net external liabilities in dollars went up by $520 million. In addition, the reporting banks swapped substantial amounts out of dollars into the other Euro-currencies. Finally, the demand for Euro-dollars was strengthened somewhat by increased recourse to the market by Japanese banks.

In early May the market began to firm again. The increase in demand seems to have come mainly from countries outside the reporting area. In the second half of the month a renewed wave of private gold-buying, partly financed with Euro-currency funds, tightened the market. With interest rates in the United States turning upwards again, the US banks in May began to slow down their repayment of Euro-dollars and in June they started once more to increase their takings. Then mid-year requirements and the war in the Middle East led to further market pressures. The three-month rate rose from 4¾ per cent. at the beginning of May 1967 to 5⅝ per cent. on Tuesday, 6th June, but, with the cessation of hostilites in the Middle East and with market support by the BIS, it fell back to 5¼ per cent. by the end of the week. During the second half of June, partly as a reflection of the renewed borrowing by US banks, demand began to strengthen again and the rate rose to 5½ per cent. in early July. This second-quarter tightening of Euro-dollar rates contrasted with easing monetary conditions in Europe and tended to turn the covered arbitrage margins in favour of the dollar. As a result there was a substantial movement out of Euro-Deutsche Mark, Euro-Swiss francs and, to some extent, sterling into dollars. The UK banks' net external position in foreign currency improved by $320 million in dollars but declined by $260 million in other currencies.

In the course of the summer demand for Euro-dollars from countries outside the reporting area other than the United States began to ease off markedly. In the United Kingdom the covered rate for local-authority deposits had in the meantime fallen substantially below that on Euro-dollars, and confidence factors also encouraged a movement by foreign holders out of sterling. The Swiss banks began to re-export the funds which had accrued to them at the time of the Middle East crisis. The continued monetary ease in several continental European countries also added to the supply of Euro-dollars. This combination of slower growth in demand for Euro-dollars and an acceleration in supply led to an easing of market conditions. The three-month rate fell back to 5⅛ per cent. in the second half of July. The premium over the rates on certificates of deposit in New York, which had widened to over ½ per cent. in May and June, declined to below $^{1}/_{8}$ per cent. This relatively low cost of Euro-dollar funds may help to explain why the US banks in the third quarter, with an increase in their recourse to the market of over $800 million, were the main group of borrowers in the market.

At the end of the summer quotations began to firm again and the three-month rate in London rose from a 5 per cent. low in the first half of September to about 5¾ per cent. in early October. This was partly the result of the usual seasonal strengthening of demand in view of year-end requirements, but the further tightening of the financial markets in the United States also contributed to the renewed rise in Euro-dollar rates. In the week after the devaluation of sterling the accentuation of the policy of monetary restraint in the United Kingdom and the United States, some flight from dollars to other currencies and an increase in the demand for dollars for gold purchases led to a sharp intensification of market pressures. This development coincided, moreover, with the usual seasonal peak. In addition, the weakening forward rate of the dollar against the continental European currencies threatened to provoke an exodus of covered arbitrage funds out of the dollar. Against this background, the central-bank governors of the gold pool countries, meeting in Frankfurt during the week-end following devaluation, decided on various measures (see pages 38 and 145) to alleviate market pressures. As a result of these official interventions, the three-month Euro-dollar rate, which had jumped to $6^{3}/_{8}$ per cent. on 21st November and advanced further to $6^{7}/_{8}$ per cent. by the beginning of the following week, receded to about $6^{3}/_{8}$ per cent. in early December and fluctuated around this level during the rest of the month. The fourth-quarter weakening of the forward quotations for sterling led to a widening of the covered arbitrage margins to the disadvantage of sterling and the UK banks' external position in foreign currencies improved by $240 million.

January 1968 saw the usual seasonal easing of market conditions and the three-month rate declined to 5½ per cent. The new US balance-of-payments programme seems at first not to have exerted a tightening influence on the market. The negative effects it may have had were more than offset by the fact that the expectations of rising interest rates it inspired led to a bulge of Euro-bond issues by US corporations, the proceeds of which were partly placed in the Euro-currency market. In early March, however, renewed withdrawals of Euro-dollars in conjunction with an increase in the demand for gold caused the market to tighten sharply. And the three-month Euro-dollar rate, despite a large increase in the Deutsche Bundesbank's preferential dollar swaps, rose to 7 per cent. just prior to suspension of the London gold pool arrangements. Shortly afterwards market conditions eased and the rate declined to 6 per cent. in early April. The respite was only short-lived. Already in the second half of April the further intensification of monetary restraint in the United States, and possibly also the effects of the US balance-of-payments programme, began to exert upward pressure on Euro-dollar quotations. By the middle of May the three-month rate was back to $6^7/_8$ per cent., and renewed tensions helped to push it to the — for that time of the year — unprecedentedly high level of $7\frac{1}{4}$ per cent. towards the end of that month.

In contrast to the usual seasonal pattern, the Euro-currency market continued to expand in the first quarter of 1968. In addition to the proceeds from Euro-bond issues and the reflux of funds from end-of-year operations, the main sources of supply were the German and Canadian banks, which shifted substantial amounts of dollars out of the United States into the Euro-dollar market. The BIS, on the other hand, substantially reduced its Euro-dollar placements. As regards uses, the US banks, and to a lesser extent the Japanese banks, seem to have been important borrowers in the market.

VI. THE EUROPEAN MONETARY AGREEMENT.

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

Modification of the Agreement.

Following a comprehensive review in 1965, the Agreement was renewed, with certain modifications, for a period of three years until 31st December 1968. The Board of Management is currently considering what proposals should be submitted to the Council for the continuation of the Agreement beyond that date.

In May 1967 the Board proposed various amendments to the Agreement in order to enable the European Fund to obtain special credits not only from Contracting Parties but also from international financial institutions situated within the territory of a Contracting Party. The Board's proposals were described in detail in the last Annual Report (page 153). On 20th June 1967 the Council adopted the Board's proposals and the relevant amendments to the Agreement came into force on that date.

Operations under the Agreement.

European Fund. At the end of March 1967 credits totalling $100 million* were outstanding. Of this amount, $70 million represented the five tranches of the sixth credit to Turkey and the remaining $30 million represented the credit to Greece, which had been granted in February 1966.

On 23rd May 1967 the Council decided to grant, with effect from 1st June 1967, a seventh credit to Turkey, for an amount of $25 million. The credit was made available for three years, the maximum period allowed under the Agreement, but Turkey was also granted the special facility provided

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

for in the Agreement of making repayments over a further period of two years. Thus, \$5 million is repayable at the end of the third year, \$5 million at the end of the fourth year and the balance of \$15 million at the end of the fifth year. Interest is payable on amounts outstanding at the rate of $3^7/_8$ per cent. per annum. Turkey drew the full amount when it became available on 1st June 1967. There were no other credits granted or drawn during the year ended 31st March 1968, nor were any repayments due on credits outstanding during this period. The table below shows the position at the value date for multilateral settlements (the fifth working day of the following month) for February 1959, when the first credits were granted, for the end of each year from 1959 to 1965, and for each month from end-1965 to March 1968 in which changes occurred.

EMA: Utilisation of credits granted from the European Fund.

At value date for settlements for month	Greece		Iceland		Spain		Turkey		Totals		
	Available and undrawn	Drawings outstanding	Available and undrawn	Drawings outstanding	Available and undrawn	Drawings outstanding	Available and undrawn	Drawings outstanding	Available and undrawn	Drawings outstanding	Total credit granted
	in millions of units of account										
1959											
February	15.0	—	—	—	—	—	21.5	—	36.5	—	36.5
December. . . .	—	—	—	—	51.0	24.0	0.5	21.0	51.5	45.0	96.5
1960											
December. . . .	—	—	5.0	7.0	76.0	24.0	15.0	21.5	96.0	52.5	148.5
1961											
December. . . .	—	—	7.0	5.0	—	—	—	50.0	7.0	55.0	62.0
1962											
December. . . .	—	—	5.0	—	—	—	—	80.0	5.0	80.0	85.0
1963											
December. . . .	—	—	—	—	—	—	—	95.0	—	95.0	95.0
1964											
December. . . .	—	—	—	—	—	—	—	105.0	—	105.0	105.0
1965											
December. . . .	—	—	—	—	—	—	—	90.0	—	90.0	90.0
1966											
February	25.0	5.0	—	—	—	—	—	90.0	25.0	95.0	120.0
March	—	30.0	—	—	—	—	—	90.0	—	120.0	120.0
October	—	30.0	—	—	—	—	—	80.0	—	110.0	110.0
1967											
March	—	30.0	—	—	—	—	—	70.0	—	100.0	100.0
June	—	30.0	—	—	—	—	—	95.0	—	125.0	125.0
1968											
March	—	30.0	—	—	—	—	—	95.0	—	125.0	125.0

On the various credits granted from the European Fund between June 1959 (when the first drawing was made) and March 1968 there were twenty-seven drawings totalling \$344.5 million; of this amount, \$219.5 million was repaid. The amount outstanding at the end of March 1968 was, therefore, \$125 million, of which \$95 million was owed by Turkey and \$30 million by Greece.

There was no call-up of capital in the period under review, so that the amount of contributions paid in remained unchanged at $38 million. Together with $148 million from the former EPU capital, this leaves the active capital of the Fund at $186 million, while uncalled capital remains at $421 million.

Multilateral System of Settlements. Details of the transactions carried out by the Fund under the Multilateral System of Settlements in each financial year since the Agreement came into force are shown in the following table.

EMA: Payments made under the Multilateral System of Settlements.

Country	Payments made by the Fund (+) or to the Fund (–)								Net amount of settlement
	1959	1960	1961	1962	1963	1964	1967	Total 1959–67	
	In thousands of US dollars								
Austria. . .	+10,527 –	+8,676 –	+5,880 –	– –	– –	– –	+ 823 –	+25,906 –	+25,906
Belgium . .	– –	– –	– –	– –	– –	– –	+ 633 –	+ 633 –	+ 633
Denmark . .	+ 10 – 67	+ 207 – 83	+ 23 –	– –	– –	– –	+ 1,830 – 2,434	+ 2,070 – 2,584	– 514
France . . .	– –	– –	– –	– –	– –	– –	+ 1,383 –	+ 1,383 –	+ 1,383
Germany . .	– –	– –	– –	– –	– –	– –	+ 3,444 –	+ 3,444 –	+ 3,444
Greece . .	– –10,707	– –9,283	+ 262 –4,924	– –2,314	+ 286 – 736	+ 141 – 799	+ 1,210 –	+ 1,898 –28,762	–26,864
Iceland. . .	– –	– – 1	– – 23	– –	– –	– –	+ 306 – 9	+ 306 – 33	+ 273
Italy	+ 243 –	– –	– –	– –	– –	– –	+ 1,047 –	+ 1,290 –	+ 1,290
Netherlands	+ 1,400 – 1,378	– –	– –	– –	– –	– –	+ 1,604 –	+ 3,004 – 1,378	+ 1,626
Norway. . .	+ 44 – 876	+ 343 –1,045	+ 274 – 251	+ 97 – 323	+ 130 – 10	– –	+ 12 –	+ 902 – 2,505	– 1,604
Portugal . .	– –	– –	– –	– –	– –	– –	+ 1,926 –	+ 1,926 –	+ 1,926
Spain . . .	– –	– –	– –	– –	– –	– –	+ 53 –	+ 53 –	+ 53
Sweden . .	– – 243	– –	– –	– –	– –	– –	+ 2,447 –	+ 2,447 – 243	+ 2,204
Switzerland.	– –	– –	– –	– –	– –	– –	+ 2,338 –	+ 2,338 –	+ 2,338
Turkey . . .	+ 2,350 – 1,304	+2,202 –1,016	+ 654 –1,895	+2,539 –	+ 667 – 337	+ 799 – 141	+ 132 –	+ 9,344 – 4,694	+ 4,650
United Kingdom .	– –	– –	– –	– –	– –	– –	+ 624 –17,368	+ 624 –17,368	–16,744
Total	14,574	11,428	7,093	2,636	1,083	940	19,812	57,567	–

In the earlier years these transactions related to the settlement of balances held under bilateral payments agreements, and the rapid decline in the volume of transactions in the years up to 1964 reflects the termination of these agreements. During this period settlements originating under the exchange guarantee given on member countries' central-bank holdings of other members' currencies took place on only three occasions and then for small amounts.

For three years after October 1964, when the last bilateral payments agreement between member countries – that between Greece and Turkey – was terminated, the settlement mechanism was not used. But with the exchange rate realignment which followed the devaluation of the pound sterling, the multilateral system was again brought into operation in November 1967. Different effective dates for the parity changes made it necessary to arrange three separate special settlements under the exchange guarantee. Twenty balances in sterling and Spanish pesetas, totalling $17.4 million and $0.1 million respectively, were settled on 29th November. Fifteen balances in Danish kroner totalling $2.4 million were settled on 30th November, and two Icelandic kronur balances totalling $9,439 were settled on 5th December. The combined total of some $19.8 million was larger than the total of settlements in any previous year and brought the cumulative amount for settlements under the Multilateral System to over $57.5 million.

No amounts of interim finance were drawn under the Agreement during the year under review.

Statement of Account.

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

Credits and claims outstanding, which amounted at the beginning of operations to $35 million, representing long-term claims on Norway and Turkey taken over from the EPU, stood at $120.5 million at end-March 1967, of which $100 million represented credits outstanding and $20.5 million the balance of the long-term claims on Norway and Turkey. The total rose to $145.5 million, its highest level ever, when Turkey drew the whole of the $25 million seventh credit made available on 1st June. In December the seventh amortisation payment of the long-term claims on Norway and Turkey reduced the total by $2.7 million to $142.8 million, at which level it remained until the end of March 1968.

Although the Fund's non-liquid assets thus rose by $22.3 million during the year under review, the decline in liquid resources was only $16.8 million because an amount of $5.5 million of the Fund's net income for the year, representing mainly the share of the former EPU capital, was retained in the Fund.

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

At value date for settlements for month	Assets				Total of Statement	Liabilities	
	Liquid resources	US Treasury account	Uncalled capital of member countries	Credits and claims outstanding		Capital Fund	Income and expenditure account
	in millions of units of account						
Opening	113.0	123.5	328.4	35.0	600.0	600.0	—
1959 December	104.4	123.5	302.9	80.0	610.9	607.5	3.4
1960 December	106.4	123.5	297.9	87.5	615.3	607.5	7.8
1961 December	109.2	123.5	297.9	87.8	618.4	607.5	10.9
1962 December	90.4	123.5	297.9	110.5	622.3	607.5	14.8
1963 December	82.1	123.5	297.9	123.1	626.6	607.5	19.1
1964 December	79.3	123.5	297.9	130.6	631.4	607.5	23.9
1965 December	101.3	123.5	297.9	113.1	635.8	607.5	28.3
1966 December	89.4	123.5	297.9	130.5	641.3	607.5	33.8
1967 January	88.9	123.5	297.9	130.5	640.9	607.5	33.4
February	89.1	123.5	297.9	130.5	641.1	607.5	33.6
March	99.2	123.5	297.9	120.5	641.2	607.5	33.7
April	99.3	123.5	297.9	120.5	641.3	607.5	33.8
May	74.5	123.5	297.9	145.5	641.4	607.5	33.9
June	76.6	123.5	297.9	145.5	643.5	607.5	36.0
July	76.3	123.5	297.9	145.5	643.2	607.5	35.7
August	76.4	123.5	297.9	145.5	643.3	607.5	35.8
September	76.5	123.5	297.9	145.5	643.5	607.5	36.0
October	76.6	123.5	297.9	145.5	643.6	607.5	36.1
November	76.8	123.5	297.9	145.5	643.7	607.5	36.2
December	82.6	123.5	297.9	142.8	646.9	607.5	39.4
1968 January	82.2	123.5	297.9	142.8	646.5	607.5	39.0
February	82.3	123.5	297.9	142.8	646.6	607.5	39.1
March	82.4	123.5	297.9	142.8	646.7	607.5	39.2

The calculation of interest payable on paid-up contributions to the Fund's capital was based upon the same principle as in previous years, whereby the cumulative amount of interest paid to each member country is equal to 90 per cent. of the share in the Fund's net income which the country would have received if the Fund had been liquidated at the end of the period in respect of which interest is paid. Net income received during 1967 was slightly higher than in 1966, and interest paid on member countries' contributions was again a little over $1 million, bringing the cumulative amount of interest so far paid to member countries to $7.4 million.

Management of the European Monetary Agreement.

The Board of Management of the EMA supervises the execution of the Agreement and advises the Council of the OECD on all related matters. The Board also follows the economic and financial situation in member countries on the basis of reports made by the Secretariat, by the various committees of the Organisation and, on occasion, by special missions. In discharging these functions the Board meets when necessary, recently about six times a year. In December 1967 the Council re-appointed M. Hay of the Swiss National Bank as Chairman of the Board for a further year.

The Bank for International Settlements, as Agent, presents monthly reports on the operations carried out under the Agreement and on the investments of the European Fund, and also provides the Board with monthly statistical material on the international gold and foreign exchange markets and on the evolution of the external monetary position of OECD countries.

VII. ACTIVITIES OF THE BANK.

1. Operations of the Banking Department.

The balance sheet of the Bank as at 31st March 1968, certified by the auditors, is reproduced at the end of the present Report.

* * *

The balance-sheet total as at 31st March 1968 amounted to 12,041,331,123 francs,* against 8,231,996,517 on 31st March 1967, thus recording a considerable increase — 3,809,334,606 francs, or 46 per cent.

BIS: Development of the balance-sheet total.

Financial years ended 31st March	Total of balance sheet	Movement
	in millions of francs	
1964	5,778[1]	+ 828
1965	7,850[1]	+ 2,072
1966	7,882	+ 32
1967	8,232	+ 350
1968	12,041	+ 3,809

[1] First section.

The total of the monthly statement of account increased steadily up to the end of December 1967, when for the first time it exceeded the 12 milliard level, standing at the record figure of 12,338 million.

The following items are not included in the balance sheet: gold under earmark, bills and other securities held in custody for the account of central banks and other depositors; the assets (gold under earmark, bank balances, bills and other securities) held by the Bank as Agent for the Organisation for Economic Co-operation and Development in connection with the European Monetary Agreement, as Depositary under the Act of Pledge concluded with the European Coal and Steel Community and as Trustee or Fiscal Agent for international government loans. As was done in the case of the balance sheet as at 31st March 1967, the amounts in question are shown at the foot of the assets column under the heading "Memorandum accounts (b)". The figures are given in the following table.

BIS: Memorandum accounts (b).

Items	Financial years ended 31st March 1967	1968
	in millions of francs	
Earmarked gold	1,233	1,219
Bank balances	26	32
Bills and other securities	678	641
Total of items not included in the balance sheet	1,937	1,892

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

COMPOSITION OF RESOURCES (liabilities).

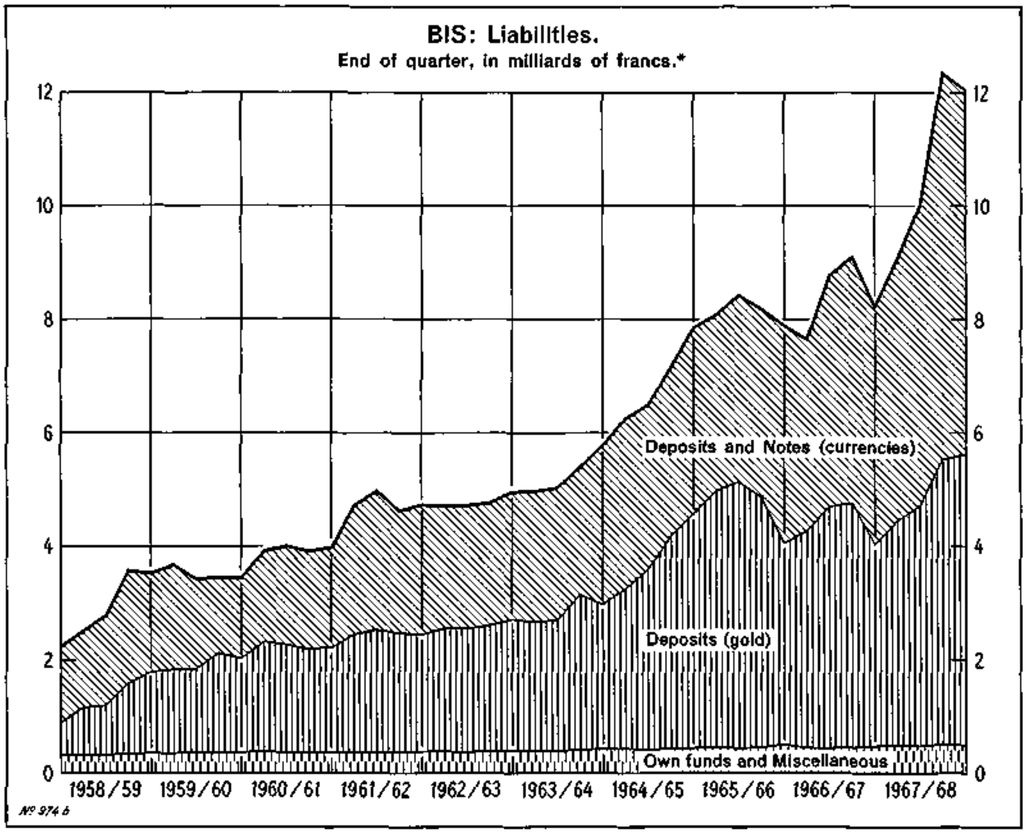
A. Own funds.

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

After distribution of the net available profit for the financial year 1966–67 the General Reserve Fund went up from 13.3 to 22.8 million francs and an amount of 10 million was credited to a newly-created Special Dividend Reserve Fund; the Legal Reserve Fund, which had been at its statutory maximum of 10 per cent. of the paid-up capital since the financial year 1964–65, remained unchanged at 12.5 million. The Bank's reserves were thus raised from 25.8 to 45.3 million.

The item "Miscellaneous" declined from 44.1 million francs on 31st March 1967 to 40.6 million on 31st March 1968.

The "Provision for contingencies" remained unchanged at 220 million; the "Provision for building purposes" was increased from 11 to 17.5 million by drawing on the net operating surplus for the financial year 1967–68.



* Total of first part of statement of account up to and including 31st December 1965; thereafter total of statement of account.

The net profit for the financial year 1967–68 amounted to 45 million; that for 1966–67 came to 32.1 million, to which was added 9.8 million carried forward from the previous financial year.

At the end of March 1968 the Bank's own funds (excluding "Miscellaneous liabilities") amounted to 452 million francs, i.e. 3.9 per cent. of its borrowed funds (11,548 million) and 3.8 per cent. of the balance-sheet total (12,041 million). If the non-paid-up capital (375 million) were included in the calculation, the ratios would be 7.2 per cent. and 6.7 per cent. respectively.

BIS: Composition of resources, in absolute and percentage terms.

Financial years ended 31st March	Own funds	Borrowed funds	Miscellaneous liabilities	Balance-sheet total
	in millions of francs			
1964	379	5,370	29	5,778*
1965	396	7,417	37	7,850*
1966	400	7,449	33	7,882
1967	424	7,764	44	8,232
1968	452	11,548	41	12,041

* First section of the balance sheet.

Financial years ended 31st March	Ratio of own funds to		Ratio of own funds plus non-paid-up capital to	
	borrowed funds	balance-sheet total	borrowed funds	balance-sheet total
	in percentages			
1964	7.1	6.6*	14.0	12.3*
1965	5.3	5.0*	10.4	9.4*
1966	5.4	5.1	10.4	9.4
1967	5.5	5.2	10.3	9.3
1968	3.9	3.8	7.2	6.7

* Ratio in respect to first section of the balance sheet.

B. Borrowed funds.

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

BIS: Borrowed funds, by origin.

Origin	Financial years ended 31st March 1967	1968	Movement
	in millions of francs		
Central banks	6,602	9,711	+ 3,109
Other depositors	869	1,305	+ 436
Notes	293	532	+ 239
Total	7,764	11,548	+ 3,784

All categories of borrowed funds increased substantially — the deposits of central banks by 47 per cent., those of other depositors by 50 per cent. and the amount of notes outstanding by 82 per cent.

BIS: Borrowed funds, by nature and term.

Term	Deposits in gold			Deposits in currencies			Notes		
	Financial years ended 31st March		Movement	Financial years ended 31st March		Movement	Financial years ended 31st March		Movement
	1967	1968		1967	1968		1967	1968	
	in millions of francs								
Sight	2,593	1,989	− 604	240	71	− 169	—	—	—
Not exceeding 3 months	325	2,825	+ 2,500	3,282	5,103	+ 1,821	291	62	− 229
Between 3 and 6 months	164	7	− 157	309	633	+ 324	2	310	+ 308
Between 6 and 9 months	338	193	− 145	53	69	+ 16	—	—	—
Between 9 and 12 months	141	114	− 27	10	1	− 9	—	160	+ 160
Over 1 year	—	—	—	16	11	− 5	—	—	—
Total	3,561	5,128	+ 1,567	3,910	5,888	+ 1,978	293	532	+ 239

The increase in the amount of notes outstanding, all of which were denominated in currencies, was mainly due to sales to commercial banks; the proceeds of these issues were used by the Bank to finance certain operations which it carried out at the request of monetary authorities.

The items "Deposits in gold" and "Deposits in currencies" rose at roughly similar rates — viz. by 44 and 51 per cent. respectively.

As far as deposits in gold are concerned, only those at not exceeding three months increased, but they did so by a substantial amount. Two factors accounted for this movement: (i) the receipt by the Bank of sizable new deposits; (ii) the conversion of sight deposits in gold into time deposits (leading to a reduction in the former category), which enabled the Bank to finance international operations within the framework of central-bank co-operation. The total of deposits at over three months declined by half.

The development of deposits in currencies was roughly parallel to that of deposits in gold. The main increase was in deposits at not exceeding three months; this was connected with: (i) operations under the arrangement concluded with the United Kingdom in June 1966 and renewed in March 1967 and March 1968, in which the Bank participates, and (ii) the purchase by the Bank in November 1967 of British Treasury notes — most of the funds required for these transactions having been provided by central banks.

There were also increases in deposits at between three and six months, which doubled, and in funds at between six and nine months. On the other hand, deposits at between nine and twelve months, which were already very small, declined almost to zero and those at over one year also showed a decrease.

As far as the item "Notes" is concerned, those at not exceeding three months went down by nearly four-fifths, whilst those at over three months, of which there had been virtually none hitherto, increased to an appreciable level.

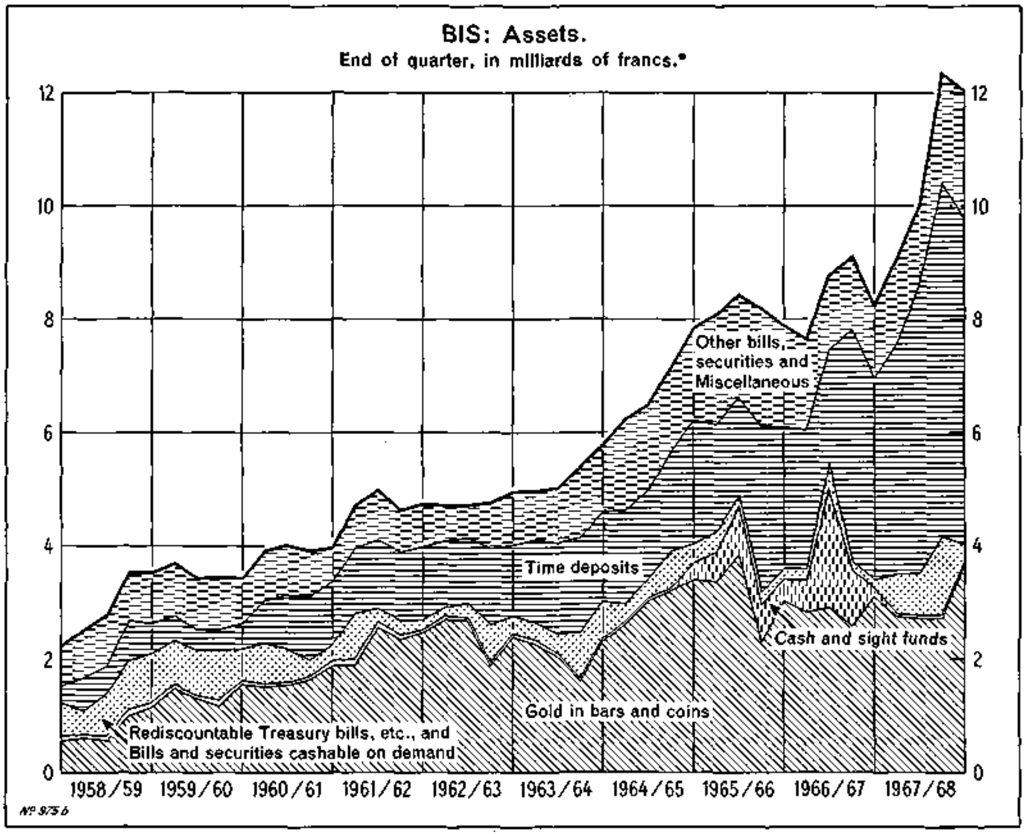
At the beginning of the financial year "Deposits in gold" represented 46 per cent. of total borrowed resources, "Deposits in currencies" 50 per cent. and "Notes" 4 per cent. On 31st March 1968 the percentage ratios were very much the same, namely 44 per cent., 51 per cent. and 5 per cent. respectively.

EMPLOYMENT OF RESOURCES (assets).

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

BIS: Gold position.

End of month	Spot position				Forward operations	Final net gold position
	Gold in bars and coins	Investments in gold	Deposits in gold	Net balance	Net balance	
	in millions of francs					
1967						
March . . .	3,096	420	3,561 (min.)	— 45	+ 472	427
April	3,270	421	3,578	+ 113 (max.)	+ 317 (min.)	430
June	2,737	421	3,971	— 813	+1,229	416 (min.)
July	2,673 (min.)	422 (max.)	3,924	— 829	+1,250	421
December. .	2,720	403 (min.)	5,032	—1,909 (min.)	+2,355 (max.)	446
1968						
March . . .	3,666 (max.)	407	5,128 (max.)	—1,055	+1,510	455 (max.)
Movement: 31st March 1967 to 31st March 1968	+ 570	— 13	+1,567	—1,010	+1,038	+ 28



* Total of first part of statement of account up to and including 31st December 1965; thereafter total of statement of account.

The increase of 570 million in the Bank's gold holdings was the result of the winding-up of various operations involving forward purchases of gold and, to a lesser extent, of the receipt of fresh deposits.

Nevertheless, the net balance of forward operations rose very sharply (by 1,038 million) owing to the conclusion of gold/currency swaps.

Among the fluctuations recorded during the financial year, mention should be made of the maximum reached at the end of December 1967 by this net balance (+2,355 million). The movement was due to the gold/currency swaps carried out with the Swiss National Bank, mainly in that month; these were gradually terminated during the first quarter of 1968.

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

Nature	Financial years ended 31st March				Movement	
	1967		1968			
	in millions of francs					
Cash						
Gold	3,096		3,666		+ 570	
Currencies	156	3,252	49	3,715	— 107	+ 463
Other investments						
Gold	420		407		— 13	
Currencies	4,559	4,979	7,918	8,325	+ 3,359	+ 3,346
Total						
Gold	3,516		4,073		+ 557	
Currencies	4,715	8,231	7,967	12,040	+ 3,252	+ 3,809

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

A. Sight funds and rediscountable investments.

The item "Gold in bars and coins" (which consisted almost exclusively of gold in bars) rose by 570 million, as explained above.

The figure for the item "Cash on hand and on sight account with banks" stood at 156 million at the beginning of the financial year. Broadly reflecting the movement in the liabilities item "Sight deposits in currencies", it fell on 31st May 1967 to approximately the level at which it closed the financial year, viz. 49 million, after which it showed only very slight fluctuations.

On 31st March 1968 total cash holdings (gold and currencies) represented just under 31 per cent. of the total of the Bank's balance sheet, compared with 39.5 per cent. a year earlier.

The item "Rediscountable Treasury bills" had amounted to 70 million on 31st March 1967. As funds received at various times during the financial year under the central-bank swap arrangements in which the Bank participates were invested in such paper, the figure for this item rose substantially. It amounted to 1,335 million at the end of 1967 and the maximum — 1,458 million — was reached at the end of January 1968. Owing to the gradual winding-up of most of these operations, it had declined to 232 million by the end of the financial year.

The item "Bills and securities cashable on demand" decreased from 74 to 70 million.

At the beginning of the financial year the total of the Bank's sight funds and rediscountable investments, comprising the asset items so far analysed, was thus 3,396 million and represented 41 per cent. of the total of the balance sheet; on 31st March 1968 the corresponding figures were 4,017 million and 33 per cent. Over the same period sight deposits on the liabilities side decreased from 2,833 to 2,060 million. Their share of the balance-sheet total was thus halved, from 34 per cent. to 17 per cent.

B. Time funds.

The figure for the item "Time deposits and advances" stood at 3,551 million at the beginning of the financial year and 5,775 million at the end, thus registering a very sharp increase — 2,224 million, or 63 per cent. The rise was due to the investment of funds obtained from gold swaps and of deposits received by the Bank under the 1966 arrangement. At the end of December 1967 this item reached its maximum level of 6,231 million, the Bank having received a substantial volume of funds from central banks for short periods running beyond the year-end, which it used for operations on various markets. It thus helped to moderate to a certain extent the movements which tend to be caused by large-scale repatriations of funds at the year-end.

The item "Other bills and securities" also rose very appreciably; it more than doubled, from 864 to 1,841 million. This increase reflects purchases of British Treasury notes and the investment made with the greater part of the proceeds from the Bank's new issues of notes.

As in the case of the deposits received by the Bank, its investments at not exceeding three months showed a considerable increase. They almost doubled over the year and their growth was actually greater than that in the total of the assets figuring in the following table. Investments at between three and six months increased very slightly.

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

Periods	Financial years ended 31st March 1967	1968	Movement
	in millions of francs		
Not exceeding 3 months	3,805	7,319	+ 3,514
Between 3 and 6 months	499	523	+ 24
Between 6 and 9 months	254	72	— 182
Between 9 and 12 months	248	82	— 166
Over 1 year	29	27	— 2
Total	4,835	8,023	+ 3,188

Investments at over six months, on the other hand, all underwent a reduction, particularly those at between six and twelve months, which decreased by more than two-thirds.

As a result of these movements, funds invested at over six months represented only about 2 per cent. of the Bank's total time investments at the end of the financial year. Finally, it should be noted that, as in the past few years, a substantial proportion of these assets was in fact mobilisable at very short notice.

* * *

To an even greater extent than in preceding financial years the growing activity of the Bank was last year for the most part bound up with the increased co-operation between central banks.

The main causes of this increased activity are, briefly, as follows: (i) the Bank's participation in the currency swap arrangements concluded between central banks, in particular in the swap network set up with the Federal Reserve Bank of New York. The volume of swaps carried out by the Bank under these arrangements reached its peak, the equivalent of US $746 million, at the end of December, and subsequently fell to the equivalent of US $55 million at the end of the financial year; (ii) the increased volume of gold/currency swaps carried out with central banks; (iii) the rise in deposits, chiefly from central banks; (iv) the increase in the facilities granted to various monetary authorities, either direct or jointly with central banks; (v) the development of its functions as an intermediary between the central banks and the market.

The balance sheet reflected the high level of the Bank's activity, even though it did not show the incidence of certain operations, such as facilities granted to central banks that were undrawn at the end of the financial year.

Finally, it should be mentioned that, owing to prevailing circumstances, the Bank reduced its operations on the gold market during the closing months of the financial year.

The net profit for the past financial year was quite appreciably higher than that for the previous financial year (for details see Section 6 below).

The volume of the Bank's operations reached a new record level, amounting to 174 milliard in 1967–68, against 110 milliard in 1966–67 and 86 milliard in 1965–66.

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

In conformity with the agreements in force, the Bank continued in the year under review to perform the functions of Fiscal Agent of the Trustees for the new bonds of the German External Loan 1924 (Dawes Loan) and of

German External Loan 1924
(Dawes Loan).

Issue	Currency	Nominal value			
		Bonds issued	Bonds purchased or drawn for redemption in respect of the financial years		Balance after redemption
			1958-59 to 1966-67	1967-68	
		Conversion bonds			
American . . .	$	44,113,000	15,129,000	2,156,000	26,828,000
Belgian	£	583,500	142,000	19,300	422,200
British	£	8,277,200	2,016,700	269,500	5,991,000
Dutch	£	1,323,900	304,300	42,700	976,900
French	£	1,929,600	464,700	62,500	1,402,400
Swedish . . .	S.kr.	14,209,000	3,210,000	446,000	10,553,000
Swiss	£	1,130,800	272,100	37,000	821,700
Swiss	Sw.fr.	8,251,000	1,825,000	257,000	6,169,000
		Funding bonds			
American . . .	$	8,207,000	2,130,000	253,000	5,824,000
Belgian	£	157,800	42,700	5,300	109,800
British	£	2,232,000	596,400	74,900	1,560,700
Dutch	£	291,600	70,400	9,500	211,700
French	£	498,900	134,500	16,800	347,600
Swiss	£	115,000	30,200	3,900	80,900
Swiss	Sw.fr.	415,000	101,000	11,000	303,000

German Government International Loan 1930
(Young Loan).

Issue	Currency	Nominal value*			
		Bonds issued	Bonds purchased or drawn for redemption in respect of the financial years		Balance after redemption
			1958-59 to 1966-67	1967-68	
		Conversion bonds			
American . . .	$	55,474,000	6,150,000	862,000	48,462,000
Belgian	B.fr.	202,803,000	22,295,000	3,042,000	177,466,000
British	£	20,656,400	2,252,800	308,000	18,095,600
Dutch	Fl.	52,558,000	5,630,000	785,000	46,143,000
French	Fr.fr.	445,607,000	48,602,000	6,663,000	390,342,000
German	DM	14,504,000	1,573,000	215,000	12,716,000
Swedish . . .	S.kr.	92,763,000	10,165,000	1,383,000	81,215,000
Swiss	Sw.fr.	58,383,000	6,407,000	872,000	51,104,000
		Funding bonds			
American . . .	$	9,006,000	982,000	126,000	7,898,000
Belgian	B.fr.	45,670,000	5,059,000	645,000	39,966,000
British	£	4,928,600	538,600	69,100	4,320,900
Dutch	Fl.	8,498,000	924,000	120,000	7,454,000
French	Fr.fr.	98,152,000	10,561,000	1,365,000	86,226,000
German	DM	416,000	45,000	5,000	366,000
Swedish . . .	S.kr.	6,014,000	666,000	84,000	5,264,000
Swiss	Sw.fr.	1,405,000	152,000	20,000	1,233,000

* Nominal value on 1st May 1968 established in accordance with the provisions of the London Agreement on German External Debts of 27th February 1953 but without taking account of the revaluation of the Deutsche Mark in March 1961.

Trustee for the new bonds of the German Government International Loan 1930 (Young Loan) which were issued by the Government of the Federal Republic of Germany in accordance with the London Agreement on German External Debts of 27th February 1953.

The financial year 1967–68 ended for the Dawes Loan on 15th April 1968 and for the Young Loan on 1st June 1968. The interest in respect of the financial year 1967–68 amounted to the equivalent of about 10.2 million francs for the Dawes Loan and of about 35.1 million francs for the Young Loan; it was duly paid to the Bank and distributed by the latter among the Paying Agents. Redemption of both loans was effected in respect of the financial year 1967–68 partly by purchases of bonds on the market and partly by drawings.

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

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

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

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

Austrian Government International Loan 1930.

Issue	Currency	Nominal value			
		Bonds assented	Bonds purchased or drawn for redemption in respect of the financial years		Balance after redemption
			1959 to 1966	1967	
American . . .	$	1,667,000	538,000	85,000	1,044,000
Anglo-Dutch .	£	856,600	269,800	44,600	542,200
Swiss	Sw.fr.	7,102,000	1,886,000	308,000	4,908,000

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

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

The total amount of these secured loans was originally equivalent to about 817 million francs. Repayments by the Community up to 1st April 1968 amounted to the equivalent of about 327 million francs, so that the total amount outstanding was reduced to the equivalent of about 490 million francs. Further particulars of these loans are given in the following table.

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

During the financial year 1967–68 the Bank received from the borrowers and distributed among the Paying Agents the equivalent of about 26 million francs in respect of interest and the equivalent of about 39 million francs in respect of redemption.

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

Secured loans of the European Coal and Steel Community.

Series of Secured Notes	Dates of issue	Countries of issue	Lenders	Original amounts of loans		Amounts unredeemed on 1st April 1968	Rates of interest %	Year of final maturity
1st	1954	United States	US Government	$	100,000,000	64,700,000	3⅞	1979
2nd	1955	Belgium	Caisse Générale d'Epargne et de Retraite, Brussels	B.fr.	200,000,000	141,000,000	3½	1982
3rd	1955	Germany	Rheinische Girozentrale und Provinzialbank, Düsseldorf	DM	25,000,000	15,877,850	3¾	1981
			Landesbank für Westfalen (Girozentrale), Münster	DM	25,000,000	15,877,850	3¾	1981
4th	1955	Luxemburg	Caisse d'Epargne de l'Etat, Luxemburg	B.fr.	20,000,000	14,100,000	3½	1982
				L.fr.	5,000,000	—	—	—
5th	1956	Saar	Landesbank und Girozentrale Saar, Saarbrücken	DM	2,977,450[1]	1,786,470	4¼	1977
6th	1956	Switzerland	Public issue	Sw.fr.	50,000,000	27,500,000	4¼	1974
7th[2]	1957	United States	Public issue	$	25,000,000	13,600,000	5½	1975
10th	1957	Luxemburg	Etablissement d'Assurance contre la Vieillesse et l'Invalidité, Luxemburg	L.fr.	100,000,000	81,569,962	5⅝	1982
11th[2]	1958	United States	Public issue	$	35,000,000	25,800,000	5	1978
13th[2]	1960	United States	Public issue	$	25,000,000	21,700,000	5⅝	1980
15th	1961	Luxemburg	Etablissement d'Assurance contre la Vieillesse et l'Invalidité, Luxemburg	L.fr.	100,000,000	91,397,335	5¼	1986
16th	1961	Netherlands	Public issue	Fl.	50,000,000	46,650,000	4½	1981

[1] This loan, which was contracted in French francs, was converted into Deutsche Mark in 1959. The original amount was 350,000,000 old French francs. [2] The Secured Notes of the 8th, 9th, 12th and 14th Series have been entirely redeemed.

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

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

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

During the past eventful year the importance and value of close co-operation between central banks in monetary matters have been clearly demonstrated and the rôle played by the Bank in this field has been growing.

The Bank has continued to participate actively in arrangements set up by groups of major central banks with the aim of relieving pressures within the international monetary system, and has served as a channel for the facilities provided for this purpose. The Bank has during the year gradually increased its participation in the mutual swap system established by the Federal Reserve Bank of New York. The total of the swap arrangements concluded between the latter and the Bank for International Settlements now amounts to US $1,600 million, of which $600 million is against Swiss francs and $1,000 million against other European currencies. As in previous years, in co-operation with certain central banks, the Bank has taken part in co-ordinated action to alleviate undesirable strains on markets, in particular the Euro-dollar market.

In the field of research and exchanges of information the Bank has continued to organise meetings of central-bank experts — in addition to the regular meetings of the Board of Directors — to study economic and monetary problems of general interest and to examine specific matters such as the development of the gold and foreign exchange markets and the Euro-dollar market.

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

The Bank's association in the work of the Deputies of the Group of Ten and its Study Groups on the international liquidity problem, the creation of a new reserve instrument and the adjustment process has continued during the year. The Bank's services have also assisted in this work.

The continued co-operation between central banks has strengthened relations between the Bank, on the one hand, and the OECD and the IMF, on the other.

6. Net profits and their distribution.

The accounts for the thirty-eighth financial year ended 31st March 1968 show a surplus of 53,497,848 francs. The surplus for the financial year 1966–67 was 47,074,487 francs.

The Board of Directors has decided, in view of the large surplus for the past financial year, to continue to build up the provision for exceptional costs of administration and the provision for building purposes, to the extent of 1,997,848 and 6,500,000 francs respectively. After deduction of these two transfers to the provisions, the net profit amounts to 45 million francs. The appropriation of this amount is fixed by Article 53 of the Statutes.

On the basis of this article, the Board of Directors recommends that the net profit of 45 million francs be applied by the General Meeting in the following manner: (i) a sum of 7,500,000 francs in payment of the cumulative dividend of 6 per cent., or 37.50 francs per share, provided for in sub-clause (b) of Article 53; (ii) a further sum of 7,500,000 francs in payment of the supplementary dividend of 6 per cent., or 37.50 francs per share, provided for in sub-clause (c) of Article 53, without supplementing the Special Dividend Reserve Fund this year; (iii) an amount of 15 million francs to be transferred to the General Reserve Fund under sub-clause (d) of Article 53; and (iv) the remainder of the available net profit, namely 15 million francs, to be transferred to a new Free Reserve Fund under sub-clause (f) of Article 53. The Board of Directors will have the right to use this Fund not only for meeting losses incurred by the Bank but also for any other purpose that is in conformity with the Statutes.

Under the proposals of the Board of Directors the Bank's total dividend for the financial year 1967–68 will amount to 75 francs. It will be payable in Swiss francs in the amount of 107.15 Swiss francs per share and the payment will be effected on 1st July 1968 to the shareholders whose names are entered in the Bank's share register on 25th June 1968.

The total distribution for the financial year 1966–67 amounted to 112.50 francs per share, of which 54.47 francs represented the settlement of the balance of the undeclared cumulative dividend. The proposed distribution of 75 francs per share for the financial year 1967–68 represents the total dividend provided for in sub-clauses (b) and (c) of Article 53 of the Bank's Statutes.

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

The Bank's accounts have been duly audited by Messrs. Price Waterhouse & Co., Zurich, who have confirmed that the Balance Sheet and the Profit and Loss Account give a true and correct view of the state of the Bank's affairs as at 31st March 1968 and of its profit for the year ended on that date. Messrs. Price Waterhouse & Co.'s certificate is appended at the foot of the Balance Sheet.

7. Changes in the Board of Directors.

At the meeting of the Board held on 8th May 1967 the Chairman, Dr. M. W. Holtrop, announced that, having retired from his post as President of the Nederlandsche Bank on 30th April 1967, he had decided to resign from his office as a member of the Board of Directors of the Bank for International Settlements as from 30th June 1967.

At the same meeting on 8th May 1967 the Board elected, under Articles 28 (3) and 29 of the Statutes, Dr. J. Zijlstra, who had been appointed President of the Nederlandsche Bank in succession to Dr. Holtrop, to be a member of the Board of Directors for the unexpired period of Dr. Holtrop's term of office ending on 31st March 1970.

At the meeting of the Board held on 12th June 1967 Dr. M. W. Holtrop announced his decision to resign from his office as Chairman of the Board of Directors and President of the Bank for International Settlements as from the end of June 1967. The Vice-Chairman expressed the Board's sincere thanks for the outstanding services which Dr. Holtrop had rendered to the Bank in his twenty-one years as a member of the Board of Directors, and in particular as Chairman of the Board and President of the Bank since July 1958.

At the same meeting the Board elected, under Article 39 of the Statutes, Dr. J. Zijlstra, President of the Nederlandsche Bank, to be Chairman of the Board of Directors and President of the Bank in succession to Dr. M. W. Holtrop for a period of three years as from 1st July 1967.

The mandate of M. Maurice Frère as Vice-Chairman of the Board was due to expire on 31st December 1967. At its meeting on 11th December 1967 the Board re-elected him, under Article 39 of the Statutes, for a further period of three years ending on 31st December 1970.

The mandates of Herr Karl Blessing, President of the Deutsche Bundesbank, and Dr. Rudolf Brinckmann as members of the Board were due to expire on 31st March and 31st May 1968 respectively. The Chairman of the Board announced at the meeting held on 11th March 1968 that the ex officio members of the Board had, under Article 28 (2), paragraph 3, of the Statutes, re-elected Herr Blessing and Dr. Brinckmann for further periods of three years ending on 31st March and 31st May 1971 respectively.

The mandate of Dr. Edwin Stopper as a member of the Board being due to expire on 31st March 1968, he was re-elected under Article 28 (3) of the Statutes at the meeting of the Board held on 11th March 1968 for a further period of three years ending on 31st March 1971.

CONCLUSION.

Economic and monetary developments over the past year have been, to say the least, eventful. A few were favourable, but more reflected grave underlying problems.

In the sphere of domestic economic activity the continental European countries have emerged from the period of pause or recession that was characteristic until the summer of 1967 and, since the autumn of that year, have been in a phase of re-expansion. It can be seen now that the dampening of activity in the previous nine months or so was less marked and extensive than in the recession year of 1958, the main exception being Germany. In any case, monetary and fiscal policies were shifted to an expansionary stance and the productive system has responded. The renewed expansion is taking place with reasonable containment of prices and without demand pressures on the labour market. Very recently, however, social and political disturbances have arisen in France which make the outlook less certain.

There has been also a renewed upsurge of activity in the United States, after the pause from the last quarter of 1966 to about mid-1967. But here the cyclical shift has been untimely. Spurred on by a huge budget deficit, the US economy has rebounded into a situation of excess overall demand; prices have been rising at quite a high rate and wage settlements have been excessive from the standpoint of price and monetary stability. In addition, the inflationary level of demand has had a severe impact on the external current-account balance. While monetary policy has been shifted strongly to restraint, with the degree of stringency relative to the demand for credit reflected in exceptionally high levels of interest rates, there is a transparent need for the calming influence of a sharp reduction in the budget deficit.

In the United Kingdom, on the other hand, restraint has been put on domestic expansion by the forceful budget of March 1968 in order to give a much-needed priority to balance-of-payments adjustment. While wage demands are still excessive, it seems that demand pressure on prices should be minimal and that expansion of activity should be quite moderate until rising export sales give an added stimulus to total demand.

Turning to the international sphere, several developments must be considered unfortunate, however much one may judge them to have been necessary in the actual circumstances of the time.

Firstly, there was the devaluation of the pound sterling in November 1967. Sterling had had repeated difficulties and it was evident that the root causes of its weakness stretched back quite some time, without determined policy action having been taken to overcome them. The immediate necessity for devaluation, however, arose out of political and economic events, mainly in the outside world, which again turned the UK balance of payments to substantial deficit and led to a huge flight from the currency. As this increased in intensity, the authorities apparently felt that the chances of success of a new round of deflationary measures, without a change in the exchange parity, were too small to warrant the risks and sacrifices involved.

Both budgetary and monetary policy are now aimed at facilitating the viability of the new parity. To solidify the external position, however, it is essential that the budget objectives be proven out in fact, that incomes and prices be brought under effective restraint and that first a balance and then a surplus in the external accounts be attained without too long a lag. The country's heavy short and medium-term external debt underlines the need for rapid achievement of a substantial balance-of-payments surplus, as does the necessity to avoid further damage to the reserve structure of the sterling area as a whole.

Secondly, as regards the United States' external position, the fateful event of the past twelve months was the new balance-of-payments programme announced on 1st January 1968. Direct controls had been called upon for several years before, so the new programme was not the first step on this path. However, the wider scope of the measures and the greater degree of restriction confirm the change from the traditional "no controls" doctrine of the United States. Taken together with tighter controls by the United Kingdom in the past few years, they mean a serious setback to the progress towards liberalisation that was an achievement of the post-war years. Though the circumstances of the Vietnam war may justify such measures, it is difficult for one to view them without regret.

The near-term reasons for the new programme were the speculative fervour, particularly in gold, which followed the devaluation of sterling, and the huge worsening of the US balance-of-payments deficit which came with the resurgence of excessive demand in the later months of last year. Behind this, however, were many years during which the balance-of-payments position ran a poor second to the domestic situation in policy considerations and during which there was reluctance to deal with the underlying causes of the deteriorating reserve position of the dollar. Earlier, the growth of dollar reserve holdings by foreign monetary authorities made a great contribution to the development of the world economy, as well as to the feasibility of the return to convertibility and to liberal exchange practices. However, it has been evident for quite some time that increasing external short-term liabilities in the face of declining gold reserves was in the long run untenable. But, in fact, US measures have not aimed at more than limiting losses of gold.

Thirdly, on Sunday, 17th March 1968, the central banks contributing to the gold pool decided to stop supplying gold to the market and to leave supply and demand forces free to determine the market price. They affirmed at the same time that transactions between central banks would still take place at $35 an ounce. This, too, was a notable event of the past year.

One begins here to run into the haze which obscures a clear vision of the future monetary system, since the longer-term practicality of this arrangement must be tested by time. At the moment the price of gold in the market is significantly above the official price; but the important question is the level of the gold price that will tend to prevail in the future after supply and demand forces in the market become more normal. If the market price tends to be close to the official price, maintenance of the arrangement would appear to be feasible. On the other hand, if there tends to be a large spread between the two prices, it would be likely to increase the immobility of official gold reserves in the settlement of balance-of-payments deficits and surpluses. As gold is well over half of global official reserves, there would be inconvenience in having it more or less frozen up. This is to leave aside the larger questions of the ultimate rôle of gold in the system, about which the principal countries do not have an agreed view.

A more cheerful side of recent events has been the completion of negotiations on the new facility in the IMF for special drawing rights, which has now been sent to member governments for approval. This could be an effective addition to international liquidity, provided that all IMF members exercise discipline in the use they make of the new facility. In essence, this means that the special drawing rights should not be used to finance persistent deficits and surpluses and thus as an escape from the adjustment process.

As there is uncertainty about when, under what conditions and in what amounts the new facility may be activated, its future importance in the international monetary system cannot yet be assessed. It is widely agreed that SDRs can become a useful supplement to existing reserve assets and other liquidity facilities. Some advocates assign them a more ambitious place, however. They visualise, after the drawing rights have become an accepted, and even valued, instrument of international settlements, that they will be the essential means by which adequate growth in global reserves is provided. Evidently, for this vision to be realised, several possible difficulties would have to be resolved.

One of these may be simply quantitative. If there are to be no future additions to the existing total of official gold reserves, it would seem necessary also that the stock of official dollar reserves be prevented from having a continuous upward trend, in one way or another, as otherwise there would be a growing threat to the convertibility of the dollar. In that event, the allocations of drawing rights would have to make up for the needed growth of reserves formerly supplied by both gold and dollars. Hence, the issues of drawing rights would have to amount to large figures — and ones which could seem excessive to whatever group of countries happened to be in surplus.

Another obstacle may be the rather basic change in attitudes that would be required on the part of the main reserve-holding countries. As the yearly issues of drawing rights followed upon one another, this instrument would become the increasingly dominant means available to countries to defend their exchange parities in times of balance-of-payments difficulty. To contemplate and freely promote the progressive development of such a situation would seem to call for greater political cohesion and more assured mutual co-operation in the adjustment process than has always been apparent in the past.

While the attainment of these objectives deserves every effort, one cannot say as yet how thoroughly they may be realised in the longer run. In the meantime, therefore, some caution may be desirable. As gold still has the advantages of universal acceptability and of intrinsic value, and the dollar the advantages of flexibility and of earning interest, it would not seem prudent to discount prematurely the future rôle of these well-tried reserve instruments.

GABRIEL FERRAS

General Manager

BALANCE SHEET AND PROFIT AND LOSS ACCOUNT

AS AT 31st MARCH 1968

BALANCE SHEET

ASSETS

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

			%
Gold in bars and coins		3,665,928,131	30.4
Cash on hand and on sight account with banks		49,139,422	0.4
Rediscountable Treasury bills		232,632,111	1.9
Bills and securities cashable on demand		70,078,916	0.6
Time deposits and advances			
Not exceeding 3 months	5,317,067,110		44.2
Between 3 and 6 months	380,756,098		3.2
Between 6 and 9 months	18,704,141		0.2
Between 9 and 12 months	58,635,886		0.5
		5,775,163,235	
Other bills and securities			
Gold			
Not exceeding 3 months	294,911,174		2.5
Between 3 and 6 months	78,142,423		0.6
Between 6 and 9 months	12,112,121		0.1
Between 9 and 12 months	21,824,355		0.2
Currencies			
Not exceeding 3 months	1,706,516,479		14.2
Between 3 and 6 months	64,047,655		0.5
Between 6 and 9 months	41,213,848		0.3
Between 9 and 12 months	1,386,178		0.0
Over 1 year	27,490,040		0.2
		2,247,644,273	
Miscellaneous assets		745,034	0.0
Buildings and equipment		1	0.0
		12,041,331,123	100

MEMORANDUM ACCOUNTS

a. Forward gold operations:	
Net balance: gold receivable (currencies to be delivered)	1,510,866,464
b. Funds, bills and other securities administered or held by the Bank for account of third parties:	
Earmarked gold	1,218,463,025
Bank balances	32,080,111
Bills and other securities	641,181,605

AS AT 31st MARCH 1968

GRAMMES FINE GOLD — ART. 5 OF THE STATUTES)

LIABILITIES

			%
Capital			
Authorised and issued 200,000 shares, each of 2,500 gold francs	500,000,000		
of which 25% paid up		125,000,000	1.0
Reserves			
Legal Reserve Fund	12,500,000		
Special Dividend Reserve Fund	10,007,964		
General Reserve Fund	22,751,960		
		45,259,924	0.4
Deposits (gold)			
Central banks			
Between 9 and 12 months...	113,611,909		0.9
Between 6 and 9 months	175,847,601		1.5
Between 3 and 6 months	7,022,142		0.1
Not exceeding 3 months	2,632,362,353		21.9
Sight	1,600,916,020		13.3
Other depositors			
Between 6 and 9 months	17,267,172		0.1
Not exceeding 3 months	192,947,157		1.6
Sight	388,393,025		3.2
		5,128,367,579	
Deposits (currencies)			
Central banks			
Over 1 year	11,007,074		0.1
Between 9 and 12 months...	1,383,009		0.0
Between 6 and 9 months	61,001,878		0.5
Between 3 and 6 months	540,454,497		4.5
Not exceeding 3 months	4,512,657,984		37.5
Sight	54,047,397		0.4
Other depositors			
Between 6 and 9 months	7,805,820		0.1
Between 3 and 6 months	92,785,357		0.8
Not exceeding 3 months	589,772,165		4.9
Sight	16,490,376		0.1
		5,887,405,557	
Notes			
Between 9 and 12 months...	160,277,761		1.3
Between 3 and 6 months	310,163,744		2.6
Not exceeding 3 months	61,799,948		0.5
		532,241,453	
Miscellaneous		40,556,610	0.3
Provisions			
Provision for contingencies	220,000,000		
Provision for building purposes	17,500,000		
		237,500,000	2.0
Profit and Loss Account		45,000,000	0.4
		12,041,331,123	100

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

In our opinion the foregoing Balance Sheet and the annexed Profit and Loss Account give a true and correct view of the state of the Bank's affairs as at 31st March 1968 and of its profit for the year ended on that date.

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

ZURICH, 3rd May 1968. PRICE WATERHOUSE & CO.

PROFIT AND LOSS ACCOUNT

for the financial year ended 31st March 1968

		Gold Francs
Net interest and other income		62,457,488
Less: Costs of administration:		
Board of Directors	141,920	
Management and Staff	7,101,184	
Office and other expenses	1,716,536	8,959,640
Net operating surplus		53,497,848
Less: Amounts appropriated to the following provisions:		
Exceptional costs of administration	1,997,848	
Building purposes	6,500,000	8,497,848
NET PROFIT for the financial year ended 31st March 1968		45,000,000

APPROPRIATION OF NET PROFIT

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

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

Dr. J. Zijlstra, Amsterdam	Chairman of the Board of Directors, President of the Bank
Maurice Frère, Brussels	Vice-Chairman

Hubert Ansiaux, Brussels
M. J. Babington Smith, London
Karl Blessing, Frankfurt a/M.
Dr. Rudolf Brinckmann, Hamburg
Jacques Brunet, Paris
Dr. Guido Carli, Rome
Henri Deroy, Paris
Dr. Donato Menichella, Rome
Sir Leslie O'Brien, London
Dr. Edwin Stopper, Zurich
Per Åsbrink, Stockholm

Alternates

Dr. Paolo Baffi, Rome, or
Prof. Pietro Stoppani, Rome
Bernard Clappier, Paris, or
Marcel Théron, Paris
C. J. Morse, London, or
R. G. Raw, London
Cecil de Strycker, Brussels

MANAGEMENT

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

Jan Knap	Assistant Manager