BANK FOR INTERNATIONAL SETTLEMENTS

THIRTY-SIXTH ANNUAL REPORT

1st APRIL 1965 — 31st MARCH 1966

BASLE

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THIRTY-SIXTH ANNUAL REPORT

submitted to the

ANNUAL GENERAL MEETING

of the

BANK FOR INTERNATIONAL SETTLEMENTS

held in

Basle on 13th June 1966.

Gentlemen,

I have the honour to submit herewith the Annual Report of the Bank for International Settlements for the thirty-sixth financial year, which began on 1st April 1965 and ended on 31st March 1966. Details of the results of the year's business operations are given in Part III, together with an analysis of the balance sheet as at 31st March 1966.

The accounts for the thirty-sixth financial year closed with a surplus of 38,578,751 gold francs. Last year the surplus was 34,519,144 gold francs. After deduction of 1,000,000 gold francs transferred to the provision for exceptional costs of administration and of 15,000,000 gold francs transferred to the provision for contingencies, the net profit amounted to 22,578,751 gold francs, compared with 22,519,144 gold francs for the preceding year.

The Board of Directors recommends that the present General Meeting should decide to distribute, as last year, a dividend of 37.50 gold francs per share. The Board also proposes that, as an exceptional measure, a lump sum should again be applied to the reduction of the amount of the undeclared cumulative dividend. This sum, which has been fixed at 15,000,000 gold francs, will represent an extraordinary distribution of 75 gold francs per share. The total distribution will thus amount this year to 112.50 gold francs, payable in Swiss francs in the amount of 160.75 Swiss francs per share.

Part I of this Report deals with economic developments and policies in Europe and the United States in 1965 and the early months of 1966. In Part II a survey is given of developments in the fields of credit, external payments and reserves and in the foreign exchange and Euro-currency markets; an outline is also given of the working of the European Monetary Agreement. Part III deals with the operations of the Bank and the functions it performs on behalf of the High Authority of the European Coal and Steel Community and as Trustee and Fiscal Agent for international loans. It also touches on the Bank's rôle in promoting co-operation between central banks as well as on its relations with other international institutions.

PART I

CURRENT ECONOMIC TRENDS AND POLICIES 1965–66.

For most industrial countries of western Europe, as well as for the United States, the economic situation at the present time is one of excessive demand and pressure on prices. In consequence, the emphasis in official policy measures is on restraint, without, however, the restraint being sufficiently strong to assure a return to monetary stability. It is characteristic, also, that monetary policy is being used much more than budgetary policy to contain the demand pressures, so that interest rates have risen substantially. France and Italy are the notable exceptions to this pattern, as they both curbed the boom by earlier action and are now having expansion on a sounder basis.

As a result of both restraint and inflation, the expansion of real output has generally slowed down during the past year. Indeed, for many countries in Europe the rise in prices during the last twelve months has been larger than the increase in national production — which is hardly an approved method of adjusting the overstrain on resources. In the United States, however, output continued to increase at a rapid rate, though with a narrowing margin of unused labour and capacity.

In the sphere of international payments, the position of many of the continental countries deteriorated in the past year; France and Italy were exceptions here also, as their surpluses increased to rather extreme levels. The situation has been better in that the deficits of the United States and the United Kingdom have been reduced. As this was accomplished in large measure by the action of direct controls, however, the need for adjustment of underlying market forces remains pressing.

United States.

In the past year there has been a significant change in the economic situation of the United States on both the domestic and external fronts, which has required a shift of emphasis in official action.

The expansionary movement of the economy is now in its sixth year and there are few signs of a change in pace. For the first time in a decade production is close to capacity, while unemployment has fallen to a twelve-year low. The very success in overcoming the under-utilisation of resources which gripped the country in the second half of the 1950s has, however, created new problems. Policy has shifted towards keeping the economy to the narrow path that separates excess demand and inflation from insufficient demand and a low rate of growth.

The high rate of increase in real gross national product — 5.5 per cent. last year and 6 per cent. in the first quarter of 1966 — was in no small part induced by fiscal impulses. The second stage of the income-tax cut became effective in January 1965; a broad reduction in Federal excise taxes was introduced in June; in September social security benefits were raised and a large retroactive payment was made; and there was an upward trend in Federal expenditure for various civilian purposes. To all this was added a sharp rise in the placement of defence contracts because of the war in Vietnam.

The expansion was supported also by business fixed investment outlays, which rose by 14 per cent. in real terms, after having registered a 10 per cent. advance the preceding year. Private consumption responded fully to these strong stimuli and advanced almost 6 per cent. in real terms. Residential construction, on the other hand, remained a weak spot, while net exports of goods and services fell back from their very high 1964 level.

A direct consequence of the economic advance was a significant drop in the unemployment rate, despite substantial increases in the civilian labour force and in the average working week. Overall, unemployment fell from 5.0 per cent. in December 1964 to 4.1 per cent. by the end of 1965, and to 3.8 per cent. in the spring of this year.

As the margin of unutilised resources narrowed, prices began to creep upwards, thus ending the stability that had hitherto characterised the American expansion. The increases over the past year, of about 4 per cent. at the wholesale level and almost 3 per cent. for consumer prices, were in good part due to transitory developments in the supply of foodstuffs. But there was a distinct upward tendency in the prices of other goods as well. With regard to wages, the record was substantially better. Their rise, on the whole, did not exceed by much the increase in productivity, and unit labour costs advanced by only 1 per cent.; it is even estimated that for manufacturing alone unit labour costs were fractionally lower in 1965 than they had been in 1960.

The government's interventions in support of restraint on prices and wages have undoubtedly played a rôle in dampening inflationary increases. Active mediation, for instance, helped to keep the key steel settlement of last September within the wage guide-posts. Similarly, despite certain pressure, the pay rises of civil servants were restricted to conform to the guide-posts. On the price side, a number of increases — notably for aluminium, copper and structural steel — were rescinded under strong government pressure, which occasionally included the release of stockpiled materials. There is also little doubt that the determination shown by the government held back price increases in some other industries as well.

The increasing signs of strain that were evident during the year did not reflect a situation of acute excess demand, as was the case in many European countries. Rather than being general, labour shortages were confined to particular industries or regions. And, with a still sizable pool of unemployed and a rapidly growing labour force, these stringencies could be eased, given enough time, by on-the-job training and the up-grading of skills. Similarly, thanks to the large volume of investment in the recent past, capacity utilisation in manufacturing had risen only from 88 per cent. in December 1964 to 90.5 per cent. in March 1966; hence, while there were output pressures in particular branches of industry, operating ratios were not generally above the optimum.

In assessing the policy needs of the situation, however, account had to be taken of the speed of the expansion and the prospects of its continuing at a rate that would lead to growing tightness of resources. On both these counts it was appropriate that the policy measures be shifted from stimulus to restraint. While it was unnecessary for such measures to aim at a cut-back in activity, they had to be designed to bring about a dampening of the rate of increase in demand so as to prevent an inflationary atmosphere from developing. For the first time since the large US balance-of-payments deficits began, therefore, there was no clash between the policies required to ensure internal and external equilibrium.

Under these conditions, monetary policy moved towards a position of less ease early in 1965. Free reserves of the banks declined until they reached a considerable negative amount, and were kept at that level up to almost the end of the year. In the meantime, however, there was a marked upsurge in credit demand that was soon reflected in the cost of money. The uptrend in interest rates began during the summer, accelerated markedly in the autumn and led, early in December, to the raising of the discount rate from 4 to 4½ per cent. Although monetary policy moved further towards restraint, bank loans continued to advance at a rapid pace, partly because borrowers anticipated additional credit tightening. As a consequence, interest rates continued to firm in 1966. Contrary to what had happened earlier in the expansion, however, the rise over the last nine months was not restricted to short-term interest rates, which advanced by about one percentage point, but spread to medium and long-term rates as well, which increased by approximately one-half of one percentage point.

By the early months of 1966, moreover, it became evident that the required degree of restraint could no longer be secured by monetary policy alone. With interest rates driven to levels high by historical standards, with the need not to impair the future flexibility of monetary policy, and especially with the prospect of a continued rise in aggregate demand that would intensify market pressures, recourse to fiscal restraint became necessary. The economy was obviously poised for another year of rapid advance, but this time with signs of imbalance and with a much reduced margin of unutilised labour. Corporations were planning to increase fixed investment at an even steeper rate than in 1965; consumer demand, bolstered by the coming into effect of a new round of excise-tax reductions, gave little sign of slackening; Federal, State and local-government outlays on civilian programmes were marked for another sharp rise; and, finally, the intensification of the war in Vietnam was going to substantially increase the government's call on man-power and capital resources.

As a consequence, some restrictive fiscal measures were taken in the spring of 1966. The excise-tax reductions on automobile sales and telephone services that had become effective on 1st January were repealed for two years, the amount of personal income taxes to be withheld during the year was increased, and the payment of corporate income taxes was accelerated. Further-more, the government declared itself prepared to ask for additional restrictive fiscal legislation if, as seems likely, the latest measures prove insufficient to stem the inflationary pressures.

Such measures, as a support to monetary restraint, would also seem appropriate in the light of external considerations. Despite substantial progress in some respects, the US balance-of-payments position remained unsatisfactory in 1965. To be sure, the deficit (as computed according to the "liquidity" concept) declined by $1.5 milliard to $1.3 milliard and would have been even smaller but for the sale of a considerable portion of the British Government's holdings of US corporate securities. This overall improvement, however, masks the emergence of certain unfavourable developments which may considerably complicate the task of further reducing the deficit in 1966.

The voluntary restraint programme on capital exports was certainly the main reason why the outflow from the United States was cut almost by half. The $3 milliard thus saved resulted almost entirely from a turn-about in US short-term capital movements, from a $2 milliard outflow in 1964 to a $0.7 milliard inflow in 1965. Private long-term capital outflow, by contrast, was only slightly reduced on balance; a substantial rise in direct investment outflows offset the effects of a sharp curtailment of long-term bank lending, while US purchases of foreign securities remained as high as in the pre-ceding year.

Fully two-thirds of the improvement in the US private capital accounts was, however, cancelled out by a $2 milliard decrease in the trade surplus. Imports soared even faster than domestic demand, while exports advanced only little, reflecting partly slower economic growth in Europe, Latin America and Japan.

Early this year, therefore, the authorities were faced with the likelihood that some of the preceding year's unfavourable balance-of-payments develop-ments would persist in 1966. With continuation of the strong domestic expansion, in particular, imports could be expected to rise again rapidly, while the war in Vietnam was resulting in additional outlays abroad. More-over, because the balance-of-payments programme had yielded such considerable results in 1965, the year-to-year reduction in capital outflows was likely to be much smaller in 1966; some further improvement could nevertheless be anticipated, since the programme had been strengthened in December and its effects were reinforced by tighter credit conditions in the United States. This situation thus called for the same restrictive policy as was necessary on domestic grounds.

United Kingdom.

A year ago the immediate problem of the UK economy was the large balance-of-payments deficit and the lack of confidence in sterling. Behind this, however, was excessive internal demand, which was exerting pressure on productive resources and causing not only a substantial excess of imports over exports but also inflation of domestic costs and prices.

In the light of this situation various measures were taken to contain domestic demand. The budget of April 1965 provided for increases in both direct and indirect taxes to yield £164 million in the coming fiscal year. It was followed by a tightening of monetary policy; the banks were required to make special deposits at the Bank of England and were asked not to offset this restriction of their liquidity by selling government securities. In addition, the Bank of England asked the banks to limit the increase in advances to the private sector to no more than 5 per cent. during the year to mid-March 1966. At the end of July these measures were supplemented by further demand restraints; consumer credit controls were tightened, restrictions were imposed on private construction other than housing and industrial building, and new non-industrial capital projects in the public sector were to be slowed down. In themselves, these measures constituted a fairly firm programme of restraint and it seemed as if they might bring about an easing of the boom by the end of the year. In the event, however, the demand pressure on resources was fully maintained through the whole of the fiscal year and by the time of the budget in 1966 unemployment was at a lower level than a year before.

This result may be attributed to two forces which continued to augment total demand over the past year — public-sector expenditure and rising wages. As regards the public sector, consumption outlays expanded more than in the previous year because of larger spending by the central government. Public investment outlays also rose, though at a slower rate, public enterprises contributing most of the increase. While steps were taken to slow down certain new public capital projects, there was a time-lag before their effects could be felt.

Despite the increase in taxes, the overall budget deficit widened substantially, to £576 million in fiscal 1965–66 from £386 million the year before. A budget deficit of this size tended to counteract the impact of the credit squeeze on the liquidity of the economy. The increase in bank credit to the private sector remained within the 5 per cent. ceiling; none the less, clearing-bank deposits rose by 7 per cent. and the total money supply by even more.

The rise of wages was a much more important factor in maintaining the pressure of overall demand. To strengthen the policy of incomes restraint, the government established a National Board for Prices and Incomes and proposed that the Board be given statutory powers. But, as a round of large wage increases was in progress, there was little immediate effect on the settlements being made — particularly in view of the tightness on the labour market. Over the past year hourly wage rates rose by about 7 per cent. and, as there was a substantial wage drift, average hourly earnings went up 9.5 per cent. Besides the tightness of the labour market and the momentum of the wage round, a general move to shorten the standard working week from forty-two to forty hours contributed to the increase in hourly rates and earnings.

Largely because of the rise in wages, but also owing to improved social security benefits and dividend payments, personal incomes increased by over 7 per cent. Even after allowing for higher direct taxes and social security contributions, disposable personal income rose at the rate of 5.7 per cent., and this meant a roughly similar increase in spending by consumers at current prices. For some months after the budget consumer spending appeared to weaken, but there was a resurgence in late 1965 and early 1966.

A more welcome factor contributing to the dynamics of monetary demand was exports, which were up by 7 per cent. on an annual basis. In absolute terms, however, the rise was of much less importance than the increase in consumer or public-sector outlays, as exports account for a smaller proportion of total national expenditure.

The increase in demand was absorbed partly by rising output but somewhat more by higher prices. In constant prices, the gross domestic product increased by 2.3 per cent. in 1965, compared with a rise of 5.5 per cent. the year before. The smaller increase in total production, in the face of active demand and a decline in unemployment, may be partly explained by the reduction of average working hours. However, it is to be explained also by the price rise itself. Apart from the demand pressure on prices, the rapid advance of wages was necessarily raising costs and exerting a cost push on prices — thereby limiting the rise of real demand. It is estimated that wage costs rose by 6.5 per cent. in 1965. As for prices, the increase at the retail level was 4.5 per cent., about one-third of which was due to indirect taxes and other charges. It has been suggested that incomes policy had some temporary effect in holding down price increases, so that there may be price adjustments to accommodate the higher level of costs in the months ahead.

Under the inflationary conditions that prevailed, it is something of an achievement that there was a substantial reduction in the balance-of-payments deficit. On current and long-term capital account the deficit was cut from £769 million in 1964 to £354 million last year, and for the fourth quarter of 1965 there was a near balance. The improvement in the deficit on the monetary position was even greater — from £747 to 249 million — as there was a large increase in the positive balancing item. The main factor in the improvement was the rise of exports, which increased at a much better rate than previously. Buoyant demand in both the United States and Germany was largely responsible, more than counteracting the fall in exports to France and Italy. In addition, there was a sharp reduction in the outflow of long-term capital from the very high level of the previous year, partly as a result of tighter exchange control measures taken by the government in April and again in July.

On the other hand, imports remained high in 1965 and were even slightly up on the previous year. Some decline of imports might have been anticipated for two reasons: first, because of the special import surcharge that was imposed in October 1964 and, secondly, because inventory accumulation was much lower over the past year compared with the high level it reached in 1964. However, these factors were more than offset by the pressure of internal final demand. In particular, the maintenance of the investment boom led to an increase in capital goods imports of 14 per cent. On the other hand, the surcharge evidently had an effect on imports of consumer goods, which declined by 11 per cent. at the same time as consumer expenditure rose by over 5 per cent.

In the early months of 1966 there was evidence of a more rapid increase in activity, with a corresponding renewed rise in imports. Although the acceleration was probably partly due to temporary factors — and, in particular, to higher consumer expenditure in anticipation of an increase in purchase taxes — the underlying pressure of demand was still strong. Early in February the authorities therefore announced that lending to the private sector by banks and other financial institutions was to be maintained until further notice within the ceilings previously set for March 1966, and further tightened hire-purchase restrictions.

By April some slight signs of ease were appearing, but demand remained excessive and a restrictive budget was consequently presented in May 1966. It provided for additional taxes to yield £386 million during the fiscal year, thus raising total revenue by close to 4 per cent. The proposed tax increase was more than twice as large as the one included in the preceding budget. Despite a continued large advance in expenditure it is estimated that the new taxes, together with the growing yields on existing taxes, will permit a £358 million rise over 1965–66 in the current-account surplus to over £1,000 million. Since Consolidated Fund loans are to increase by only £69 million, the overall deficit should decline by £289 million — from £576 to 287 million.

Of the new revenue, £315 million is to come from a selective tax on employment and will not bear on consumption demand as heavily as income or excise taxes. The new tax is intended to extend the tax base to service industries and to induce a shift of labour from services and construction to manufacturing. As payments of the tax are to start in September, whereas refunds, to which some industries will be entitled, will not start until the

United Kingdom: The budget.

Items	Financial years 1963-64	1964-65	1965-66	1966-67 Estimates before budget changes	after budget changes
	Results			Estimates	
	in millions of £ sterling				
Revenue					
Tax revenue	6,649	7,431	8,324	8,945	9,331
Other receipts	639	726	821	893	893
Total revenue	7,288	8,157	9,145	9,838	10,224
Expenditure					
Supply services	6,000	6,480	7,140	7,728	7,728
Consolidated Fund standing services	1,198	1,233	1,316	1,449	1,449
Total expenditure	7,198	7,713	8,456	9,177	9,177
Surplus	90	444	689	661	1,047
Consolidated Fund loans (net)	— 527	— 830	—1,265	—1,334	—1,334
Overall deficit (—)	— 437	— 386	— 576	— 673	— 287

following February, the yield will be larger this fiscal year than in subsequent periods, when it will fall to £240 million. While the tax may have some small anticipatory effects, the main impact will begin in September. However, demand pressures may be somewhat less strong in the intervening months because of the pre-budget buying already mentioned. A slight temporary easing of this kind had been noticeable in the months following the 1965 budget.

The Chancellor of the Exchequer also announced that the import surcharge introduced in 1964 would be allowed to expire next November. To further strengthen the balance of payments in preparation for this step, a programme to reduce investment outflows to the developed countries of the sterling area was introduced. With the co-operation of the major British industries, and under the supervision of the Bank of England, the programme aims at postponing for the next year or two all investments in these countries that cannot be financed from foreign sources or which do not promise a "quick, substantial and continuing benefit to the balance of payments". In addition, the Chancellor announced a stringent review of government expenditure abroad and early negotiations with the German Federal Government for the elimination of the entire foreign exchange cost of keeping UK forces in Germany.

The additional measures of restraint introduced by the new budget constitute an important element in the struggle for price stability and balance-of-payments equilibrium. For the measures to succeed, however, the tight credit position which will naturally emerge from existing policies will need to be maintained; and, above all, it will be essential to stop inflationary wage increases.

Developments in continental western Europe.

Economic developments in continental western Europe during the past year were largely shaped by the earlier measures that had been taken in most countries to curb inflation. As a consequence, there was a general and substantial slow-down in economic activity. Pressures on resources nevertheless persisted, and many economies still operated at over-full employment. As restrictive policies were undertaken at different times and applied with varying degrees of vigour, their effects differed substantially from country to country.

In Italy, France and Belgium, which had moved strongly against inflation in late 1963 or early 1964, the rise in real gross national product over the previous year — 3–3½ per cent. — was among the lowest in continental Europe. These countries, however, were the first to be able to relax restrictive measures, either because the rise in prices had been checked or because aggregate demand had fallen to a critical extent. Hence they enjoyed, by and large, a more rapid advance during 1965 — particularly in the second half — than the countries that had been less vigorous in combating inflation.

This pattern was especially evident in Italy. The restrictive measures taken in late 1963 were soon followed by a fairly sharp downturn that persisted during most of 1964. Recovery then began, but was still insufficient to decisively lift the economy out of its depressed state. As further measures were clearly called for, the authorities moved throughout 1965 to stimulate the economy, and the pace of the recovery accelerated markedly late in the year and early in 1966.

In France, too, the stabilisation programme initiated in September 1963 led to a sharp brake on the expansion. The economy stagnated on a high plateau for a full year until the spring of 1965, when signs of a revival began to appear. The recovery accelerated early in the autumn, and continued at this pace in the opening months of 1966 as well, when further moderate expansionary steps were taken.

In Belgium, where the main restrictive measures had been introduced somewhat later than in Italy and France, the firming began only in late 1965; it was aided by the relaxation, in April 1965, of the restraint imposed on public investment and by some easing of monetary policy in July. The recovery strengthened considerably early in 1966, and in May the authorities acted to slow down the expansion in public expenditure and bank credit.

A very different pattern emerged in those countries whose policies had been less restrictive. Here, by and large, economic activity failed to show much upward trend during 1965 and the opening months of 1966. The slow-down resulted from a combination of measures that dampened demand and of capacity shortages that limited the growth of production. In those countries where capacity constituted the main brake on expansion, the slow-down was, of course, accompanied by an intensification of inflationary pressures.

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 equip- ment	Dwell- ings			
		in percentages							
Austria	1963	5.2	6.2	2.6	3.0	0.5	8.9	7.9	3.9
	1964	4.4	5.2	8.1	9.3	2.9	8.0	9.3	6.6
	1965	4.4	3.7	5.0	6.5	— 1.5	6.6	9.7	3.0
Belgium	1963	5.5	11.6	2.1	4.2	— 5.7	7.3	8.6	4.8
	1964	4.2	3.0	7.3	1.4	31.5	13.0	12.6	5.0
	1965	3.0	6.5	1.0	3.0	— 5.0	11.0	8.5	3.0
Denmark[1]	1963	0.4	4.6	— 2.3	— 2.2	— 3.4	10.5	— 1.4	1.9
	1964	5.9	5.2	20.1	18.5	28.2	8.8	19.9	7.3
	1965	4.5	4.6	5.6	4.4	11.3	9.2	6.9	5.0
Finland	1963	4.4	7.4	— 0.8	— 2.0	2.8	1.9	— 1.4	2.3
	1964	4.5	3.7	8.1	14.0	— 9.3	5.8	19.4	6.4
	1965	5.4	5.9	7.3	8.7	2.0	4.1	5.6	5.0
France	1963	6.8	1.2	7.6	6.8	10.0	8.2	12.3	5.2
	1964	4.7	4.8	11.8	7.6	24.6	7.7	12.2	5.9
	1965	3.2	2.1	5.3	3.8	9.3	11.0	3.7	3.4
Germany	1963	3.0	8.3	2.8	3.6	0.0	9.6	8.3	3.5
	1964	5.4	— 0.6	11.9	12.4	10.0	10.3	10.9	6.6
	1965	6.2	6.8	6.4	7.9	— 0.2	7.1	14.2	4.5
Italy	1963	8.9	5.1	8.5	7.1	12.1	6.9	22.4	5.5
	1964	2.3	4.0	— 6.5	—12.0	6.0	11.6	— 5.1	2.7
	1965	2.1	3.7	— 8.2	— 9.3	— 6.0	19.9	0.9	3.4
Netherlands	1963	6.6	4.7	2.0	1.7	4.1	5.9	9.1	3.1
	1964	5.7	1.6	16.5	14.2	28.4	11.9	15.0	8.2
	1965	7.0	1.6	6.5	5.0	13.4	8.6	6.2	5.5
Norway[1]	1963	3.7	3.2	8.5	9.9	0.3	10.1	9.2	4.7
	1964	4.1	6.0	4.7	5.2	2.0	10.7	8.1	6.4
	1965	2.6	10.7	6.8	7.2	4.3	7.3	9.5	5.9
Sweden[1]	1963	5.0	6.1	7.4	7.2	7.9	6.6	6.5	4.9
	1964	5.3	5.8	7.4	6.1	11.8	11.9	10.7	7.9
	1965	3.9	6.0	5.7	7.0	1.8	2.6	9.0	3.4
Switzerland	1963	5.1	8.2	6.4	7.8	2.1	5.3	5.2	4.6
	1964	4.4	6.0	8.7	8.1	10.5	6.8	8.7	5.0
	1965	3.7	3.4	1.5	0.3	5.0	7.8	1.9	4.3
Total for above countries	1963	5.4	6.0	4.8	4.8	4.9	8.1	9.9	4.3
	1964	4.5	2.3	7.7	6.5	11.7	10.0	9.8	5.7
	1965	4.2	4.9	4.2	4.1	4.4	8.9	7.4	4.0
United Kingdom	1963	4.6	1.5	2.4	2.5	2.1	4.3	3.2	4.4
	1964	3.7	1.8	16.4	14.0	26.7	3.4	8.6	5.4
	1965	1.5	3.8	3.7	3.8	2.9	5.2	2.1	2.3
United States	1963	4.1	1.8	4.3[2]	4.8	2.8	7.3	3.9	3.8
	1964	5.6	0.2	6.3[2]	8.8	— 0.4	13.4	5.3	5.0
	1965	5.9	2.2	7.2[2]	10.5	— 2.4	1.9	11.8	5.5

[1] 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. [2] Private investment and new civil public construction.

Germany to a large extent fell within the latter category, with expansion limited by labour shortages. Demand continued to rise rapidly and to cause inflationary pressures, so that a restrictive policy was clearly called for. Fiscal measures, however, were exerting a considerable expansionary impact at the beginning of 1965 as, under previously enacted legislation, income taxes were cut, social insurance benefits increased, and other government outlays substantially raised. Under these circumstances, monetary policy moved strongly towards restraint. This action showed some results in the second half of the year, and economic activity started to level out. A more restrained fiscal policy had in the meantime been worked out for 1966, and in the first months of that year inflationary forces were less intense.

In the Netherlands and Sweden, too, economic activity was limited by the availability of labour. But while this led to little growth in Sweden, in the Netherlands output remained on an upward trend that even accelerated during the last six months of 1965. The slow-down in Switzerland must be largely ascribed to the pursuance throughout the past year of the restrictive measures adopted in the spring of 1964. Although the economy continues to show signs of strain, the measures have led to a reduction of excess demand pressures.

A feature of the slow-down in activity was a lowered rate of increase in fixed investment outlays. Fixed investment in Italy actually declined for the second consecutive year, despite a rise in public works; residential construction dropped sharply, while equipment outlays contracted until the middle of 1965, recovering only gradually thereafter. In Belgium there was some further growth in business fixed investment, but housing declined and public works were cut back. As a result, total fixed investment was little changed. The rate of growth of fixed investment outlays fell from 11.8 to 5.3 per cent. in France, even though there was a rise in public capital formation. Private enterprises, whose profit margins were squeezed between rising costs and blocked prices, invested less than in 1964; the 10 per cent. tax credit for investments that was announced last February, along with the forces of the recovery, should, however, lead to an improvement.

In most of the other countries, too, gross fixed investment increased at a much slower pace than in 1964. In real terms, the rate fell from 11.9 to 6.4 per cent. in Germany, from 8.7 to 1.5 per cent. in Switzerland, from 16.5 to 6.5 per cent. in the Netherlands and from 20.1 to 5.6 per cent. in Denmark. The decline was much smaller in Sweden, as a moderate upturn in plant and equipment investment offset much of the reduction in residential building. In Germany equipment outlays rose again — by over 10 per cent. — but there was a deceleration as the year progressed; on the other hand, there was a much smaller rise in construction, especially for public works, which reflected primarily unfavourable weather conditions.

The increase in private consumption in France and Belgium was more moderate than in 1964, while in Italy it remained virtually unchanged. In all three countries, however, a definite pick-up started in the second half of the year, helped in Italy by the suspension of hire-purchase restrictions and in Belgium by the anticipation of increased excise taxes in 1966. In Switzerland, too, the rate of increase of private consumption slowed down somewhat, partly because of the declining labour force. In Germany, and even more in the Netherlands, by contrast, private consumption forged ahead, although a tapering-off began in Germany towards the end of 1965.

A disquieting development in 1965 was the sharp rise in public consumption expenditure in virtually all continental countries, at a time when restraint was called for in most of them. While the rise in France was kept at 4½ per cent. in money terms, it reached 9 per cent. in Switzerland, 11 per cent. in Italy, 12 per cent. in Germany, 13 per cent. in the Netherlands and Sweden and 15 per cent. in Belgium. These advances were mostly due to large increases in the remuneration of civil servants.

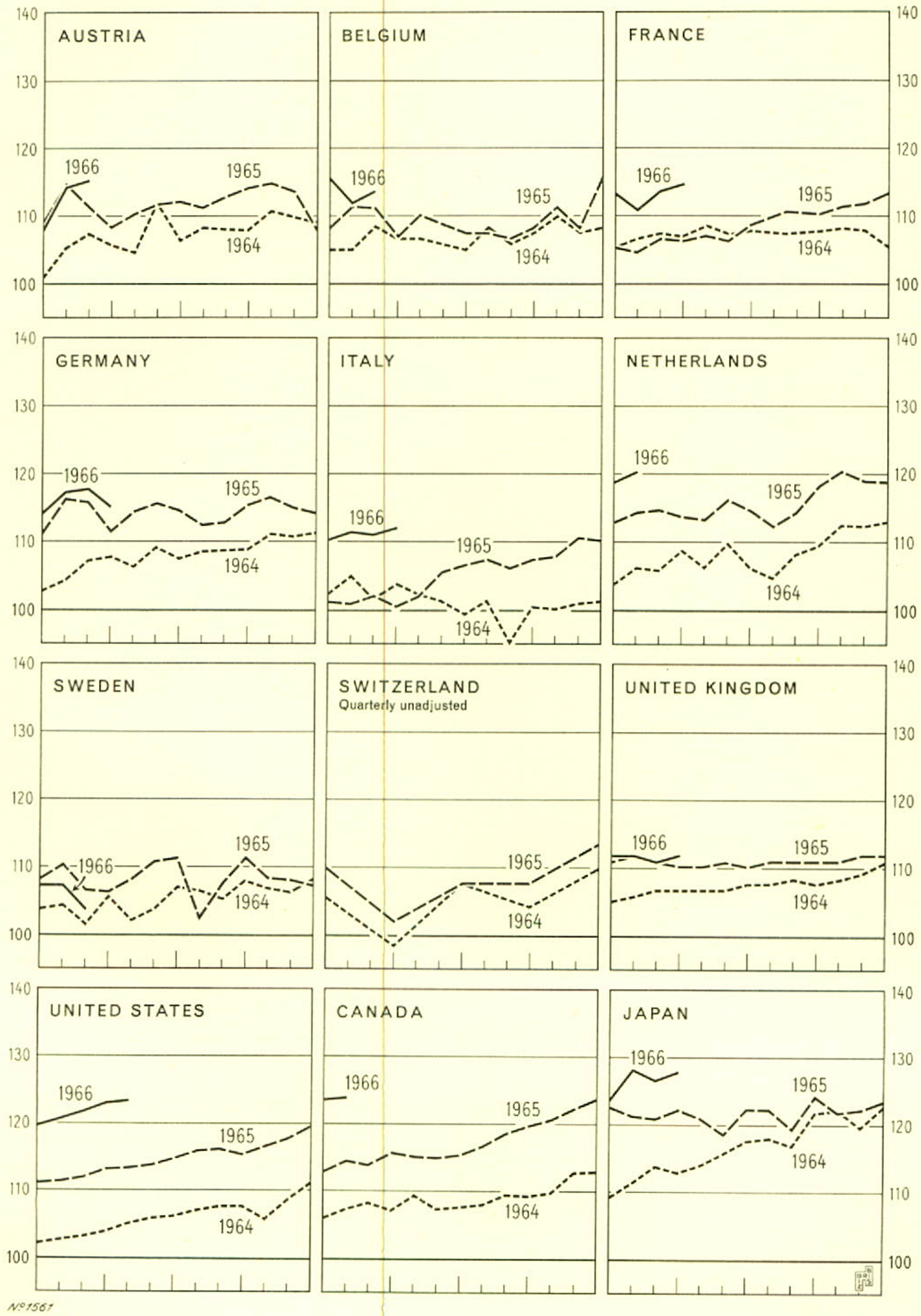
Foreign demand proved a major element of strength for the continental countries taken as a whole. Their exports to the United States, in particular, rose sharply — by 17.5 per cent. — and provided a significant stimulus in the cases of France, Italy, Sweden and Germany. Shipments to the United Kingdom, on the other hand, rose only little, as a consequence of that country's import surcharge.

There were wide country-to-country differences, however, in the importance of this factor. Foreign demand, notably from Germany but also from the United States, constituted an especially strong support for the recovering economies of Italy, France and Belgium. In Germany, by contrast, exports stagnated at a high level throughout most of the year, since goods were diverted to the domestic market and sales to France and Italy remained depressed. In the latter part of the year, however, exports began rising again quite steeply. In Switzerland exports rose steadily throughout the year, partly under the impact of the stabilisation programme.

On the supply side, too, there was further overall growth but, again, at a less rapid pace than in 1964. The patterns were primarily established by industrial production. By and large, rapid growth in the services sector continued, while agriculture fared less well than in 1964. Unfavourable weather conditions resulted in poor harvests in most of central Europe, especially in Austria, Germany, the Netherlands and Belgium. In France and Italy, on the other hand, agricultural production expanded further.

Industrial production rose steadily in Italy from the low point it had reached in the autumn of 1964, and the advance accelerated substantially as from the following spring; by the first quarter of 1966 the index was almost 10 per cent. above its level a year earlier. In France the upswing in industrial production came only in the second half of 1965, but in the early months of this year the index stood 7 per cent. higher than in the same period of 1965. The upturn was concentrated in consumer goods industries — notably motor-cars — while capital goods industries were still in the doldrums. In Belgium, on the other hand, the rise in industrial production came later and was more moderate.

Industrial production.
Adjusted monthly indexes: 1963 = 100.



In most other countries, by contrast, increases in industrial production tended to taper off markedly during the year. In Germany, for instance, industrial production was 5.4 per cent. higher in 1965 than in 1964, but the December-to-December advance was only 1.6 per cent., and the first quarter of 1966 did not show a much better result. A similar, although less sharp, development also occurred in Austria, Sweden and Norway; the same also held true for Switzerland in the first half of 1965, but a pick-up was noted later in the year. The Netherlands and Spain were exceptions, however, with further substantial growth.

In countries where the rise in demand outstripped domestic supply possibilities, the gap was, of course, partly made good by imports. This was particularly the case in Germany, Sweden, Spain and the Netherlands. As domestic demand pressures eased towards the end of 1965, however, the import rise slowed down in Germany, and a similar development also took place in Sweden. In the Netherlands, by contrast, the rise in imports accelerated markedly in the last few months of the year, as a result both of a more rapid gain in domestic activity and of increased purchases in anticipation of the higher 1966 excise taxes.

Developments in France and Italy were the opposite of those in Germany. During the first half of the year imports were falling off in France, while in Italy they were only recovering from their sharp 1964 drop. With the domestic upturns gaining momentum, however, imports began to move ahead in France and their rise accelerated in Italy.

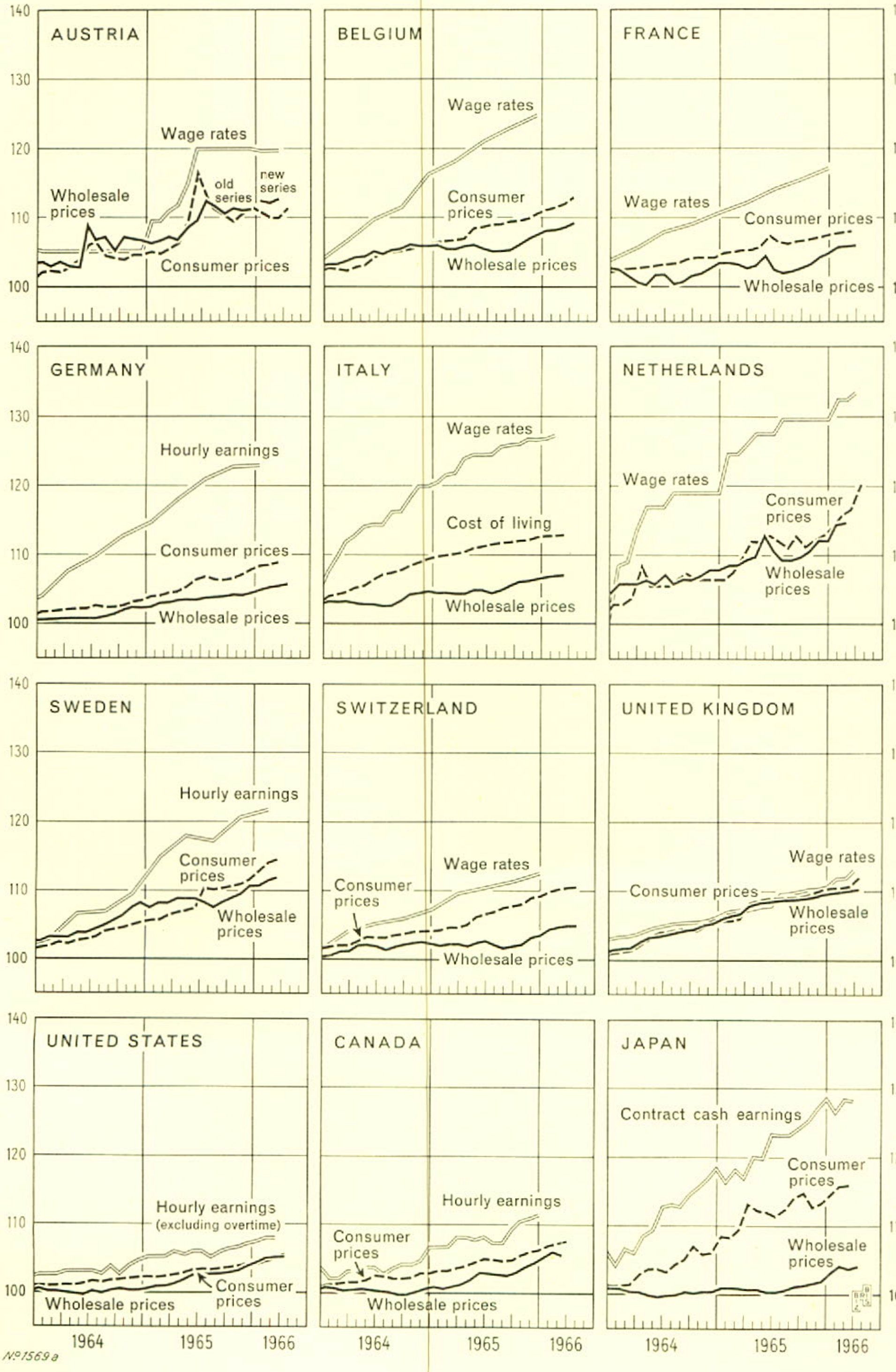
Price developments continued to be unsatisfactory in continental western Europe during the past year. Only in Italy, France and Norway were consumer price increases held to a 2½–3 per cent. range between the first quarters of 1965 and 1966. Even these results mask earlier pressures that were repressed by price controls. In all other countries the rises in consumer prices were larger: between 4 and 5 per cent. in Germany, Belgium and Austria, 5½ per cent. in Switzerland, and around 7 per cent. in Denmark, the Netherlands and Sweden.

To some extent the price increases resulted from special factors. Owing to the poor harvest in 1965, agricultural prices rose substantially in most countries, while the world-wide increases in the prices of many primary metals late in 1964 also contributed to the upward push in consumer prices during 1965. Excise taxes were raised in Denmark, Sweden, Belgium and the Netherlands during the past year; the price increases that followed resulted, of course, from the fight against inflation rather than from inflation itself.

Even after allowing for these special factors, however, the price increases were substantial. Coming after several years of unfavourable price developments, they indicate a stubborn and dangerous inflationary problem. Since 1958, for instance, consumer prices have risen by 17 per cent. in Belgium, 19 per cent. in Germany, 21 per cent. in Switzerland, 27 per cent. in the Netherlands, 32 per cent. in France, and 38 per cent. in Italy; in the United States the rise over this period was 10 per cent.

Wholesale and consumer prices and industrial wages.

Indexes: 1963 = 100.



The price rises evident last year in France and Italy are primarily ascribable to the aftermath of earlier pressures. The earlier distortions in relative wage rates among occupations, as well as the repression of price increases by direct controls, were bound to result in later adjustments.

In most other continental countries the problem was essentially one of continuing excess demand. A long period of expansion under conditions of over-full employment cannot fail to lead to pressure on prices. The solution, basically, is one of equating demand and supply and avoiding strain on resources.

This, however, was not achieved last year, when, overall, the labour situation continued to be extremely tight. Conditions were, of course, relatively easy in the countries that had moved with determination to reduce excess demand. Indeed, for the second consecutive year unemployment increased in Italy throughout most of 1965, as the recovery had not yet extended to some of the more labour-intensive industries and as, in the industries that were expanding production, this was frequently achieved by lengthening the working week. In France, where unemployment was much less, the economic recovery was slow enough at first to be accommodated largely by the reduction of stocks and the rise of labour productivity. At a second stage longer hours began to be worked, but it was only towards the end of the year that employment started firming somewhat.

In all other countries the labour situation remained strained, and was not helped by the widespread trend throughout western Europe towards shorter working weeks and longer paid vacations. In Germany, for instance, the reduction in the working week offset almost entirely the appreciable increase in the labour force that resulted from a 23 per cent. rise in the number of foreign workers to 1.2 million. And since the labour force was already fully employed at the beginning of the year, production could increase only to the extent to which productivity was advancing; with strong demand conditions, therefore, the labour shortage increased throughout much of the year. Some easing became apparent in the autumn, however, as demand began to slow down. A slight easing was also registered in Belgium, Denmark and Switzerland. In Switzerland this happened despite an almost 2 per cent. decline in the labour force by the end of 1965, resulting from the policy of reducing the number of foreign workers. In the Netherlands and in Sweden, by contrast, there were no signs that the labour shortage was abating.

Under these circumstances, a new surge in labour costs was probably inevitable. Hourly earnings advanced by over 10 per cent. in Austria, Denmark and Sweden, by 8–9 per cent. in Germany and the Netherlands, and by 7 per cent. in Belgium, while hourly wage rates increased by between 5 and 6 per cent. in France, Italy and Switzerland, and by over 14 per cent. in Spain. Although productivity continued to advance at a good pace in most countries, unit labour costs increased almost everywhere, and especially sharply in Sweden, Austria, Germany and the Netherlands. The rise was more moderate in France, Belgium and Switzerland. Only in Italy did unit labour costs actually decline, as a result of a productivity gain typical of the early stages of recovery.

The cost of capital, too, rose, or at best remained high, in most continental European countries during the past year. In Germany and Denmark long-term interest rates rose by more than one percentage point, while the advance in Sweden and the Netherlands was not much smaller. In Belgium and Switzerland interest rates remained throughout the year at levels that were high for these countries. Only in Italy did interest rates decline over the year from the exceptional levels reached in 1964, but they still remained substantial.

This pattern of high and rising interest rates reflected three main factors. Credit demand, especially from the public sector, was strong in almost every country. The expansion of credit, on the other hand, was held back by the authorities as part of most stabilisation programmes. Finally, the United States' balance-of-payments measures and, towards the end of the year, that country's tight credit situation reduced the flow of capital into continental western Europe.

The upsurge of interest rates in a number of leading countries was, of course, bound to result in a firming of rates throughout the rest of the Continent as well, and the Euro-dollar market played a major rôle in this transmission process. Developments in this market during the year clearly reflected the general tightening of credit conditions. The withdrawal of funds that followed the introduction of the US balance-of-payments programme raised Euro-dollar interest rates up to mid-1965, but the advance was cancelled out over the following three months, as the Italian authorities enabled their commercial banks to provide the market with ample funds. With the end of this support and with the rapid rise of interest rates on US certificates of deposit, however, Euro-dollar rates shot up again in October and rose strongly thereafter. By April 1966 they were fully one percentage point above the level obtaining twelve months earlier, and one and a quarter points higher than in either February or September 1965.

The spreading firmness in interest rates emanating from countries in which credit conditions were tight occasionally presented serious difficulties for the authorities of countries — such as Italy and Belgium — which wished to reduce their interest rate structures for both internal and external reasons.

The overall balance-of-payments surplus of continental western Europe declined by \$0.4 milliard in 1965, but nevertheless still amounted to some \$2.6 milliard. The relatively small deterioration resulted from a rise in the current-account deficit.

Italy, however, saw its trade balance improve by fully \$1.0 milliard as a result of both the slack in domestic activity and strong demand abroad, while its balance-of-payments surplus increased by \$0.8 milliard to \$1.6 milliard. France had a \$1.1 milliard balance-of-payments surplus, some \$0.3 milliard higher than in 1964, even after a debt prepayment of \$179 million; there was a major improvement in the trade balance, partly offset by a deterioration on capital account. Italy and France were among the very few countries that improved their payments positions over the previous year.

In most other countries, indeed, excessive domestic demand pressures led to higher imports and a deterioration in the balance of payments. In Germany, for instance, the trade surplus was halved, falling by \$1.1 milliard, while the service accounts worsened by \$0.5 milliard; the drop, however, was partly offset by an improved position in the capital accounts, so that the overall balance of payments deteriorated by only \$0.4 milliard to a \$0.3 milliard deficit. In Spain the import surplus rose by two-thirds, or \$0.7 milliard, and, despite a further improvement in the service accounts, the balance of payments deteriorated by fully \$0.5 milliard. Sweden's and Austria's balances of payments deteriorated by \$0.2 milliard, and those of Denmark, Finland and the Netherlands by \$0.1 milliard each.

Eastern Europe.

Growth rates of national income produced during the last decade in eastern Europe have as a rule been well below planned targets but have nevertheless been substantial. The fastest growth has been registered in Bulgaria and Rumania — 8.2 and 7.9 per cent. per annum respectively — and the slowest in Czechoslovakia and eastern Germany — 4.5 and 5.3 per cent. respectively.

Growth rates for overall industrial output have been much higher — between 7½ per cent. in eastern Germany and over 13½ per cent. in Bulgaria. The gap between the expansion of industry and the growth of national income is explained by the much slower advance of agriculture.

Available statistical information shows that generally growth has been slowing down in the more recent years. This is partly a normal result of a process of rapid industrialisation from low starting levels, but it is also explained by the recent emphasis on balanced expansion and on higher quality. In fact, the change in attitude which had already begun in a few of these countries in 1963–64 became general in 1965 and provided for better adaptation of output to domestic and external demand, more efficient use of productive resources and greater cost-consciousness. In moving towards a less rigidly run economy, it has been recognised that productivity can be improved more effectively by rewarding skill and that the price system should be more in line with production costs and world prices. It was agreed that this result could be best achieved if more flexibility were granted to management, especially in light industry, by widening the scope for decisions at factory level.

In 1965 agriculture, as so often in the past, put up a very uneven performance. In Hungary and Czechoslovakia output fell short of the 1964 figure, whereas in Poland — where 1964 had been a poor year — a rise of

7½ per cent. was registered. Agricultural production in the USSR was only fractionally larger than in 1964, which, however, had been a year of bumper crops.

The overall expansion rate in 1965 — as is almost always the case — was based chiefly on the results achieved by industry, which were quite good. In fact, the gross output of industry for the area as a whole can be estimated to have risen by about 8½ per cent., which is 1 per cent. more than in 1964 and ½ per cent. more than planned for. As in the past, the largest gains were recorded in Bulgaria and Rumania, with 13.6 and 13.1 per cent. respectively. In both cases the leading sectors were energy, metallurgy and chemicals. One-half or more of the additional output was accounted for by higher labour productivity. In Poland and eastern Germany industrial output in 1965 rose practically as much as it had done the year before (by over 9 and 6 per cent. respectively), while the gap between the production of capital goods and that of consumer goods seems to be narrowing.

Centrally-planned economies:
National income, industrial production and productivity.

Countries	National income[1]			Industrial production[2]			Productivity[3]		
	1964	1965	1966 plan	1964	1965	1966 plan	1964	1965	1966 plan
	annual increases, in percentages								
Albania	4.0	3.0	.	7.4	3.0	.	.	.	.
Bulgaria	9.9	6.0	9.0	10.4	13.6	10.6	7.4	6.7	6.0
Czechoslovakia	0.9	2.5	3.8	4.1	7.9	5.5	3.6	5.9	.
Eastern Germany	4.5	4.7	5.2	6.7	6.1	5.2	7.3	6.0	.
Hungary	4.7	2.0	4.0	8.9	4.3	4.0–6.0	5.0	3.8	3.2–4.8
Poland	6.6	6.0	3.7	9.2	9.1	6.5	6.0	3.9	3.6
Rumania	11.0	8.0	.	14.4	13.1	10.5	10.2	6.6	7.4
USSR	9.0	6.0	6.4	7.1	8.6	6.7	3.8	4.7	4.7
Yugoslavia	12.5	3.0	8.0–10.0	16.0	8.1	7.0–9.0	6.9	5.0	6.0–7.0

[1] Net material income. [2] Gross output. [3] Output per man in industry.

Improvements over the previous year's results and the targets for 1965 were recorded in Czechoslovakia and the USSR. In Czechoslovakia the recovery from the 1963 dip in output has been very striking — the 1964 rise in output of over 4 per cent. having been followed by one close to 8 per cent. in 1965. In part this was the result of the coming into operation of a number of projects initiated a few years ago, which also explains the rise of 6 per cent. in output per man. In the USSR the 8.6 per cent. increase in gross industrial output was due in large measure to the expansion in the production of consumer goods. After rising by 5 per cent. in 1963 and 3.8 per cent. in 1964, this went up by 8.5 per cent. last year — thus practically equalling the rise in the producer goods sector.

Two countries in the area fell short in 1965 of their industrial performance in 1964. They were Albania and Hungary, where growth rates of 3 and 4.3 per cent. respectively were recorded — only half the previous year's figures. In Albania two poor crops in succession adversely affected the output of the food-processing industries, which constitute the largest single industrial branch. In Hungary, too, agriculture had a bad year. In addition, the expansion rate of industrial production was halved, although this reduction was planned so as to contribute to the programme aimed, particularly, at redressing the country's external balance. This object was achieved in 1965 by a strict limitation of imports. At the same time workers' earnings were kept nominally stable, while in real terms they actually declined slightly. It seems that 1965 and 1966 will mark a turning-point in Hungary's economy towards better use of resources and higher quality standards.

In Yugoslavia the main feature of the year 1965 was the monetary reform in July, when the dinar was devalued by 40 per cent. to a new parity of Din. 1,250 = US $1. This measure follows the inflationary developments in 1963 and 1964, when both investment and private consumption were rising at a rate of 12–14 per cent. and the foreign trade gap was steadily widening, so much so that in 1964 it amounted to $430 million. In that year the cost-of-living index rose by 18 per cent. and workers' earnings by between 35 and 40 per cent., despite the tightening action which began to be taken in the middle of the year.

The plan for 1965 provided for some restraint in investment but still considered a 10 per cent. rise of personal consumption in real terms to be feasible. This turned out to be too optimistic. Free prices continued to advance and others were raised by the authorities in order to narrow the gap between domestic and foreign prices and to reduce the pressure on resources. As a result fixed investment in real terms turned out to be 10 per cent. below the 1964 level (the planned decline was 4 per cent.) and personal consumption increased by only between 2 and 3 per cent. Thus, while exports maintained their rising trend, imports fell by nearly 3 per cent. — against a rise of 25 per cent. the year before. The first results of the reform, especially in the external accounts, are satisfactory, but a rather large amount of foreign indebtedness has been incurred and it appears that a prolonged effort will be needed to maintain balance between domestic demand and available resources.

Multilateral surveillance.

Under the balance-of-payments strains of the 1960s the means used to finance external deficits and surpluses have considerably expanded. In the preceding decade settlements were made primarily out of official reserves and through the facilities of the European Payments Union. In recent years, however, there has been frequent use of intra-central-bank credits and large recourse to IMF resources and other techniques. Moreover, shifts in the external positions of the commercial banks have played a much greater rôle than previously, mainly through the growth of the Euro-currency market.

It was in the light of the greater use of international credit that the Ministers of the Group of Ten instituted multilateral surveillance in the autumn of 1964. The intention was to have a joint review of the soundness of external financing, particularly so that bilateral credit arrangements would not obscure the need for active adjustment policy measures. For this purpose a rather broad view of financing transactions must be taken, which goes beyond the use of official reserves and credits, since monetary policy measures often have a strong influence, direct or indirect, on movements of private funds. Ideally, the appropriate concept would be the liquidity deficit or surplus of the economy, embracing all external transactions of a monetary character. In practice this can only be approximated, by taking the external short-term position of the commercial banking system in addition to that of official assets and liabilities — quite sufficient as a yardstick in the case of most countries. Apart from their use for surveillance, the data provide an insight into how the international monetary system is working.

The principal changes in the external monetary positions during the past year reflected the balance-of-payments surpluses of Italy and France and the deficits of the United Kingdom and the United States.

Italy. Italy's balance of payments changed from deficit to surplus in April 1964, and for the rest of that year and throughout 1965 the surplus continued at a high level. In terms of the monetary movements shown in the table, the surplus was $2.8 milliard over the period of twenty-one months and, apart from seasonal variations, was fairly even at $135 million a month. This would be a large surplus for any country and its financing could not readily be left to inflexible rules of the game but required management in the light of monetary conditions at home and abroad. This need became more exigent as the surplus accumulated, with the result that the composition of the assets arising from the surplus in 1965 is in marked contrast to that in 1964.

Italy: External monetary movements.

Items	1964 April–December	1965	Total April 1964–Dec. 1965
	in millions of US dollars (+ = increase in assets, decrease in liabilities)		
Net official reserves	+ 865	+ 400	+ 1,265
of which			
Gold	*— 35*	*+ 295*	*+ 260*
Foreign exchange	*+ 770*	*— 110*	*+ 660*
Swaps	*—*	*+ 100*	*+ 100*
Short-term Roosa bonds	*— 150*	*+ 125*	*— 25*
Short-term foreign liabilities	*+ 280*	*— 10*	*+ 270*
Net IMF and GAB* position	+ 145	+ 405	+ 550
Other official monetary assets	— 35	+ 150	+ 115
Net official position	+ 975	+ 955	+ 1,930
Banks' foreign position	+ 260	+ 620	+ 880
Overall balance	+ 1,235	+ 1,575	+ 2,810

* General Arrangements to Borrow.

The most important financing element in 1965 was the improvement in the foreign position of the commercial banking system. This factor had accounted for 20 per cent. of the overall surplus in the last nine months of 1964, whereas it constituted 40 per cent. last year. In the earlier period the banks reduced their liabilities to the Euro-dollar market mainly of their own accord. The much larger movement in 1965, however, was in response to policy action by the Italian authorities. The banks were offered dollar swap facilities against lire without cost and left free either to acquire assets abroad or to reduce their liabilities. As interest rate differences were favourable to such operations, the banks utilised the funds abroad on a large scale and before the end of the year their exchange liabilities to foreigners were less than their assets. These operations were supported by the US Treasury and the Federal Reserve System, which provided some forward cover for the exchange risk incurred by the Italian monetary authorities. In thus transferring foreign exchange from the official to the private sector, the Italian authorities were able to maintain better control over domestic liquidity; from an international standpoint the operation offset possible tension in the Euro-dollar market at a time when funds were moving back to the United States in substantial amounts.

The second important element in the financing of Italy's 1965 surplus was a series of steps taken by the Italian and US authorities with the object of absorbing the flow of uncovered dollars into the foreign exchange reserves. Four principal steps may be mentioned: the United States drew $205 million of lire from the IMF; Italy purchased $125 million of eighteen-month US Treasury bonds denominated in lire; the Federal Reserve System drew $100 million (net) on its swap facility with the Bank of Italy; and towards the end of the year, when the banks' net foreign indebtedness had been eliminated, the Italian authorities purchased $160 million of US Treasury medium-term obligations.

In addition, the way in which Italy's surplus was financed was affected by the sterling crisis. The United Kingdom drew $180 million of lire from the IMF in May 1965 and this, together with the US drawings already mentioned, accounts for practically the whole of the increase of $405 million in Italy's net IMF and GAB position during 1965.

The final element in financing the 1965 surplus was gold, acquired to the extent of $295 million. This was somewhat more than Italy had used in 1964 to cover its deficit and to meet its special IMF quota increase.

During the first quarter of 1966 the Italian external surplus was $75 million, about the same as it had been in the corresponding quarter of 1965. Owing mainly to the reversal of end-year operations, the banks' net foreign position improved by $220 million, whilst net official monetary assets declined by $145 million.

Looking at the official monetary movements as a whole, the striking change was that, whereas foreign exchange holdings accounted for most of the surplus in 1964, they actually declined by $110 million in 1965. While the effect was to maintain the gold ratio in official reserves, the management of the surplus appears to reflect the view that balance-of-payments swings should be financed mainly by credit, with gold movements playing a relatively minor rôle.

France. France's external surplus showed a marked increase in 1965, rising from $795 million the year before to $1,140 million. The monetary counterpart of the surplus was rather different in a number of respects from what it had been the previous year, partly through changes in French policy and partly as a result of outside events. One difference was that the increase in first-line official reserves covered only 40 per cent. of the surplus, as compared with 80 per cent. in 1964. On the other hand, the increase in the gold reserve alone was far bigger than in the previous year and amounted to 85 per cent. of the overall surplus. Thirdly, there was a marked improvement in the foreign position of the commercial banks during 1965, so that the official sector did not have to absorb the whole of the surplus.

France: External monetary movements.

Items	1964	1965 Year	1965 I	1965 II	1965 III	1965 IV
	in millions of US dollars (+ = increase in assets, decrease in liabilities)					
Net official reserves	+ 650	+ 435	+ 265	+ 50	+ 55	+ 65
of which						
Gold	*+ 555*	*+ 980*	*+ 470*	*+ 235*	*+ 125*	*+ 150*
Foreign exchange	*+ 95*	*— 620*	*— 255*	*— 200*	*— 90*	*— 75*
Short-term foreign liabilities	—	*+ 75*	*+ 50*	*+ 15*	*+ 20*	*— 10*
Net IMF and GAB* position	+ 170	+ 265	+ 20	+ 160	+ 65	+ 20
Other official monetary assets	— 5	+ 10	+ 10	+ 35	— 35	—
Debt prepayments	—	+ 180	—	—	+ 180	—
Net official position	+ 815	+ 890	+ 295	+ 245	+ 265	+ 85
Banks' foreign position	— 20	+ 250	— 5	+ 105	— 30	+ 180
Overall balance	+ 795	+ 1,140	+ 290	+ 350	+ 235	+ 265

* General Arrangements to Borrow.

The salient features of the monetary movements in 1965 appear most clearly from the quarterly figures. During the first quarter the overall pattern of 1964 was repeated and practically the whole of the $290 million surplus went into the reserves. The gold reserve alone, however, went up by $470 million, whilst the exchange reserve declined by $255 million. This was in line with the policy announced at the beginning of the year of taking future reserve increases in gold and of converting into gold part of the official dollar balances that had accumulated from the past.

In the following nine months, when the surplus totalled $850 million, only $170 million was added to the official reserves. 80 per cent. of the surplus, therefore, was financed in other ways, which changed from quarter to quarter. During the second quarter the main financing items were IMF and GAB credits of $160 million and a reduction of $105 million in the banks' net foreign liabilities, whilst during the third quarter the debt repayment of

$180 million to the US Government covered 75 per cent. of the surplus. In the fourth quarter the pattern of financing took a different turn. Official financing played a secondary rôle, more than half the surplus being covered by a decline of $180 million in the banks' net foreign liabilities.

The change in the French banks' foreign position during this quarter was made possible by the fact that, for the first time since the war, they were allowed to make franc loans to non-residents. In addition, interest differentials on an exchange covered basis were such that it was advantageous for banks outside France to obtain their franc requirements partly through swaps with French banks rather than by spot purchases.

France's balance-of-payments surplus for the first quarter of 1966 was $180 million, considerably less than the figure of $290 million recorded in the corresponding period of 1965. Net official assets rose by $115 million, of which $100 million was added to the gold stock, whilst the banks' net foreign position improved by a further $65 million.

The large decline in dollar holdings for the year as a whole was a result not only of gold purchases but also of debt prepayment to the United States and the extension of credit to the IMF. In all, however, the financing of the surplus reflects the view that movements of gold should have an important rôle in settling international balances.

United Kingdom. Another side of the recent workings of the international monetary system is revealed by the way in which the United Kingdom's balance-of-payments deficit in 1964–65, as well as the movements into and out of sterling, were financed. Three main phases can be distinguished: the pre-crisis phase covering the first nine months of 1964, the period of crisis from October 1964 to August 1965 and the subsequent phase of recovery. Two things stand out from the figures. One is that the deficit of $2,790 million since the beginning of 1964 was entirely financed without more than temporary drawings on the first-line reserves — in the customary accounting of reserves on a gross basis. In fact, taking the two years together, the reserves actually rose by $350 million. And the second thing is the variety of other ways by which the deficit was financed.

In the pre-crisis period from January to September 1964 the official financing required to manage the deficit of $1,450 million was limited to $115 million from the reserves, plus $200 million of central-bank assistance taken mostly in September, when pressure on sterling began to build up. The remaining $1,135 million counterpart of the deficit came from an inflow of funds to London. The sterling balances rose by $565 million, half of which came from the outer sterling area's payments surplus, and in addition the net exchange liabilities of UK banks went up by nearly $400 million as a result of UK borrowing through the Euro-dollar market. During this phase, therefore, the deficit was mostly financed by autonomous factors.

This situation was more than reversed during the crisis year. The deficit during that period was $1,485 million, but the total of official financing

United Kingdom: External monetary movements.

Items	1964 I–III	1964 IV – 1965 III	1964 IV	1965 I	1965 II	1965 III	1965 IV
	in millions of US dollars (+ = increase in assets, decrease in liabilities)						
Official assets	— 115	— 275	— 715	+ 15	+ 460	— 35	+ 250
of which							
Reserves	*— 115*	*+ 215*	*— 225*	*+ 15*	*+ 460*	*— 35*	*+ 250*
IMF gold tranche . . .	—	*— 490*	*— 490*	—	—	—	—
Official liabilities	— 465	—1,740	— 565	— 150	— 705	— 320	+ 125
of which							
£ liabilities (net) to foreign monetary authorities	*— 265*	*+ 840*	*+ 355*	*+ 255*	*+ 165*	*+ 70*	*— 155*
Central-bank assistance	*— 200*	*— 670*	*— 405*	*— 415*	*+ 540*	*— 390*	*+ 275*
IMF credit tranche position	—	*— 1,910*	*— 515*	*+ 15*	*— 1,410*	—	*+ 5*
Net official position . . .	— 580	—2,015	—1,280	— 135	— 245	— 355	+ 375
Other sterling liabilities (net)	— 300	+ 690	+ 630	+ 180	+ 45	— 165	— 205
Banks' net position in foreign currencies . . .	— 390	+ 85	— 40	— 305	+ 245	+ 185	+ 40
Miscellaneous	— 180	— 245	+ 50	— 35	— 20	— 240	— 65
Overall balance	—1,450	—1,485	— 640	— 295	+ 25	— 575	+ 145

required was $2,855 million. The difference between these two figures is accounted for by a decline in sterling balances, due partly to a payments deficit in the outer sterling area and partly to withdrawals of funds from London, mostly by the non-sterling area. Officially-held sterling balances went down by $840 million and privately-owned ones by $690 million.

The official financing during this year was secured by the drawing of $2,400 million on the IMF and by taking a net amount of $670 million in central-bank assistance. An essential technique by which the Bank of England maintained some sort of control over the flight of funds during the crisis was by providing forward cover on a large scale at moderate rates. In effect, the Bank offered insurance against the risk of exchange instability.

The most intense period of the crisis was the last quarter of 1964, when a fall of $1 milliard in the sterling balances was added to a balance-of-payments deficit of $640 million, excluding payments of $175 million on the US and Canadian Government 1946 loans which were postponed. The official financing required was secured by a $1 milliard drawing from the Fund, net central-bank assistance of $405 million and use of the reserves to the extent of $225 million.

In the first half of 1965 the payments deficit was considerably reduced, partly for seasonal reasons. However, the pressure on sterling continued, largely because of a further decline in the sterling balances. The reserves were protected for some time by means of central-bank assistance and in May a drawing of $1,400 million was made on the IMF. This more than covered the financing needs, as it allowed repayment of the debts to central banks and an increase in reserves of $475 million.

The technical position of sterling at this point seemed set for a reversal in the flow of funds, as a large short position against sterling had been built up. However, a substantial (largely seasonal) payments deficit re-emerged in the third quarter and the lack of confidence was such that there was also a big outflow of money from London in July and August which further increased the short position. In this situation, new large central-bank facilities were arranged early in September. As selling pressure had apparently about exhausted itself, this action turned the tide of confidence and there was a substantial reflow of funds during the month. For the third quarter as a whole the official financing required — $425 million — was less than the deficit. It was obtained almost entirely through a net increase of $390 million in central-bank assistance.

During the fourth quarter of 1965, the first full quarter of recovery, the inflow of funds to London continued and there was a very large improvement in the balance of payments. The overall surplus was $145 million, though had the repayments on the 1946 US and Canadian Government loans been made there would have been a small deficit of $30 million. The inflow of funds during this quarter showed up mainly in a rise in the sterling balances. Official balances went up by $155 million and others by $205 million. Most of this can be attributed to the restoration of confidence in sterling, but in addition the balance of payments of the outer sterling area, which had been an important element in the financial strains of the crisis year, improved. The payments surplus and the inflow of funds allowed the Bank of England to repay $275 million to the Federal Reserve Bank of New York and to add $250 million to the reserves. Nor was this the full extent of the improvement, since there was also a considerable reduction in the Bank of England's forward exchange commitments.

The recovery of sterling continued during most of the first quarter of 1966. The outstanding feature of the monetary movements during the quarter was the transfer of $885 million from the Treasury's dollar security portfolio to the Exchange Equalisation Account. Official reserves rose by $570 million during the quarter. Excluding the transfer of dollars from the Treasury's portfolio, there would have been a decline of $315 million. At the same time, however, more than this amount of central-bank assistance was repaid. When the date of the general election was announced, however, sterling came under some pressure and the uneasiness of the market was indicated by the March-April reserve loss of $130 million.

It is difficult to generalise from this experience about the liquidity needs and operation of the monetary system, because any currency is bound to suffer a deterioration of confidence when convincing measures to correct a serious deficit are not taken. However, it is evident also that in difficult situations the authorities cannot risk drawing heavily on reserves, as that in itself contributes to lack of confidence.

United States. The table on external monetary movements for the United States has been drawn up to afford parallel treatment to that of other countries, though there are obvious differences in presentation owing to the reserve-currency status of the dollar. However, changes in the overall balance of the United States are often more difficult to interpret for two reasons. First, changes in the foreign position of the banks often cannot be looked upon as an element of monetary movements; for example, the large increase in the banks' foreign assets in 1964 was considered by the US authorities as increasing the deficit, since the outflow of dollars could later become a charge on the reserves. Secondly, complications may arise because of the Euro-dollar market. For instance, if US non-bank corporations place funds with foreign banks, non-official dollar liabilities will rise; but the table would not show a corresponding increase in monetary assets, since data for the non-bank private sector are not included. The resulting overall deficit would, of course, be only statistical. However, the error last year would tend to be in the other direction, as there was a withdrawal of US funds from foreign banks.

In 1965 the overall deficit shown in the table rose substantially, reflecting the adverse movement in the basic balance of payments on current and long-term capital account. The official financing requirement increased less, however, primarily because the voluntary restraint programme on capital exports led to a reduction in outstanding bank claims abroad — despite which there was still a small rise in non-official holdings of dollars.

As regards official financing, the main difference between the two years was that in 1964 the rise in official dollar balances covered over 80 per cent.

United States: External monetary movements.

Items	1964	1965				
		Year	I	II	III	IV
	in millions of US dollars (+ = increase in assets, decrease in liabilities)					
Official assets	— 170	—1,220	— 840	— 70	— 40	— 270
of which						
Gold	*— 125*	*—1,665*	*— 830*	*— 590*[1]	*— 125*	*— 120*
Foreign exchange	*+ 220*	*+ 350*	*+ 55*	*+ 55*	*+ 415*	*— 180*
IMF gold tranche	*— 265*	*+ 95*	*— 65*	*+ 465*[1]	*— 330*	*+ 25*
Liabilities to official institutions[2]	—1,040	— 105	+ 880	+ 135	— 235	— 885
Prepayments received on government loans	—	— 180	—	—	— 180	—
Net official position	—1,210	—1,505	+ 40	+ 65	— 455	—1,155
Banks' short-term foreign claims	+1,525	— 325	— 25	— 175	— 260	+ 135
Liabilities to non-official institutions and persons	—1,555	— 150	— 205	+ 150	— 710	+ 615
Net position on above items	— 30	— 475	— 230	— 25	— 970	+ 750
Overall balance	—1,240	—1,980	— 190	+ 40	—1,425	— 405

[1] Including $259 million gold subscription payment to IMF. [2] The figures for 1965 are not entirely comparable with those for 1964.

of the need, whilst in 1965 the gold loss alone was larger than the total. The large decline in the gold stock reflected not only the current deficit but also a $259 million gold transfer to the IMF in connection with the increase in Fund quotas and some conversion of existing dollar holdings by France in the earlier part of the year. Partly offsetting the gold loss was an increase of $350 million in official holdings of foreign currencies, essentially due to drawings by the Bank of England on its swap facility with the Federal Reserve System.

The IMF gold tranche position of the United States showed little change for 1965 as a whole. The increase of $95 million, however, takes account of the gold subscription payment, so that other US transactions with the Fund were on balance negative to the extent of $165 million. This figure is, broadly speaking, the net result of gross US drawings of $435 million and of drawings of dollars by other members totalling $280 million, of which the United Kingdom accounted for $200 million.

Liabilities to foreign official institutions increased by $105 million during 1965. This figure includes the movements both in foreign monetary authorities' dollar balances held under swaps with the Federal Reserve System and in their holdings of US Government non-marketable bonds, neither of which items moves autonomously. Foreign countries' swap dollar holdings declined by $185 million in 1965, whilst their net holdings of non-marketable bonds went up by $280 million. Excluding the effects of these transactions, there was therefore an increase in liabilities to foreign official institutions of $10 million in 1965.

Official US monetary movements last year can be summed up as follows: whilst a substantial deficit on overall account was being financed, support was being given at the same time to sterling to the extent of over $500 million for the year as a whole — and at times on a larger scale — through the IMF and through swap credits. As both official and non-official dollar holdings abroad rose by relatively small amounts, the impact of the official financing was concentrated on the gold stock.

For the first quarter of 1966 the overall deficit, on the same basis as in the table, was $250 million. The major official financing items were net drawings of $135 million on the IMF and a reduction of $70 million in the gold stock.

* * *

It is evident from this account that the operation of the international monetary system has moved quite a way from the conception foreseen by the participants at Bretton Woods. For one thing, the use of credit rather than reserves to cover deficits and surpluses has grown considerably, without a new orthodoxy having been developed to define the proper limits to its use. For another, there are conflicting views on the proper function of gold in the system.

Gold: Supply and demand.

If there is ever a normal balance of supply and demand forces for gold and a typical statistical position of the market, last year was clearly not the year. The supply of new gold in 1965 reached the record level of $1,985 million, as there was a further rise in production and a renewed increase in Russian sales. On the demand side, however, private buying took an unprecedented total of $1,585 million, leaving only $400 million available for official use. The jump in private purchases was $465 million and the drop in the amount left for official use $325 million. China was a significant official taker of gold for the first time, with purchases from the market of about $150 million; stocks of western official institutions therefore rose by only $250 million, compared with an average of $800 million for the two preceding years.

Private buying was stimulated by the announcement early in the year that French external surpluses would henceforth be taken in gold and that France advocated a general return to the gold standard. Against the background of the US and UK deficits this suggested to many the possibility of a rise in the price and heavy speculative gold-buying ensued. As Russian gold was not being offered in the market at the time, new supplies were relatively low and the gold pool had to feed the market to meet the demand. The data on gold reserves indicate that, at its peak, the amount temporarily put into the market by the gold pool was about a quarter of a milliard dollars — not a large figure, considering that there was official buying by non-members of the pool as well as active private purchases.

Another wave of private demand came in the third quarter, apparently stimulated by the conflict between Pakistan and India and the Vietnam war, and Chinese buying added to the strain on the market. However, Russian sales began in August and, together with the better position of sterling in the last four months of the year, brought about an improvement in the market situation. By the end of the year the pool had recouped the gold it had previously sold.

One thing clearly shown by this experience is that the gold pool can readily keep control over the market by buying and selling to meet market conditions, even when the public feels a strong inducement to speculative buying. This is the case because the underlying situation of the market is an excess of supply over demand, so that something remains for the pool as the residual buyer. And, since citizens of several countries, including the United States, are barred from holding gold, speculative buying can hardly build up to a temporary volume that takes more than a small fraction of the gold pool countries' reserves to satisfy. Thus, the pool members anticipate a surplus of gold from the market and the fact is that they had very little last year. It is timely, therefore, to reflect on where the supply and demand forces for gold have been tending and on whether an adequate flow for monetary purposes seems likely. The available data on supply and demand leave some mysteries in the statistical position of gold but they also show significant changes.

On the supply side, the outstanding development of the post-war period has been the exploitation of the new South African goldfields, principally in the Orange Free State, which were discovered in 1938 and began to produce in significant volume by 1953. The rapid expansion of output from these areas is comparable only to the opening-up of the Witwatersrand sixty years before. From 2 million ounces in 1953, output of the new mines rose to 24 million ounces in 1965, and over the past five years it has been much larger than the total availability of gold for monetary purposes. Without this gold, the problem of international monetary arrangements would have had to be tackled long before now.

Production from all other mining areas, apart from the USSR, has been on a downward trend, output of 22 million ounces in 1953 having declined to 17 million in 1965. The decline has been particularly marked in the older South African mines; but, generally, the higher level of costs against the fixed price has narrowed the field of profitable operations and given little scope for new ventures. The new mines in South Africa have been the exceptions, because of the richness of the deposits and a geological formation that allows low-cost extraction methods.

In the years ahead the decline in output from the older mining areas can be expected to continue, perhaps at about the same pace as before. But a change in trend seems certain in the newer mining areas, as the phase of rapid opening of new mines has tapered off. While output from the new mines is not yet at its full potential and should continue to increase, it can hardly match the spectacular gains of the past ten years. Hence, whereas gold production of all countries has risen on average by 1.4 million ounces a year for more than ten years, the prospects are that it will settle down after a few years to an increase of perhaps less than half that amount — barring unforeseeable developments, either favourable or unfavourable.

New gold supply.

Year	South Africa			Canada	United States	Other countries	Total output	Russian sales	Total new supply
	New mines	Old mines	Total						
	in millions of ounces								
1953	2.5	9.4	11.9	4.1	2.0	6.1	24.1	2.1	26.2
1954	3.7	9.5	13.2	4.4	1.8	6.2	25.6	2.1	27.7
1955	5.3	9.3	14.6	4.5	1.9	5.9	26.9	2.1	29.0
1956	6.8	9.3	15.9	4.4	1.8	5.8	27.9	4.3	32.2
1957	8.6	8.4	17.0	4.4	1.8	5.8	29.0	7.4	36.4
1958	9.6	8.1	17.7	4.6	1.7	6.0	30.0	6.3	36.3
1959	11.8	8.3	20.1	4.5	1.6	5.9	32.1	8.5	40.6
1960	13.3	8.1	21.4	4.6	1.7	5.9	33.6	5.7	39.3
1961	15.5	7.4	22.9	4.5	1.5	5.8	34.7	8.5	43.2
1962	18.3	7.2	25.5	4.2	1.5	5.7	36.9	5.7	42.7
1963	20.6	6.8	27.4	4.0	1.5	5.7	38.6	15.7	54.3
1964	22.5	6.6	29.1	3.8	1.5	5.5	39.9	12.8	52.7
1965	24.2	6.3	30.5	3.6	1.7	5.2	41.0	15.7	56.7

Another marked change on the supply side has been in the sales of Russian gold. From 1956 to 1962 this source of supply had been on a plateau, averaging about $250 million a year. In the past three years, however, the level of Russian sales has been above $500 million. These gold sales were associated with purchases of foreign wheat, but no information is available as to whether there was emergency drawing upon gold reserves or whether gold production has risen to a higher level. As Russian authorities have been favourable to building up the national gold reserves, and as emergency cutting of other imports was a possible alternative, it is perhaps likely that some rise in gold output has occurred. If so, market supplies in the future may continue to benefit from Russian sales higher than the 1956–62 average.

Recognising the uncertainties involved in any projection, one may take as a working hypothesis that total supply will tend to be somewhat under $2 milliard a year and that there is little prospect of its exceeding that level by a significant margin. It would tend to be well under that figure if the bulge in Russian sales proves temporary.

If an estimate of the supply side is precarious, the hazards on the demand side are still greater, first, because of gaps in the statistics and, secondly, because the motives behind private gold-buying cannot be clearly separated in quantitative terms.

As the market operates, the gold acquired for monetary purposes is the residual which remains after private demand has been met. From a statistical standpoint, however, the annual figures for private demand, shown in the table, are the residual obtained from the difference between the new supply and the increase in official reserves. What one would like is a fairly firm notion of the components of this private demand, namely: the amount taken for industrial consumption, the amount taken by saving in the form of gold, and the amount which represents essentially a shorter-term speculation on or hedge against a possible rise in the world price. This would allow an appraisal of the prospects for monetary gold on the assumption that any doubts about the world price were stilled. Of course, when the public is seized by such waves of doubt, the whole matter of private demand is very much up in the air.

While some statistics on the industrial use of gold are reported for quite a few countries, they are very incomplete in many cases and it is only for about a dozen countries that the data provide a reasonable indication of the trend. These are confined to the higher-income countries; even in these figures there is under-reporting (mainly for tax reasons) in a few countries, perhaps to the extent of over 10 per cent. of the amounts shown in the table. About 75 per cent. of this gold is used in fabricating jewellery and other gold articles, while the rest is about equally divided between dentistry and industrial use in the narrower sense.

It can be seen that the reported consumption has had a rather steady upward trend and has tripled over the past ten years. As a luxury good, gold jewellery would be expected to have a high income elasticity and it is clear

Supply and use of gold.

Year	Supply of gold			Net official purchases	Private demand		
	New production	Russian sales	Total		Reported industrial use[1]	Other private absorption	Total
	in millions of US dollars						
1953	845	75	920	455	.	.	465
1954	895	75	970	670	.	.	300
1955	940	75	1,015	665	.	.	350
1956	975	150	1,125	490	165	470	635
1957	1,015	260	1,275	690	195	390	585
1958	1,050	220	1,270	680	200	390	590
1959	1,125	300	1,425	750	220	455	675
1960	1,175	200	1,375	345	265	765	1,030
1961	1,215	300	1,515	600	285	630	915
1962	1,290	200	1,490	330	330	830	1,160
1963	1,350	550	1,900	840	325	735	1,060
1964	1,395	450	1,845	725	430	690	1,120
1965	1,435	550	1,985	400[2]	465	1,120	1,585

[1] Figures for Australia, Austria, Belgium, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom and the United States. [2] Includes about $150 million of purchases by China.

that full employment and expanding individual earnings have widened the market for it. Even so, the steep rise shown by the data requires further explanation. This may be found in the stability of the price of gold over a period when consumer-price indexes for the advanced countries have risen by about 20 per cent. The demand surely appears to reflect the public's view that gold articles have become relatively cheaper. This is borne out, for example, by the significant rise in the sales of commemorative gold medals, usually at a price of about double the value of the gold content, and by the premium paid for gold coins that have little numismatic value. While such gold-buying is not speculative in the usual sense, because resale is not anticipated, some element of saving is involved from the buyer's standpoint and this is likely to remain a factor in demand.

"Other private absorption" is a residual jumble of all elements of demand which can be only crudely untangled. First, there is industrial consumption over and above what is included in the reported data for twelve countries, but leaving aside eastern countries where the purchase of simple gold ornaments is a customary mode of saving. It may be surmised that this additional industrial use had an upward trend similar to the reported series and accounted for around $150 million last year. Secondly, there is the non-industrial private demand. This evidently has had a much faster rate of increase; the level in 1964 would be about five times that of 1955. The question is the proportion accounted for by longer-term saving.

The series for "Other private absorption" has moved quite differently from that for "Reported industrial use". Instead of showing a fairly even upward trend, it has increased in three large steps: the first in 1956 coincident with the Suez crisis, the second in 1960 coincident with the price eruption on the gold market and the third last year. In both the earlier cases the amount of gold taken by the market tended to taper off after the year of heavy buying, although in 1962 there was a renewed upsurge caused primarily by the Cuban crisis. It remains to be seen what will happen after the very large offtake of last year; so far this year demand has been well below that of 1965.

From the behaviour of the market and other evidence, it would seem that, in the first instance, stocking-up by the gold trade itself is a major factor in a year of heavy demand. For the chain of business firms, from dealers to processors, manufacturers and artisans, gold is the dominant raw material and it is to be expected that they react quickly to events which seem a threat to the world price. However, the same events have evidently had their effects on a much wider public, accentuating the basic trend of saving in gold even after a calmer atmosphere returned to the market.

The indications are that most of this component of private gold offtake over the years is accounted for by fairly firmly held savings in gold, rather than by large blocks of speculative holdings awaiting a shorter-term capital gain. A year like 1964, when there was little evidence of heavy speculative buying in the market, suggests the level to which this saving demand has grown. The motives behind it are varied. Generally, the buyer seeks protection against current or possible future monetary disturbance and many also consider gold a useful asset for times of possible political upheaval. Another reason is to hide funds in order to evade taxes on current income and inheritances. In the past ten years there have been important monetary weaknesses to stimulate hoarding. Besides the weakness of sterling and the French franc after the Suez crisis, several currencies in South America have depreciated and confidence in the rupee has been lacking. The US payments deficit has also reduced the attractiveness of dollar securities as a vehicle for long-term saving. In general, the saver's objective is not to make a profit by gold-holding but to protect himself against possible loss for at least part of his wealth. In recent years, however, it seems evident that gold saving has been influenced by the relative cheapness of the metal.

Several conclusions seem warranted from these observations on the limited data available:

(1) The trend value of industrial use and saving demand at present appears to be somewhat above $1 milliard.

(2) The annual increase in private demand, apart from speculative buying waves, now seems to be somewhat larger than the average increase in gold supplies likely to be forthcoming from western world production.

(3) The flow of new gold to monetary uses, even in the absence of speculative buying, is not likely to exceed $700–800 million a year and will have a slowly declining trend. This flow will be smaller if Russian sales fall back to the level of a few years ago.

(4) The amount of gold held as a shorter-term speculation is much less than is sometimes suggested. At a guess, it might have amounted to between

$1 and 2 milliard at the end of 1965. A much larger amount has gone into private hoards, which are held more as saving than as speculation. On past experience, the strengthening of individual currencies would not lead to large-scale reduction of such accumulated gold savings.

Supplementing gold.

It is against this statistical background that the Group of Ten found that the prospective supply of gold for monetary purposes would not be likely to provide an adequate increase in monetary reserves. There is not a shortage of gold in the sense that private demand cannot be met out of new supplies. However, if the increase in monetary reserves had to rely on new gold alone, they would tend to decline rather sharply in relation to the rising volume of international transactions. This does not mean that there has been any shortage of international liquidity, because liquidity has been created through reserve currencies, IMF facilities and in other ways. It is agreed, however, that such liquidity cannot in the long run command acceptance as a full substitute for gold in monetary reserves. Hence the search for a new reserve asset to supplement gold.

On a superficial view it may not seem difficult to design such a supplement, since the mechanics of a system of reserve units or drawing rights are rather easy to visualise. But discussion of the problems involved has shown ample scope for different viewpoints, not only on such matters as the institutional arrangements, the scope of membership and voting procedure, but also on the basic nature of the scheme and its operational effectiveness.

A first question that arises is the nature of the new reserve assets. To some it seems that provision for the new reserve assets involves an agreement to create an international fiduciary money — like bank-notes — which in itself will be legal tender in transactions among the central banks of the participating countries. As such, it may seem either a liberating step forward or a dangerous innovation, depending on one's confidence in governments' ability to manage the system wisely. A deeper view, however, is that the arrangement, whatever its form, must be seen as a reciprocal credit facility, since the only right it can give to a participating country is the right to draw on the currencies of other members. Any country which uses the facility clearly incurs a debt which would have to be repaid, not only with shifts in surplus and deficit positions, but also in the event that a surplus country were to withdraw from the arrangement or that the whole scheme were to be liquidated. As a credit arrangement, there would not be reciprocity in including countries whose currencies could not be drawn either because their currencies were inconvertible or because they were continually in deficit.

A second question concerns the guarantee that is to attach to debtor-creditor positions that arise as the facility is drawn upon. There is force to the contention that outstanding balances must have a guarantee in weight of gold if the monetary authorities are to consider them as true gold supplements. This would only be a formal condition if the monetary authorities had the power to assure that the world price of gold would remain fixed under any and all circumstances. But, since the supply of gold will be dependent upon the unknown abundance of ore deposits and the evolution of extraction costs, while the demand will be dependent on the future attractiveness of gold to the public, this power cannot be assured in perpetuity. To some, therefore, a gold guarantee seems arbitrary and it may be that some legislatures would balk at committing their country to so indefinite a contract.

A third question, rather less technical, almost suggests itself. It is how a new credit facility can be devised so as to fully resolve the problem of the shortage of gold for the adequate growth of monetary reserves.

It is not evident that this result would be automatic; since the supplement to gold would mean that gold must steadily become a declining proportion of reserves, the principal countries must be prepared to co-operate in adjusting themselves to this necessity. This requires rather profound changes in the operation of the system, not as it affects the business community, but as it affects the monetary authorities.

At the present time the reserves of about half of the principal countries are virtually on a full gold basis and several more countries aim at quite a high proportion of gold. Other central banks around the world have a similar gold policy, if to a lesser extent. The central-bank attachment to gold is based on a variety of motives. There is the element of tradition in some cases, linked with the idea or the legal requirement of a certain gold backing for the domestic currency. There is also the belief that gold, with its intrinsic value, is the most assured store of international purchasing power and that, because of its universal acceptability and anonymity, gold can be used by a sovereign nation in times of emergency, such as war, when other reserves cannot be used. And to some it is a matter of principle that to take surpluses in gold avoids contributing to inflationary financing and makes public opinion in deficit countries aware of the deficit.

For the United States there are, in addition, technical reasons for the reserves to be held almost entirely in gold under present conditions. As there is not an open money market in most countries, the placement of foreign exchange holdings by the United States has to be arranged case by case and most other countries are not anxious to do this because they consider their markets too small to take on a reserve-currency function. In addition, a foreign currency holding by the United States is not readily convertible into another foreign currency in the market, because the practice of most central banks is to hold their reserves in dollars or gold.

For all such reasons it is quite meaningful to speak of a monetary demand for gold, apart from the demand for reserves in general. Inasmuch as gold is the basic reserve asset, this demand is always present in the system to a greater or lesser extent. Over the past five years, however, it has undoubtedly been swelled by the large outflow of dollars from the US balance-of-payments deficit, which has raised some uncertainty about the fixed link between the dollar and gold.

For the system as a whole, of course, the monetary demand for gold is restricted to what is left of new supplies after private demand has been met. But for most countries there is a source of gold other than new supplies, and the way the system has been operating is to drain off gold from this source — that is, the US gold stock. In effect, the gold acquired by most central banks, other than the United States, sinks to the bottom of their reserve pile and has little chance of coming out. When most other countries get into deficit, substantial financing is often available from their non-gold reserves, from the foreign assets of the banks, and from the variety of public and private credit facilities, to tide over their difficulty. With access to short-term funds in New York, the Euro-dollar market, the IMF and even long-term dollar borrowing, gold remains at home. This results in a tendency for gold to leave the United States and not to come back.

Simply to introduce a new facility for reserve assets, which must be limited so as to preserve discipline in the system, would not be likely to overcome this situation. For most countries it would just provide another means of non-gold financing of deficits, while its use by the United States would not be likely to do more than displace dollars in official settlements and reserves, unless other countries changed their practices with respect to reserve composition.

Various suggestions have been put forward to meet this problem. One is that there should be some kind of agreement on the harmonisation of reserve policies among the principal countries — a sort of self-imposed rationing of the available new gold supplies. Another is that a gold transfer ratio should be attached to all drawings on the new reserve facility, with the idea that this would lift some gold to a higher place in the countries' reserve piles and make gold circulate more freely.

Agreement on combining some such provisions with the new reserve facility is difficult to reach, however, not only because it involves a break with traditional practices but because the basic interests of the countries differ. It must be evident that these difficulties are not formal or mechanical — they are in the broadest sense political. Operating the system with a declining proportion of gold in reserves necessarily means moving to a more managed system. And this requires more active financial co-operation, less scope for individualistic and inconsistent policies, greater emphasis on multilateral surveillance, and more assured accommodation of policy measures to international balance. These are matters about which governments are wary of making commitments.

PART II

MONETARY AND ECONOMIC SURVEY.

I. CREDIT DEVELOPMENTS AND POLICIES.

Interest rates in both North America and western Europe now stand at relatively high levels. In the United States and Canada, where demand pressures began to be excessive in 1965, credit policy was tightened and short and long-term yields rose. In the United Kingdom, with margins of unused capacity and labour narrow, credit restraint has recently been reinforced, and interest rates are again near their 1965 highs. On the Continent, reflecting the different intensity of demand pressures, interest yields have moved up substantially in some countries, such as Germany, the Netherlands and Sweden, while rising moderately or keeping to high levels in most others.

These movements were occasioned largely by domestic developments and have done little to correct the underlying international payments disequilibrium that has persisted in recent years. This has necessitated a continued, and in some cases increased, reliance upon selective techniques to control capital movements. These controls have contributed, among other things, to a growing volume of capital issues, denominated mostly in dollars, for placement outside national capital markets.

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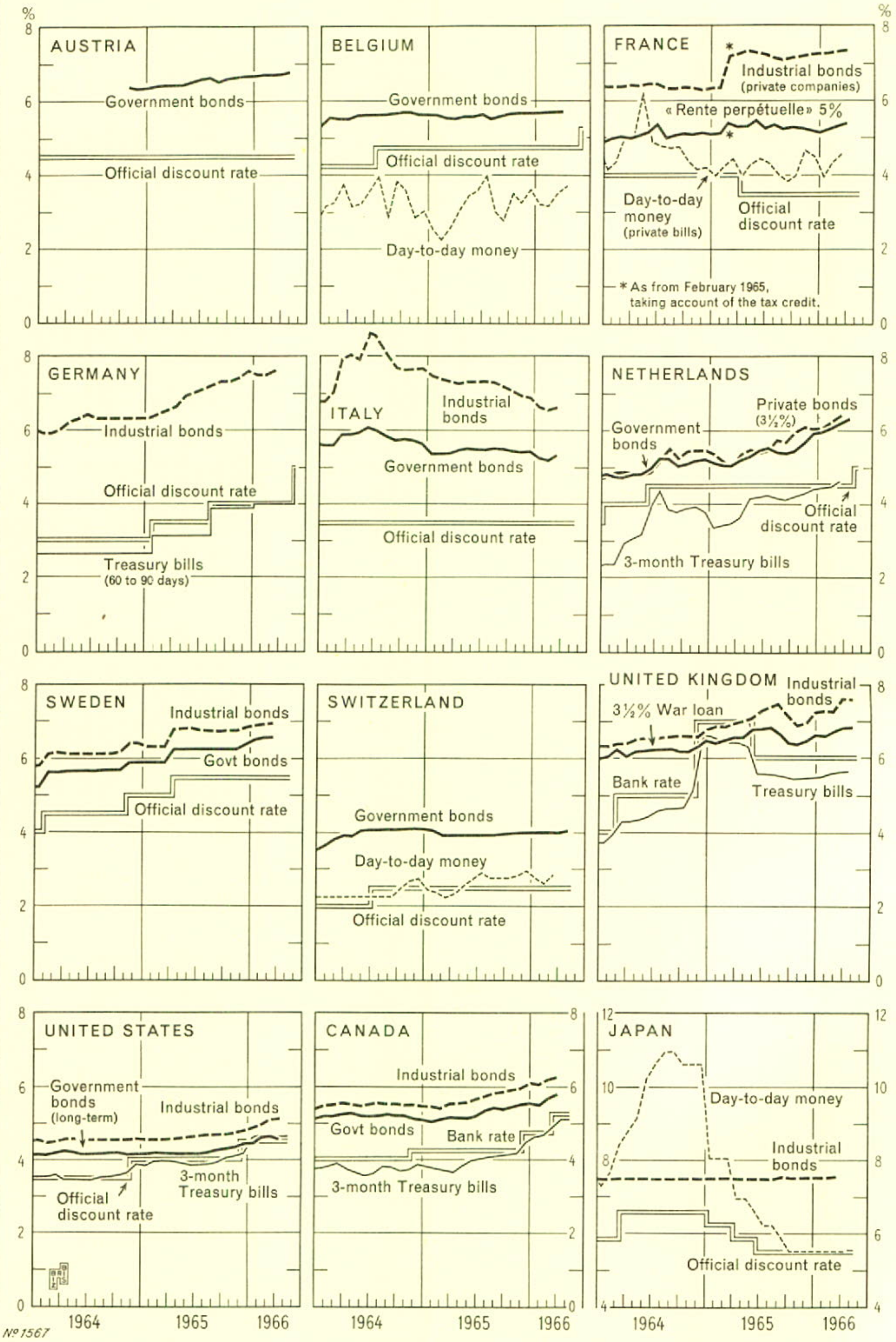
Interest rates and the flow of funds.

In the United States long-term interest rates have risen quite notably over the past year. The yield on long-term government bonds, after a long period of relative stability, began to increase last summer, moving from 4.15 per cent. in July to 4.71 per cent. by early March 1966, thereafter tending to ease off while corporate bond yields continued upwards. The rise in short-term rates started earlier and has gone further, amounting since late 1964, largely as a consequence of two discount rate increases, to more than a full percentage point.

These changes, which marked a shift in monetary policy from relative ease to moderate restraint, occurred against a background of a sharp accelera-tion in credit demand. Although corporate profits rose buoyantly, helped by continuing stability of unit costs, capital outlays increased still more, leading to greater recourse to borrowed funds. Consumer credit and borrowing by State and local authorities also accelerated. After the middle of 1965 interest rates

Interest rates.



were influenced increasingly by expectations of growing defence and plant and equipment outlays.

A year or so ago the reconciliation of US domestic and external objectives seemed to require primarily a change in the policy mix rather than in the level of demand. Stricter credit conditions were indicated as a means of curtailing the excessive outflow of capital, while a further easing from the budget side could be regarded as an appropriate means of counteracting the domestic effects of tighter money. Since that time credit conditions have in fact tightened appreciably, but, with government expenditure and private investment rising more rapidly than anticipated, aggregate demand has tended to advance at an excessive rate. This is reflected not only in the behaviour of prices but also in the deterioration in the balance of payments on current account. With the need for fiscal action pending, though partly also because of monetary conditions in western Europe, the US authorities have continued to rely on selective measures to help keep down the outflow of capital.

In Canada interest rates have risen since the middle of 1965 more than in the United States, reflecting strong demand pressure originating in public expenditure, plant and equipment outlays and housing. In its budget presented in March 1966 the government introduced a series of measures aimed at moderating demand and credit-market strains.

In the United Kingdom the yield on a representative long-term government stock stood in May 1966 at 6.7 per cent., which is about the same as the level reached last summer and considerably above the 6.1 per cent. prevailing in the autumn of 1964 before the start of the sterling crisis. The yields on short-term government bonds have risen still more. Partly on domestic grounds and partly because of high rates elsewhere, Bank rate has been kept at 6 per cent.

In the course of 1964 and 1965, not least as a result of the government's own budget and lending programme, investment grew to excessive proportions in virtually all economic sectors. Coupled with too high a level of domestic demand, cost-push inflation posed a serious problem. In these circumstances both private and public demand for funds converged heavily on the credit mechanism, the resulting strains on which were relieved partly by extensive government borrowing from the IMF. The corrective measures evolved during 1965 put some emphasis on fiscal and incomes restraint, although the actual achievements in these areas left much to be desired. Therefore, the monetary authorities continued to rely heavily on monetary weapons, combined with various measures acting directly on the balance of payments. The May 1966 budget, putting stress on saving and productivity, significantly reinforces previous stabilisation measures. At the same time the government intensified its selective efforts to reduce the external deficit, introducing a voluntary restraint programme to limit capital outflows to the developed countries of the sterling area.

On the Continent interest rates have been climbing upwards — in differing degrees in different countries — since about 1963, reflecting the

Gross national saving and investment.

Countries	Years	Gross national saving			Total saving and invest-ment	Gross national investment			
		House-holds	Enter-prises	Public author-ities		Gross domestic fixed capital formation		Change in stocks	Net external balance
						Housing	Plant and equip-ment		
		as percentages of gross national product at market prices							
Belgium.	1963	7.3	11.3	0.4	19.0	4.2	15.2	0.1	— 0.5
	1964	7.8	11.4	1.4	21.6	5.3	15.8	0.4	0.1
	1965	20.4		— 0.3	20.1	5.3	14.3	— 0.5	1.0
Denmark	1963	9.0	5.8	5.5	20.2	3.5	16.1	— 0.0	0.6
	1964	.	.	5.8	22.2	4.1	17.8	2.1	— 1.9
	1965	.	.	.	22.4	4.5	17.7	1.6	— 1.4
Finland	1963	9.4	12.3	5.5	27.2	6.3	19.5	1.8	— 0.3
	1964	8.1	11.6	7.7	27.5	5.3	20.2	4.3	— 2.4
	1965	9.3	11.5	6.8	27.6	5.2	20.9	3.8	— 2.3
France	1963	9.1	7.8	3.5	20.4	5.2	14.9	1.1	— 0.8
	1964	9.1	7.9	4.4	21.4	6.2	15.0	1.5	— 1.3
	1965	9.5	7.7	4.6	21.8	6.7	15.1	0.2	— 0.2
Germany	1963	7.3[1]	11.4	7.3	26.0	6.1	19.2	0.5	0.2
	1964	8.1[1]	11.8	7.8	27.8	6.3	20.1	1.1	0.3
	1965	9.1[1]	11.2	6.2	26.5	6.1	20.4	1.2	— 1.2
Italy	1963	19.8		3.5	23.3	7.1	16.5	1.1	— 1.5
	1964	20.0		3.6	23.6	7.7	14.1	0.7	1.2
	1965	22.9		0.8	23.7	6.8	12.2	0.8	4.0
Netherlands. . .	1963	8.2	12.8	4.7	25.6	3.9	19.7	1.3	0.7
	1964	9.0	12.3	5.7	27.1	4.7	20.5	3.1	— 1.2
	1965	9.2	12.6	5.0	26.8	5.0	19.9	1.4	0.4
Norway	1963	20.1		6.6	26.7	4.3	26.0	— 0.4	— 3.2
	1964	21.3		6.6	27.9	4.0	24.9	0.2	— 1.2
	1965	23.5		5.5	29.0	4.0	24.6	1.9	— 1.4
Sweden.	1963	6.0	7.7	9.4	23.1	5.7	17.8	— 0.2	— 0.2
	1964	6.8	7.9	10.0	24.7	6.0	17.6	1.2	— 0.1
	1965	5.4	18.9		24.3	5.9	18.2	1.7	— 1.5
Switzerland . . .	1963	5.3	11.7	9.8	26.7	7.1	21.5	1.4	— 3.4
	1964	6.4	11.5	9.6	27.6	7.6	21.9	1.5	— 3.4
	1965	6.7	21.5		28.2	7.6	20.8	1.0	— 1.2
United Kingdom.	1963	5.4	10.2	1.6	17.0[2]	3.1	13.0	0.6	0.3
	1964	5.6	10.8	2.6	18.1[2]	3.7	14.0	1.7	— 1.2
	1965	5.2	10.4	3.6	18.4[2]	3.7	14.1	1.0	— 0.4
United States . .	1963	7.0	8.2	3.2[3]	18.3[2]	4.7[3]	12.1[3]	1.0	0.5
	1964	7.6	8.5	2.6[3]	18.7[2]	4.5[3]	12.5[3]	0.8	0.9
	1965	7.0	8.9	3.2[3]	19.1[2]	4.2[3]	13.1[3]	1.2	0.6
Canada	1963	5.8	14.4	2.6	22.3[2]	4.0	17.7	1.2	— 1.2
	1964	4.3	14.9	3.8	23.0[2]	4.3	18.8	0.8	— 0.9
	1965	5.6	14.0	5.0	24.4[2]	4.1	20.5	1.8	— 2.2
Japan.	1963	15.5	11.7	9.3	35.1[2]	5.2	27.3	2.9	— 1.2
	1964	14.7	13.6	7.7	37.3[2]	5.3	27.4	4.9	— 0.6
	1965[4]	11.6	13.2	9.6	33.6[2]	6.6	27.5	— 1.4	0.9

[1] Includes depreciation charged on residential buildings. [2] Including a residual error. [3] Including, as an element of both saving and investment, new civil public construction. [4] January–September.

authorities' growing preoccupation with domestic inflationary pressures. Earlier, when external surpluses were spread more widely and productive factors were in more elastic supply, interest rates had tended to decline hand in hand with an expansion of production.

In 1965 and early 1966 long-term yields rose in a number of countries and remained high in others. In Germany the yield on public-authority loans went up quite sharply, reaching 7.7 per cent. in December 1965, compared with 6.4 per cent. a year earlier and 6.0 per cent. in December 1963; some public loans by the spring of 1966 yielded upwards of 8 per cent. In the Netherlands the government bond yield stood in April 1966 at somewhat over 6.5 per cent., one and a half percentage points higher than a year before and more still compared with the level of 4–4½ per cent. that had prevailed until 1963. In Sweden the government bond yield, continuing its earlier rise, went up from 5.8 per cent. at the beginning of 1965 to 6.6 per cent. by early 1966, while in Denmark it rose from 6.3 per cent. in the first quarter of 1964 to 8.9 per cent. by the end of 1965. In Switzerland, after a general rise in interest rates from 1963 to 1964, the yields on long-term securities other than government bonds increased somewhat further in 1965. In Belgium the government bond yield rose substantially in 1963, remained fairly steady in 1964 and early 1965, but began to firm up late last autumn. Long-term yields in Italy, although now much below their 1964 crisis peaks, are still appreciably above the levels of early 1962.

With regard to short-term interest rates, money-market conditions tightened considerably in a number of continental countries in 1965. In some cases, however, the monetary authorities appear to have exercised a certain forbearance in the matter of discount rate changes. Germany, it is true, raised its discount rate in two stages from 3 to 4 per cent., but given the domestic and external circumstances the level was still relatively low. Sweden increased its rate in April 1965 from 5 to 5½ per cent. Other countries generally refrained from further increases, while in France the monetary authorities were able in April 1965 to reduce the rate back to 3½ per cent., the level ruling prior to the initiation of the stabilisation programme.

On 2nd May 1966 the Nederlandsche Bank increased its discount rate from 4½ to 5 per cent. Subsequently, on 27th May, the Bundesbank raised its rate by a full percentage point to 5 per cent. A few days later, on 2nd June, the National Bank of Belgium adjusted its rate from 4¾ to 5¼ per cent. In each case the change was made for domestic as well as external reasons.

On the Continent, just as in the United Kingdom, Canada and, more recently, the United States, public-sector developments have been an important, often central, factor underlying the rise in interest rates. This is true of Germany, the Netherlands, Belgium, Switzerland, Denmark, Finland and Spain. In all these cases the central government's expenditure has increased relative to tax revenue since about 1963. Moreover, in some countries, especially Germany, the Netherlands and Sweden, the rapid rise in local-authority expenditure has aggravated existing financial strains.

The reasons for these adverse trends in the public sector are diverse. In most cases expenditure for the provision of public services has accelerated substantially, reflecting in some measure infrastructural needs created by the previous rapid growth of private consumption and investment. Rising public-sector wages have sometimes played a part, particularly in Italy in 1962–63, the Netherlands, Denmark and Belgium. In some countries, notably Germany and the Netherlands, earlier tax reductions were instrumental in bringing about the present situation. Whatever the reason for the development may be, however, the fact remains that budgetary needs have to be weighed against broader domestic and external objectives and made to bear their share of the task of restraint. An easing of monetary pressures through greater public-sector restraint would be appropriate not only on external grounds but also in terms of domestic economic growth. In other words, by helping to increase national saving, improved budget positions, combined with easier credit conditions, would make room for a sustained high rate of investment, while reducing the pull on funds from abroad. To judge by their budgets for 1966, most countries now appear to be shifting towards greater fiscal restraint.

Meanwhile, private-sector capital outlays did, in fact, slow down or level off in a number of continental countries last year, and the emphasis placed on monetary restraint appears to have been a contributory factor. This was especially true in Germany, where credit tightness was accompanied by reduced margins for self-financing by business firms. Credit restraint was also a factor in the slowing-down of investment in the Netherlands, Switzerland and, earlier, Belgium. On the other hand, in France and, more recently, Sweden budget restraint has paved the way for the stable advance in industrial investment which now seems to be in progress.

Changes in official discount rates since 1963.

Country and date of change	Official discount rate in %
Austria	
17th March 1960	5
27th June 1963	4½
Belgium	
6th December 1962	3½
18th July 1963	4
31st October 1963	4¼
3rd July 1964	4¾
2nd June 1966	*5¼*
Canada	
13th November 1962	4
6th May 1963	3½
12th August 1963	4
24th November 1964	4¼
6th December 1965	*4¾*
14th March 1966	*5¼*
Denmark	
23rd May 1961	6½
19th August 1963	6
13th November 1963	5½
11th June 1964	6½
France	
6th October 1960	3½
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*
Greece	
1st November 1960	6
17th January 1963	5½
Iceland	
29th December 1960	9
1st January 1965	*8*
1st January 1966	*9*
Japan	
27th November 1962	6.57
20th March 1963	6.21
20th April 1963	5.84
18th March 1964	6.57
9th January 1965	*6.205*
3rd April 1965	*5.84*
26th June 1965	*5.475*
Netherlands	
25th April 1962	4
8th January 1963	3½
6th January 1964	4
4th June 1964	4½
2nd May 1966	*5*

Country and date of change	Official discount rate in %
Portugal	
12th January 1944	2½
1st September 1965	*3*
Sweden	
8th June 1962	4
18th January 1963	3½
14th June 1963	4
31st January 1964	4½
6th November 1964	5
9th April 1965	*5½*
Switzerland	
26th February 1959	2
3rd July 1964	2½
United Kingdom	
26th April 1962	4½
3rd January 1963	4
27th February 1964	5
23rd November 1964	7
3rd June 1965	*6*
United States	
12th August 1960	3
17th July 1963	3½
24th November 1964	4
6th December 1965	*4½*

Although interest rates have moved upwards on both sides of the Atlantic, this has not been a simple "escalation" process. The tightening of credit policy in the United States and also in the United Kingdom was clearly desirable from both a domestic and an international point of view. The rise in interest rates on the Continent, though not intended to counteract the external repercussions of rate movements elsewhere, nevertheless worked in this direction. The aim of the increases on the Continent was not to attract foreign funds but rather to curb domestic inflationary pressures. In so far as an escalation of rates did occur, it derived from the fact that higher rates abroad allowed continental countries greater scope for directing monetary policy to domestic ends.

The selective control of capital movements.

Currency convertibility requires that domestic demand, cost and credit conditions be consistent with balance-of-payments needs. For monetary policy, which is relatively more effective in influencing the particular channels through which funds move than the actual level of expenditure, this normally implies an orientation primarily towards curbing excessive inflows or outflows of capital. By the same token, convertibility induces countries to make greater use of fiscal and incomes policy in trying simultaneously to achieve both domestic and external objectives. In these ways it tends to direct the various policy instruments towards their most efficient uses, thereby contributing to sustainable expansion.

In practice, however, most countries have been reluctant or unable to accept the discipline inherent in convertibility. Instead, in order to make more use of monetary policy for domestic purposes, they have sought in various ways to weaken the links between domestic credit conditions and external flows of capital. The result has been a gradual drift away from convertibility, confined up to now largely to selective controls over capital transactions.

In seeking some autonomy in credit policy, countries have used quite different techniques, depending upon their particular problems and institutional arrangements. These fall essentially into two categories, one consisting of measures acting directly on the balance of payments, the other of those acting on the domestic availability of credit and on interest rate structures. While some of these measures operate on market principles, and thus may be less objectionable than those working through quantitative restrictions, all have the effect of insulating domestic credit conditions to some degree from external forces.

In the United States the problem of excessive capital movements began about 1960, and between then and 1964 the annual outflow of private capital (including unrecorded transactions) averaged $5.5 milliard, as against only some $2 milliard over the years 1955–59. On the whole these movements, far from having a speculative character, have to all appearances been inspired by normal profit motives. Special factors, it is true, such as Europe's return to convertibility in 1958 and the inception of the European Economic Community in the same year, have contributed to the size of these movements and may have made it difficult to avoid some temporary selective controls. However, the relative ease of US credit conditions was a permissive, and even activating, factor of considerable importance.

To limit these movements, the authorities first acted selectively on the interest rate structure, sustaining short-term yields while keeping long-term rates at relatively low levels. In July 1963 the interest equalisation tax was introduced and later extended to include bank loans at over one year. Under the voluntary foreign credit restraint programme introduced in February 1965, a credit ceiling was established for bank loans to foreigners, and companies were requested to improve their individual balances of payments by 15–20 per cent. in 1965. Then, in December 1965, under the voluntary programme, corporations were asked to keep the average of their direct investment for the years 1965–66 to 135 per cent. of the average for 1962–64. For 1966 this implied a substantial reduction compared with the investment actually carried out in 1965.

In the United Kingdom capital movements by residents have been regulated primarily by exchange controls, while those by non-residents, who are generally free from such controls, have been influenced mainly by monetary and forward exchange policy. In view of the heavy outflows since 1964, action has been required on all three fronts. As to exchange control, several measures were taken — mostly as part of the broader restraint programme of July 1965 — with the aim of curbing direct and portfolio investment abroad (particularly outside the sterling area) and narrowing the scope for payments leads and lags. In addition, the newly-announced corporation tax was designed, among other things, to reduce the incentive to invest abroad. In the monetary field interest rates were kept relatively high. Moreover, the authorities intervened extensively on the forward exchange market.

At the same time, the use of monetary measures for domestic restraint posed a problem, owing to the switching of Euro-currency deposits into sterling for domestic lending purposes. This was largely overcome as a by-product of the recourse to measures which acted on the volume of credit directly rather than through interest rates. These consisted of the quantitative ceiling placed in the spring of 1965 on bank advances, the earlier decision gradually to limit the growth of local-authority debt and, finally, the restrictions imposed in 1965 and early 1966 on hire-purchase borrowing.

On the Continent selective techniques to regulate capital movements, and thus bank liquidity, have long been an integral feature of monetary policy, partly because of the relative importance of the external sector. In recent years, however, when domestic inflationary pressure has often been combined with external surpluses, these techniques have been ramified, mainly with a view to encouraging capital outflows and limiting inflows.

A key rôle has been played by the regulation of the banks' foreign positions, which, with convertibility and the growth of the Euro-currency market, have reached sizable proportions. In some cases this has been done by specifying certain limits for these positions (as, for example, in Italy, France, the Netherlands, Norway, Sweden and Austria). In others net liabilities have been made subject to special reserve requirements (Germany) or special deposits (Switzerland). Sometimes also the growth of gross liabilities has been made subject to special deposits (Denmark) or a reduction in central-bank rediscount quotas (Germany).

Operations in foreign exchange are also used to influence capital movements and bank liquidity. Thus in Germany the authorities have over certain periods offered favourable swap facilities to the banks, varying the terms according to need. In Italy the authorities have also made currency swaps with the banks, at par, or placed foreign exchange deposits with them. On occasion, in order to regulate bank liquidity, the Swiss authorities have also arranged such swaps with the big commercial banks. In the Netherlands open-market operations in foreign exchange have been used to influence short-term capital movements.

In some cases capital inflows are discouraged purely by limitations as to the short-term instruments in which foreign funds may be placed. Where money markets are essentially interbank markets, as in Italy and France, or where foreigners are generally prohibited from acquiring short-term government paper, as in Germany and Belgium, international movements of funds have tended to be confined to time deposit transactions via the banks. In order to deter inflows some countries, including Germany, Switzerland and France, have in recent years forbidden the payment of interest on non-resident time deposits.

In the field of exchange restrictions, a number of countries impose prohibitions or limits on residents' foreign borrowing and lending activity and regulate the timing of their external payments and receipts. In Italy, France, the Netherlands and Sweden residents have little scope for borrowing abroad. In order to limit capital movements via leads and lags, most countries continue to lay down certain limitations as regards the timing of payments and receipts. These regulations are difficult to enforce, although in its 1963–64 payments crisis, it is true, Italy substantially reduced the payment period for imports, with good results.

As regards long-term international capital movements, most countries now accord a great deal of freedom for direct and portfolio investment. However, virtually all of them, with the exception of Germany, regulate foreign borrowers' access to their domestic capital markets. Switzerland and, for a short period in 1961–62, the Netherlands have permitted substantial foreign loan issues, though only in so far as such issues did not seem to put undue upward pressure on interest rates. Restrictions on foreign access to continental capital markets derive largely from the wish to reserve savings for domestic uses and to preserve some autonomy as regards interest levels. Another consideration has been the small size of some economies relative to the potential foreign demand for funds.

Continental countries, besides acting directly to control capital movements, have also employed quantitative means to affect the domestic demand for and supply of funds, thereby tending to limit the rise in interest rates and indirectly the inflow of unwanted capital. Thus, a number of countries have placed ceilings on the permissible rate of growth of bank credit. Over recent years this device has been introduced in the Netherlands, Switzerland, France, Belgium, Norway, Denmark (for mortgage institutions) and Spain. Last year its application was suspended in France and Belgium, but in the latter country it was reintroduced late in April 1966. Italy, while not employing the system of ceilings, exercises a discretionary quantitative control over access to central-bank credit and over bank loans above a certain size. In some cases countries have also continued, or revived, the use of building permits, hire-purchase restrictions and direct controls over domestic capital issues.

One may conclude that on both sides of the Atlantic national authorities have come to rely increasingly on selective measures that enlarge the scope for independent monetary action. Is this development, however, to be characterised as a substantive and dangerous retreat from convertibility? Or are such techniques to be regarded as indispensable to the stability of a reasonably free and workable international payments system? Either conception would contain an element of truth. Clearly, over specific periods and in some circumstances, the use of selective instruments may avoid other kinds of distortion. Moreover, if fiscal policy is inflexible or incomes policy ineffective, the authorities may have little choice but to direct monetary policy to domestic ends and to shield the balance of payments by selective controls over capital flows. Again, even with an ideal domestic policy mix, monetary policy cannot cope with capital movements if policy in other countries leaves something to be desired.

The drawback of such selective techniques lies in their susceptibility to prolonged retention. Once imposed, they weaken the link between the external payments position and the appropriate policy mix. In so far as the domestic scope for monetary policy is widened, the pressure to act in the fiscal and incomes fields is accordingly reduced. In the case of deficit countries, in particular, the extended reliance on selective measures is analogous to having unlimited access to international reserves and credit facilities. Thus, the danger is that, instead of trying to reconcile its various policy goals, a country will tend to neglect basic external adjustment. While such an outcome is not inevitable, the danger is a real one.

Capital markets and international loan issues.

A striking feature of the past year has been the growing volume of international issues in Europe. Altogether, these issues are estimated to have reached a figure of \$1.3 milliard last year, as against somewhat less than \$1 milliard in 1964. Of this total, only some \$500 million was accounted for by issues placed on particular European capital markets, as is reflected in the table on the next page. Loans expressed in Deutsche Mark and issued in Germany, it is true, were quite substantial, rising from $220 million in 1964 to about $340 million in 1965. Those issued on the Swiss market declined somewhat further to about $50 million. In the Common Market countries the Community's institutions accounted for a small increase in international loans. Loans placed in London, exclusively by sterling-area borrowers, dropped to negligible proportions.

The biggest proportion of last year's loans, in other words, represented issues arranged principally through New York, London and Luxemburg for placement on an international basis. The bulk of these "Euro-issues" took the form of dollar loans, which for the year as a whole are estimated to have amounted to over $775 million, as against about $575 million in 1964 and only some $75 million in 1963. These figures include both public and private placings.

Another outstanding feature of 1965 was the change in the composition of the borrowers in Europe. Japan, which had borrowed heavily in 1964, cut back its European flotations sharply in 1965. The Scandinavian countries, which had also taken up large amounts in 1964, reduced their recourse to foreign loans last year. On the other hand, international institutions, including those of the Common Market, increased their European loan activity, as did also certain sterling-area countries.

The novel element, however, was the appearance on the European market of US corporations, or their financial subsidiaries, which began to place loans on a major scale. For the year as a whole these companies are estimated to have borrowed in Europe some $365 million, of which two-thirds was in dollar-denominated issues. Such "off-shore" borrowing has been an outgrowth, in the first instance, of the US balance-of-payments programme.

Under the voluntary programme announced in February 1965 it was stipulated that US companies should seek to improve their individual balances of payments with developed countries by 15–20 per cent. during the year. A wide range of possibilities was allowed for achieving this improvement, including a better trade balance, a reduction in direct investment, a larger repatriation of earnings and/or greater borrowing abroad. Thus, in the absence of sufficient gains on its trade account, a company would have a strong inducement to borrow abroad, even at rates substantially above those on the US market. In the programme announced for 1966 this inducement is, if anything, even stronger. Under the overall ceiling, direct investment financed by US funds and retained earnings overseas is to be cut back by about $800 million compared with the estimated level for 1965; however, the ceiling does not apply to direct investment financed by borrowing outside the United States. Corporate plans, in fact, call for a sharp increase in investment in Europe in 1966.

Broadly speaking, the US balance-of-payments guide-lines, together with the interest equalisation tax, have established a discriminatory US interest rate structure as regards long-term capital movements. The rates paid by foreigners borrowing in the United States (except those exempt from the tax) and the rates offered by US companies borrowing abroad are now about 1 per

Capital markets: Net issues.

Countries	Years	Public		Private[1]		Foreign issues	Total	Private and foreign issues	Total new issues
		State	Local authorities and public bodies	Shares	Bonds				
		in milliards of national currency units						as percentages of GNP	
Belgium.	1963	2.87	7.17	6.98	10.88	0.08	27.98	*2.6*	*4.0*
	1964	7.89	13.73	11.47	5.26	0.17	38.52	*2.2*	*5.0*
	1965	17.21	12.57	6.27	14.93	.	50.98	*2.6*	*6.2*
Denmark	1963	— 0.19	—	0.13	3.10	—	3.04	*5.9*	*5.6*
	1964	— 0.18	—	0.24	3.49	—	3.55	*6.0*	*5.8*
	1965	— 0.14	—	0.30	4.82	—	4.99	*7.4*	*7.2*
France	1963	2.09	0.40	4.17	4.67	0.06	11.39	*2.3*	*2.9*
	1964	0.55	0.47	5.01	5.14	0.15	11.32	*2.5*	*2.6*
	1965	0.00	0.68	5.02	6.34	0.12	12.16	*2.5*	*2.6*
Germany	1963	1.80[2]	1.46	1.32	8.80	0.11	13.49	*2.7*	*3.6*
	1964	1.51[2]	1.76	2.24	10.24	0.89	16.64	*3.2*	*4.0*
	1965	1.15[2]	1.96	3.96	9.36	1.36	17.79	*3.3*	*4.0*
Italy	1963	— 200	129[3]	398	1,144	14	1,485	*5.2*	*4.9*
	1964	70	159[3]	555	1,221	—	2,005	*5.4*	*6.1*
	1965	161	501[3]	376	1,295	14	2,347	*4.8*	*6.6*
Netherlands . . .	1963	0.61	0.40	0.07	— 0.02	— 0.12	0.94	—	*1.8*
	1964	0.20	0.29	0.21	0.14	— 0.05	0.78	*0.5*	*1.3*
	1965	— 0.03	0.59	0.11	0.71	0.04	1.41	*1.2*	*2.0*
Spain	1963	5.00	8.58	19.30	20.70	—	53.58	*4.3*	*5.7*
	1964	15.00	8.33	20.12	19.93	—	63.38	*3.8*	*6.0*
	1965	27.51	9.10	34.76	25.93	—	97.30	*4.8*	*7.7*
Sweden	1963	1.88	0.35	0.36	1.95	—	4.54	*2.9*	*5.6*
	1964	0.11	0.57	0.48	2.94	—	4.10	*3.8*	*4.6*
	1965	— 0.29	0.30	0.93	2.71	—	3.65	*3.7*	*3.7*
Switzerland[4] . .	1963	— 0.33	0.26	1.53	2.19	0.53	4.19	*8.5*	*8.3*
	1964	— 0.16	0.66	1.54	2.11	0.25	4.40	*7.0*	*7.9*
	1965	— 0.21	0.75	1.54	1.81	0.21	4.10	*5.9*	*6.8*
United Kingdom .	1963	— 0.14[5]	0.09	0.20	0.24	0.02	0.41	*1.5*	*1.3*
	1964	— 0.11[5]	0.09	0.23	0.29	0.06	0.55	*1.8*	*1.7*
	1965	0.22[5]	0.21	0.07	0.37	0.02	0.89	*1.3*	*2.5*
United States[6] .	1963	2.51[7]	6.00	1.00	5.60	1.10	16.21	*1.3*	*2.7*
	1964	0.82[7]	5.40	3.00	6.70	0.93	16.85	*1.7*	*2.7*
	1965	— 4.70[7]	6.10	3.10	8.10	1.24	13.84	*1.8*	*2.0*
Canada	1963	0.63	0.92	— 0.06	0.38	—	1.87	*0.7*	*4.3*
	1964	0.56	0.86	0.32	0.55	—	2.29	*1.9*	*4.9*
	1965	— 0.06	0.65	0.36	0.79	—	1.74	*2.2*	*3.4*
Japan.	1963	— 1	50	654	842[8]	—	1,547	*7.0*	*7.2*
	1964	— 17	69	860	904[8]	—	1,816	*7.1*	*7.3*
	1965	— 10	132	277	1,409[8]	—	1,808	*6.2*	*6.7*

[1] Includes issues of semi-public credit institutions and nationalised industries. [2] Change in market holdings of bonded loans and premium Treasury bonds. [3] Includes indirect Treasury borrowing. [4] Includes privately-placed issues. [5] Change in marketable debt (excluding Treasury bills) in public hands. [6] Based on Federal Reserve flow-of-funds data, excluding mortgage loans. [7] Change in public holdings of marketable debt having a maturity of one year or more. [8] Includes public corporation bonds.

cent. or more above what they otherwise would be. Net foreign issues in the United States, it may be noted, came in 1965 to about $1.2 milliard, as against $0.9 milliard in 1964 and almost $1.1 milliard in 1963. Practically all of these consisted of issues exempt from the interest equalisation tax. Western Europe, which had placed foreign securities on the US market to the net amount of almost $425 million in the two-year period 1962–63, repatriated over $200 million net in 1964–65.

To what extent US corporate borrowing abroad has actually improved the US external payments position is difficult to say. Clearly, it has been to the advantage of foreign holders of US long-term securities — both institutional investors and others — to switch over to the relatively high-yield US corporate dollar issues offered in Europe. It is possible, though this can be little more than a guess, that as much as one-third of the funds raised by these corporations in Europe has derived from switching out of other dollar securities or diverting potential new purchases from the US domestic market.

More generally, little is known about the sources of funds to the Euro-issue market. Although the funds originate to some extent from such areas as the Middle East and Latin America, they probably come for the most part from continental European countries. In the first place, there is little standing in the way of such investment for residents of most of these countries, as they now have considerable freedom as regards foreign security purchases. UK residents, on the other hand, are virtually excluded owing to the large premium prevailing on London's investment currency market, while purchases by US residents are subject to the interest equalisation tax. Secondly, in view of the persistence of inflation in Europe in recent years, securities denominated in US dollars or other strong currencies, bearing yields close to those on domestic capital markets, are attractive to some investors for international diversification purposes. Finally, the fact that these issues are not subject to withholding taxes has probably done much to bring investors to the market. These reasons, together with the high yields obtainable on Euro-issues, help to explain their initial success.

A misconception about the Euro-issue market is that the funds coming to it are drawn in large measure from the short-term Euro-currency market. What is much more likely is that the subscribers, mainly residents of continental countries, simply convert domestic currencies into the necessary foreign exchange, thus indirectly affecting the central reserves, or else switch from other foreign security holdings. It is true, on the other hand, that underwriters have on occasion been left with stocks of securities which have required them to have temporary recourse to the Euro-currency market.

Effective interest yields on Euro-issues rose substantially in 1965 and early 1966, reflecting both the large volume of issues and developments on national capital markets. By early 1966 the yields on various US corporate issues stood at 6.25–6.50 per cent. As an indication of the trend, the yield on a dollar loan of the European Coal and Steel Community, which early in

1965 had stood at about $5\frac{1}{2}$ per cent., had risen by the end of the year to 6.1 per cent. and by May 1966 to $6\frac{1}{2}$ per cent.

In 1966, up to early April, foreign issues in Europe, already launched or in the pipeline, came to over $650 million, including about $275 million by US corporations. As this was already one-half the previous year's total, it is not surprising that the market began to show signs of congestion, with the result that certain issues were postponed and others partly left with the underwriters. Yet, with the US balance-of-payments programme continuing, corporate issues in Europe can be expected to go on at a fairly high rate. However, higher borrowings costs, together with a slackening of switching operations by European investors, may tend to curb the flow of new loans. In March, it may be noted, Canadian financial institutions were asked by the government not to purchase Euro-issues of US companies.

In broader perspective, European countries have, since the introduction of the US interest equalisation tax in July 1963, swung round on portfolio account vis-à-vis the United States from being net importers to net exporters of capital. In addition, there has been an increase in borrowing in Europe, by both European and third countries. Other things being equal, a sizable shift of this sort could be expected to lead to considerable pressure on European interest rates. For the most part the shift has expressed itself more in financial than in real terms, representing a displacement of borrowing from the United States to Europe with little effect on patterns of investment and trade. European interest rates are now considerably higher, it is true, but the increases would to a large extent have been brought about in any case on domestic grounds. In view of the high levels of gold and foreign exchange reserves, national monetary authorities have generally been able to keep domestic policy fairly independent of the changing pattern of international lending.

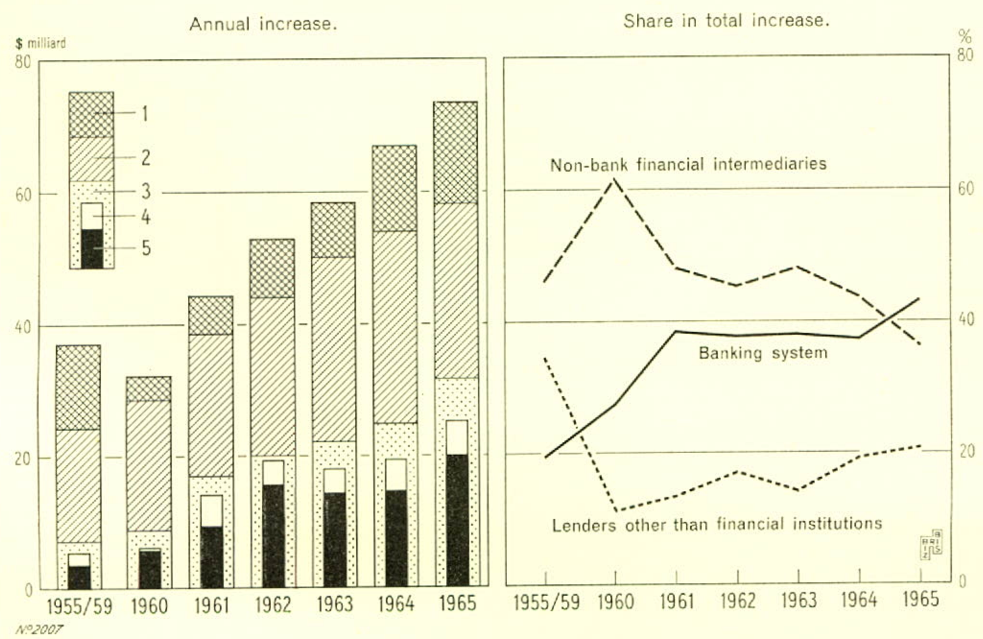
None the less, the growth of Euro-issues raises some fundamental questions. Recent national monetary policies, combined with selective controls to influence capital movements, have helped to reduce external payments imbalances. However, this has been accomplished in ways that imply, firstly, an arbitrary separation of the United States from the European capital markets as regards interest rates and, secondly, a tendency towards the de facto integration of European markets along lines not envisaged by the European monetary authorities themselves. As far as Europe is concerned, there is, indeed, a strong case for a closer integration of capital markets. To this end, however, countries should seek actively to bring this about through policies which help to increase the overall availability of savings, for both domestic and foreign uses, rather than yield passively to external developments which tend merely to redistribute the existing supply. This implies, above all, the need for more adequate budget and incomes policies. As regards the United States, monetary policy is now much better adjusted than a year ago to the realities of the external payments situation, but there is a need here also, partly through the budget, to see that excess demand does not aggravate the external payments situation.

Credit developments in individual countries.

United States. Private credit demands, which had already grown at a high rate in the years 1962–64, accelerated strongly last year. The expansion of credit in all forms to private non-financial borrowers, including State and local governments but excluding foreigners, came to over $66 milliard, which was about 19 per cent. greater than in 1964. New credit to these sectors was thus equivalent to about 39 per cent. of gross domestic investment plus durable consumer goods expenditure, whereas for the years 1962–64 the average figure was just over 35 per cent. and for the earlier expansion years 1955–57 it was less than 31 per cent. The biggest increases last year were in bank loans and consumer credit, while funds raised through securities and mortgages rose moderately.

On the other hand, reduced recourse to borrowing on the part of the Federal Government and foreigners helped in 1965 to keep down the overall growth of credit. Largely reflecting its expenditure restraint in the first half of the year, the Federal Government reduced its net borrowing from $6.7 milliard in 1964 to $3.1 milliard in 1965. Over the same period lending to foreigners was cut back from $4.6 to 2.8 milliard, mostly as a result of the voluntary foreign credit restraint programme. Overall, then, the total funds raised on the US credit markets last year came to $72 milliard, 7½ per cent. more than in 1964.

United States: Net credit flows.



[1] Credit supplied by lenders other than financial institutions. [2] Credit supplied by non-bank financial intermediaries. [3] Credit supplied by the banking system (including the Federal Reserve System). [4] Change in commercial-bank demand deposit liabilities. [5] Change in commercial-bank time deposit liabilities.

Commercial-bank credit expanded in 1965 by $27.8 milliard, thereby accounting for almost two-fifths of all funds raised in the credit markets. In the years 1962–64 this proportion had been about one-third and in 1955–57 less than one-sixth. The banks' higher lending last year fell into three categories — ordinary loans, consumer credit and purchases of State and local-government securities — which together came to $26.2 milliard, as against $16.3 milliard in 1964. In order to expand lending on this scale, at a time of increasing monetary tightness, the banks were compelled to reduce their Federal Government security holdings by $3.7 milliard. The commercial banks' time deposit liabilities went up in 1965 by $20.1 milliard, or about 16 per cent., while the money supply (currency and demand deposits) grew by $8.0 milliard, an increase of 5 per cent.

The growth in recent years in the proportion of net credit flows accounted for by the banking system (including the central bank) is due to several factors. Firstly, credit policy from about 1960 onwards was relatively easy, and the Federal Government's budget deficits were financed mostly at short term. Secondly, largely on balance-of-payments grounds, short-term interest rates were substantially increased relative to those at long term, thus enabling the banks to compete more effectively for deposits. Thirdly, the banks have been active since about 1960, by means of certificates of deposit, in attracting liquid funds from business firms.

Reflecting largely an increased demand for business loans, the expansion of credit accelerated from the beginning of 1965. In view of this situation, and in order also to reinforce the effects of the voluntary foreign credit programme, the authorities began to provide reserves less freely than before. Short-term interest rates, already under the influence of the discount rate increase from 3½ to 4 per cent. in November 1964, moved upwards until March but fell back somewhat during the spring. In the second half of 1965, however, with government expenditure speeding up and capital outlays rising buoyantly, short-term rates advanced again, and the increase now spread to long-term rates as well. In early December, by which time pressures on market rates had mounted considerably, the Federal Reserve authorities raised the discount rate from 4 to 4½ per cent. and Regulation Q ceiling rates from 4–4½ to 5½ per cent. on all time deposits of 30 days or more. These changes were followed by an increase in the commercial banks' prime lending rate from 4½ to 5 per cent., which was raised again to 5½ per cent. in March 1966.

The Federal Reserve authorities increased their holdings of government securities during 1965 by $3.9 milliard, compared with a rise of $3.3 milliard in the preceding twelve months. It must be borne in mind, however, that last year's gold loss, which these security acquisitions, among other things, served to compensate, came to $1,665 million, whereas in 1964 the loss had been only $125 million. Thus, taking account of this and other factors affecting bank liquidity, it is clear that the authorities exercised increasing restraint in supplying reserves to the credit system. In consequence, the member banks' net position vis-à-vis the Federal Reserve System shifted from one of free reserves of almost \$170 million in December 1964 to one of net borrowing of approximately \$180 million by the spring of 1965. For the rest of the year, except for a temporary easing of reserve availability about the time of the December discount rate increase, net borrowed reserves averaged approximately \$150 million, but by the spring of 1966 they had risen to \$300–350 million.

The absorptive capacity of the capital market declined in 1965. Net capital issues by all sectors dropped to \$13.8 milliard from \$16.8 milliard in the preceding year (see table, page 50). However, net bond flotations by non-financial corporations rose by \$1.4 milliard to \$5.4 milliard and those by State and local authorities by \$0.7 milliard to \$6.1 milliard. Share issues by non-financial corporations were quite small. One element of strain in the market came from banks' and other financial institutions' sales of Federal Government securities (those maturing in more than one year), which amounted in 1965 to about \$3.6 milliard. The monetary authorities, apparently in order to ease this strain, allowed the market's total holdings of Federal Government securities at over one year to decline by some \$4.7 milliard.

The effect of monetary restraint, given the strength of demand for borrowed funds, has been not to slow down the earlier rate of credit expansion but rather to hold back its recent acceleration. In this connection, given the fast growth of government expenditure and private capital outlays, together with the private sector's relatively high degree of liquidity, there is a limit to what can be expected from monetary action alone. It is true that the banks, whose loan/deposit ratios now stand at unusually high levels, are hard-pressed for liquidity. Indeed, viewed in terms of the balance of payments, monetary restraint is working out much as expected, partly because US banks have turned increasingly in recent months to the Euro-currency market as a source of funds.

Under present conditions, however, it is questionable whether monetary restraint will help significantly to slow down the growth of corporate capital outlays, although it may affect housing and State and local-government investment. In the years 1962–64 the corporate sector's investment was matched, in global terms, by its own gross saving. In spite of this, and because of the existing degree of credit ease, corporations borrowed at a high rate and appear to have used these funds for extending credits to customers, building up liquid assets and investing abroad. In 1965, as their investment began to outstrip the availability of internal funds, corporations sharply increased their borrowings, partly in anticipation of need. At present, with the credit shoe beginning to pinch, it is possible that firms will respond more by curtailing their financial uses of funds, including overseas investment, than by stretching out their domestic investment projects, which are under the stimulus of both present and prospective demand. Hence, to the

United States: Sources and uses of corporate funds.[1]

Items	Annual averages 1955–57	Annual averages 1962–64	1965
	in milliards of US dollars		
Gross saving	29.6	45.2	55.5
Gross investment	32.8	45.1	59.6
Financial surplus (+)	— 3.2	+ 0.1	— 4.1
Corresponding changes in			
Liquid assets	0.3	2.0	1.2
Consumer credit	0.4	0.9	1.2
Net trade credit	2.4	4.4	5.6
Other financial claims (net)[2]	1.5	1.5	5.5
Securities and mortgages	— 6.9	— 8.0	— 9.6
Loans, bank and other	— 3.3	— 4.5[3]	—12.6[3]
Discrepancy	2.4	3.8	4.6

[1] Non-financial corporations only. [2] Includes investments abroad. [3] Includes an increase in tax liability averaging $0.8 milliard in the years 1962–64 and amounting to $1.6 milliard in 1965.

extent that further restraint is applied, fiscal measures might provide not only the most appropriate but also the most effective means of curbing demand.

Meanwhile, over the first four months of 1966 new loans and investments of the weekly-reporting Federal Reserve member banks were running about $700 million below the amount in the corresponding period of the preceding year, but still some $1.1 milliard above that for 1964. While continuing to increase business loans at a rate not far below that in 1965, the banks cut back substantially their new acquisitions of mortgages and State and local-government securities.

Canada. Domestic developments in Canada last year differed from those in the United States in three respects: the upswing in plant and equipment expenditure was more pronounced; provincial and local-government expenditure increased sharply; and house-building, though beginning to flatten out, remained at a very high level. Although employment rose by 3.8 per cent., contributing to a 6.6 per cent. growth in the real gross national product, the economy's capacity to produce fell short of the expansion of total expenditure. By the spring of 1965 monetary demand had become excessive, and this led for the year as a whole to rising prices and a substantial widening in the external current deficit, which was covered mostly by an increase in long-term borrowing abroad.

As a counterpart, these developments gave rise to growing credit-market strains, which as a matter of policy were only partially eased by open-market operations. The chartered banks' loans in Canadian dollars, accelerating because of heavier borrowing by local authorities and finance companies, rose in 1965 by 20 per cent., as against 14 per cent. in 1964. On the other hand, the public's deposits with the banks, particularly time and savings deposits, also grew faster, rising by 12 per cent., compared with 7½ per cent. in the previous year. To a certain extent these changes, on both the deposit and the lending sides, were occasioned by the failure of a finance company last June, which precipitated a shift in funds to the banks. This may be seen from the fact that the public's holdings of relatively liquid claims in all forms, including bank deposits, are estimated to have risen in 1965 by only 9 per cent., or little more than in 1964. With regard to the banks' liquidity, pressures were eased to some extent in 1965 by an increase in their net foreign liabilities and in government deposits, so that they were able to keep their holdings of government securities at much the same level. Over the year as a whole, however, the ratio of the chartered banks' "more liquid" assets to total deposits fell from 32 to 30 per cent., a level regarded by them as exceptionally low.

The Federal Government's budget, which on a national accounts basis had swung over from a deficit of Can.$290 million in 1963 to a surplus of Can.$330 million in 1964, improved further to reach a surplus of Can.$550 million in 1965. This surplus, achieved despite a reduction in personal income taxes as from the middle of last year, found its counterpart, as in the preceding year, in advances to government lending agencies. In addition, however, the government redeemed a small amount of its longer-term debt, thereby helping to make way for a rise in corporate financing via the capital market. Moreover, although their spending increased sharply in 1965, the provinces and municipalities curbed their new issue activity somewhat, while borrowing much more from the banks and through sales of short-term market paper.

From the spring of 1965 onwards, long-term interest rates rose considerably, while the Bank of Canada's discount rate was adjusted upwards from 4¼ to 4¾ per cent. in December 1965 and again to 5¼ per cent. in March 1966. At the turn of the year the prime rate on conventional residential mortgages stood at 7½ per cent., its highest level since the 1920s. Long-term interest rate differentials vis-à-vis the United States, although narrower for a time in early 1965, were kept at around 1 per cent. Although the covered differentials on short-term investments fluctuated widely, no large movements of funds occurred. Generally, the aim of policy was to encourage sufficient capital imports to cover the current-account deficit without inducing an excessive accumulation of reserves.

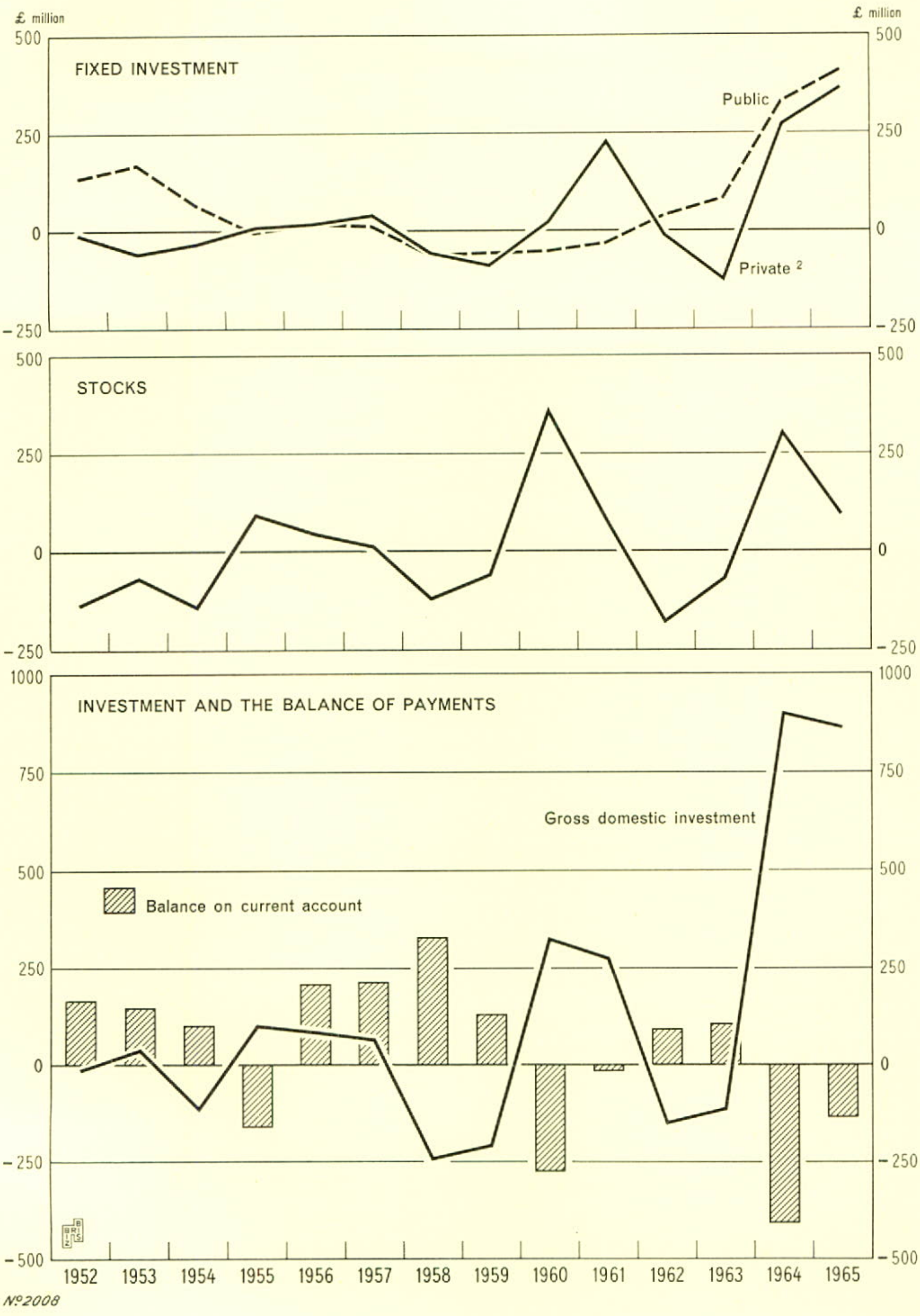
In early 1966 the outlook was for a further excessive rise in money incomes, propelled by a steep increase in plant and equipment outlays and public expenditure. Against this background, new fiscal measures were introduced in March. Accordingly, personal income taxes are to be increased as from June, which will have the effect of cancelling out last year's reduction in so far as the middle and higher income groups are concerned. Moreover, in order to encourage the postponement of capital expenditure, the present 11 per cent. sales tax on machinery and equipment will be reduced to 6 per cent. in April 1967 and eliminated altogether in 1968, while depreciation allowances for certain assets acquired over the next twelve months will be cut sharply for a period of three years. Finally, in order to reduce the funds available for investment, a refundable tax of 5 per cent. will be levied on corporations' gross profits after tax. It will be payable monthly as from May 1966 for a period of eighteen months and will be refunded with interest after an interval of eighteen to thirty-six months. All in all, however, these measures will do no more than offset the projected rise in government expenditure.

United Kingdom. In little more than a decade the United Kingdom has experienced three external crises in which a deterioration on current account has figured prominently. On each of these occasions — 1955, 1960–61 and 1964–65 — gross domestic investment in current prices increased quite sharply: in 1955 by 19 per cent., in 1960 by 21 per cent. and in 1964 by 25 per cent., with the swing from external surplus to deficit becoming progressively larger. In view of the relative stability of savings relationships, together with the United Kingdom's heavy dependence on external trade, it was, in fact, almost inevitable that an acceleration of investment on this scale should express itself as a deficit in the balance of payments. On the other hand, viewed in terms of trend, the authorities have had some success over the years in raising the rate of capital formation. Over the ten-year period from 1954 to 1963 — both years of moderate external surplus — gross domestic investment rose from about 16½ to almost 19 per cent. of the gross domestic product at factor cost.

In one important respect the development in 1964–65 stood in sharp contrast to that in 1960–61 and 1955. Whereas in the latter two periods the rise in private-sector fixed investment (including nationalised industry) had been compensated in part by an easing-off in public-sector investment, in 1964 both private and public fixed investment expanded together. In the course of 1965, partly as a result of restraint measures, fixed investment by the public authorities and in dwellings tended to level off, while that in the distributive and service industries declined. The rate of stock-building was also considerably lower than in 1964. However, fixed investment by manufacturing industry and the public corporations continued to rise. On balance, gross domestic investment amounted in 1965 to 21.8 per cent. of the gross domestic product at factor cost, thus remaining near the post-war high of 22.3 per cent. reached in 1964. This, together with rising public and private-sector wages, tended to keep the economy under strain last year.

These investment results accorded more or less with official policy, which was to restrain demand selectively so as to permit a continued high rate of productive investment. These intentions were reflected partly in the April 1965 budget, which acted to curb private consumption, but clearly also in the mode of application of credit restraint. From the spring of 1965 onwards, following a high rate of credit expansion in the previous year, the overall growth of credit to the private sector was rather stringently controlled. In late April the Bank of England made a call for special deposits, amounting to 1 per cent. for the London clearing banks and ½ per cent. for the Scottish banks. Shortly after, in early May, the clearing banks were asked to limit the growth in their advances (in sterling) to an annual rate of no more than 5 per cent. in the year to March 1966. At the same time, however, the recommendations made to the banks in December 1964 as to the direction of lending were reaffirmed, i.e. that priority should be given to exports and productive manufacturing investment, while loans for property development, hire-purchase and "professional and personal" needs should be curtailed. The clearing banks were further asked to restrict the increase of acceptances and commercial bills. The Bank of England also requested other financial institutions to observe a comparable degree of restraint.

United Kingdom: Fluctuations in investment[1] and the balance of payments.



[1] Expressed as deviations from the 1954–63 trend, which is represented by the zero line. The trend rates of growth for 1954–63 were: gross domestic investment, 6.7 per cent.; public fixed investment, 4.0 per cent.; private fixed investment, 7.9 per cent.; and stocks, 2.7 per cent. [2] Private fixed investment includes public corporations.

In early June the Bank of England reduced Bank rate to 6 per cent. from its emergency level of 7 per cent. But at the same time hire-purchase down-payments were raised from 20 to 25 per cent. for motor vehicles and from 10 to 15 per cent. for most other goods. Subsequently, with pressures on sterling again mounting, a series of new restraint measures was announced at the end of July. These included direct action to slow down non-industrial investment by public authorities and nationalised industries, limitations on local-authority borrowing and lending activity, a licensing procedure for certain non-essential building, a shortening of hire-purchase repayment periods and a tightening of exchange control. At this time the Bank of England stressed to the banks the importance, while continuing to favour credits for productive investment and exports, of limiting credits for imports, especially those of manufactured goods for home consumption and imports for stock-building.

For the calendar year as a whole the banking sector's advances (including those in foreign currencies) to UK residents increased by £425 million, or by 6½ per cent., against 17½ per cent. in 1964. From May 1965 onwards, after the credit ceiling on sterling advances had become effective, bank lending stayed well within the prescribed limits. The British Bankers' Association's analysis of advances for the twelve months to February 1966 shows that advances to the chemical, metal and engineering industries went up by approximately 22 per cent., while those to other borrowers rose by little more than 1 per cent. There was, furthermore, a marked decline in advances to hire-purchase companies and personal and professional borrowers. For the banking sector as a whole, resident deposits expanded last year by about £775 million, or 7½ per cent., compared with 5½ per cent. in 1964. Advances to non-residents in 1965 rose about £100 million less than their deposits (both in sterling and foreign currencies).

The acceleration of deposit formation, despite the slower growth in lending to the private sector, reflected the larger central-government deficit last year and its financing mostly via the banking system. The central government's net balance, or financing requirement, came to £596 million in the calendar year 1965, compared with £423 million in 1964, the difference being more than accounted for by an increase in lending to the local authorities. Of the 1965 total, the amount obtained by the Exchequer from official net sales of foreign exchange for sterling, together with changes in foreign-held government debt, was £117 million, as against £637 million in 1964. Thus, £479 million was raised last year from domestic sources, whereas in 1964 government debt in the hands of banks and the public had been run down by £214 million. The Exchequer's shift, in effect, from foreign to domestic sources of credit was facilitated by the squeeze on credit to the private sector and the related improvement in the balance of payments.

The banks supplied the Exchequer last year with £308 million, or close on two-thirds of the funds it raised from domestic sources. In addition to the funds deriving from the April call for special deposits, the banks' holdings of Treasury bills increased by £85 million and of government stock by £73 million. With regard to debt placed with the public, the expansion of notes and coin brought the Exchequer £195 million, but the loss in competitiveness of National Savings instruments last year resulted in a decline of £134 million in non-marketable debt. Moreover, the public's holdings of Treasury bills (mainly those held by companies) dropped by £37 million, following a decline of £70 million in the previous year. On the other hand, thanks partly to improved confidence and a more active funding policy, sales of government stock to the public increased to £147 million from only £5 million in 1964. In this connection, individuals as such reduced their holdings of both government stock and National Savings, shifting more to deposits with building societies and claims on local authorities. Companies, increasingly pressed for liquidity, cut back their holdings of both Treasury bills and local-authority debt. At the same time, however, non-bank financial institutions came in to take up government and local-authority debt to the amount of some £500 million, as against less than £300 million in 1964.

Capital-market activity by other sectors kept the gilt-edged market under considerable pressure during the year. Net issues by local authorities rose to £212 million from £90 million in the preceding year. Moreover, while those by quoted industrial and commercial companies came to £404 million, the same as in 1964, the introduction of the new corporation tax brought a substantial shift from share to bond financing as it increased the relative cheapness of the latter. Net borrowing by manufacturing industry went up by about 14 per cent., while that of property companies and others fell by 20 per cent. In addition, flotations by financial institutions dropped sharply from £108 million in 1964 to £39 million in 1965.

Monetary restraint, because it has been severe but selective, has facilitated the financing of a large Exchequer deficit while at the same time permitting a continued high level of fixed investment. At the beginning of February 1966 credit to the private sector was further tightened, the Bank of England having requested the clearing banks and other financial organisations, until further notice, to keep their advances, acceptances and commercial bills within the levels previously set for March 1966. Previous recommendations on the direction of lending were left unchanged. Also early in February hire-purchase terms were made more restrictive, the maximum repayment period for most goods being reduced from thirty to twenty-four months (that for cars to twenty-seven months) and the minimum down-payment raised from 15 to 25 per cent.

Britain's "stop-go" cycle of the past has been rooted largely in the fact that the rate of investment is, in the short run, closely and inversely related to the external trade balance. From the point of view of growth and longer-term external viability, the wish to break out of this cycle with a sustained high level of investment is understandable. However, it is important that policy to that end should also comprise forceful action to increase the rate of gross national saving. This has implied, among other things, the need to raise the public sector's own contribution to saving and to bring about an effective incomes policy.

The May budget, though in itself limited in what it can achieve, is broadly consistent with these requirements. The selective employment tax, which discriminates against the service and construction industries to the benefit of manufacturing industries, is designed to achieve multiple goals. To the extent that it causes a movement of labour into manufacturing, it is expected to raise productivity, ease wage pressures and improve the external balance. To the extent that the tax falls on labour retained by the service and construction industries, thereby affecting their prices and profits, it will tend to curb consumption and less essential investment while increasing budgetary saving. After the tax becomes effective in September, reimbursements under the scheme — to be made not at all to services and construction but in full to transport, agriculture and public administration and at a premium to manufacturing — will not begin until early in 1967, continuing thereafter with a time-lag. Therefore, as a by-product of its application, the tax will be tantamount to a once-for-all compulsory loan, the impact of which will be strongest during the initial months. In view of this, and of the limits imposed on further bank credit expansion, the liquidity situation will, other things being equal, tighten considerably over the year.

With the new tax and other changes, the Exchequer's budget surplus, excluding lending, is expected to increase from £689 million in the financial year 1965–66 to £1,047 million in 1966–67. Exchequer lending, mostly to local authorities and nationalised industries, is estimated to rise from £1,265 to 1,334 million. In this way the Exchequer borrowing requirement is expected to fall from £576 to 287 million. Moreover, the financing problem should be eased by recent improvements designed to make National Savings media more attractive. Thus, assuming the continuation of relatively high interest rates, which are justified on both external and domestic grounds, the financing of the Exchequer by domestic borrowing outside the banking system should present no undue difficulty.

Germany. In the early months of 1965 gross domestic investment, which had been advancing buoyantly since early 1963, continued to rise. As at the same time wage increases exceeded productivity gains, causing profit margins to narrow further, the enterprise sector's borrowing needs accelerated. Public-sector budgets, far from helping to compensate for the large volume of private investment, were themselves becoming more inflationary. Moreover, a marked rise in personal disposable income led, despite an increase in the savings ratio, to an unusual advance in consumption. Together, these developments contributed to a growing external current-account deficit, leaving it to monetary policy, which had become restrictive as from the summer of 1964, to carry an increasingly heavy burden of restraint. From the spring of 1965 onwards this policy began to show results, as the expansion of both capital expenditure and credit slowed down.

For the year as a whole the credit institutions' total domestic lending (including investments in securities) rose by DM 32.6 milliard, or 13 per cent., i.e. at approximately the same rate as in 1964. Lending to the private sector

The banking system: Monetary survey.

Countries	Years	Annual changes in main assets: Net foreign assets	Credit to public sector	Credit to private sector	Annual changes in main liabilities: Money	Quasi-money	Gross national product, at market prices	Money and quasi-money,[1] as percentages of GNP
		in milliards of national currency units						
Austria	1963	4.51	3.42	5.27	3.52	7.00	201.86	*49.5*
	1964	2.51	2.38	11.38	3.08	10.42	221.39	*50.9*
	1965	— 1.66	2.15	15.03	4.19	10.72	238.90	*53.4*
Belgium.	1963	— 1.30	21.20	16.40	24.50	8.20	697.92	*47.4*
	1964	8.80	9.10	10.60	19.70	6.10	774.50	*45.8*
	1965	6.80	16.30	14.10	21.30	11.60	834.50	*46.3*
Denmark	1963	1.66	— 0.35	2.09	1.63	1.38	54.59	*49.3*
	1964	0.81	— 0.85	3.58	1.39	1.51	61.62	*48.4*
	1965	0.17	0.72	2.38	1.57	1.26	69.03	*47.5*
Finland[2]	1963	117	56	468	265	464	20,464	*41.4*
	1964	126	— 48	1,130	56	949	23,356	*39.9*
	1965	— 236	21	1,167	45	1,022	25,991	*40.2*
France	1963	4.16	3.78	10.70	19.06	0.69	395.97	*39.2*
	1964	3.80	— 0.32	10.66	12.21	2.61	435.24	*39.2*
	1965	3.33	1.29	12.16	14.85	3.01	461.44	*40.6*
Germany	1963	3.20	5.10	19.20	4.20	12.00	377.60	*37.6*
	1964	2.70	7.70	21.70	5.40	13.90	413.80	*38.6*
	1965	0.50	8.10	25.30	5.10	17.30	448.80	*40.4*
Italy	1963	— 780	810	2,594	1,402	1,031	30,193	*62.6*
	1964	483	548	870	908	872	33,112	*61.9*
	1965	992	888	1,793	1,871	1,489	35,460	*65.5*
Netherlands. . .	1963	0.63	— 0.11	0.92	1.21	2.26	52.34	*63.3*
	1964	0.11	0.16	1.07	1.15	2.42	60.80	*59.8*
	1965	0.08	0.87	1.19	1.70	2.42	67.92	*60.0*
Norway	1963	0.39	0.21	1.00	0.48	1.01	40.51	*54.7*
	1964	0.27	0.20	1.39	0.57	1.23	44.98	*53.4*
	1965	1.15	0.10	1.22	0.54	1.74	50.96	*51.2*
Spain	1963	5.10	12.00	76.80	41.90	53.60	938.60	*63.6*
	1964	21.00	28.10	90.00	60.30	78.00	1,062.90	*67.4*
	1965	— 5.80	34.90	125.50	62.30	82.40	1,260.00	*67.9*
Sweden.	1963	— 0.13	— 0.63	5.65	1.18	3.31	80.96	*71.2*
	1964	1.06	— 0.62	4.13	1.27	2.70	90.06	*69.2*
	1965	0.12	— 0.35	4.57	1.08	2.77	98.54	*67.4*
Switzerland . . .	1963	0.88[3]	0.80	3.95	1.80	4.54	50.37	*125.2*
	1964	0.85[3]	0.61	3.92	1.72	4.30	55.57	*124.8*
	1965	0.54[3]	0.86	4.46	1.09	4.73	60.20	*125.1*
United Kingdom[2]	1963	.	292	495	.	—	30,450	.
	1964	— 578[4]	— 200	967	585[5]	—	32,890	*34.5*
	1965	— 304[4]	550	570	909[5]	—	35,230	*34.4*
United States . .	1963	— 0.50[6]	5.90	16.80	5.80	13.40	589.20	*42.7*
	1964	— 0.10[6]	6.40	17.80	6.80	13.20	628.70	*43.0*
	1965	— 1.20[6]	6.90	26.30	6.70	19.30	676.30	*43.4*
Canada	1963	0.15	0.24	0.49	0.52	0.51	43.42	*36.2*
	1964	0.35	— 0.26	1.02	0.71	0.50	47.40	*35.4*
	1965	0.16	0.04	1.67	1.20	0.78	51.99	*36.0*
Japan.	1963	39	241	4,871	2,078	2,884	21,421	*103.7*
	1964	— 274	727	3,791	1,177	2,772	24,968	*105.0*
	1965	154	745	2,774	1,043	1,888	27,140	*107.9*

[1] Annual averages. [2] In millions of national currency units. [3] National Bank only. [4] Includes the Exchange Equalisation Account's assets, net IMF position and deposit banks' net assets. [5] Including deposits at short notice. [6] Official assets plus net IMF position.

Source: IMF, *International Financial Statistics.*

expanded somewhat more than that to public authorities, whose share in the total growth of credit dropped from about 26 per cent. in 1964 to 22 per cent. in 1965. Within the total, the banks' holdings of securities — small relative to their loan operations but significant to the capital market — went up by only some 9 per cent., as against 16 per cent. in 1964. The increase in loans, on the other hand, was slightly larger than in 1964, reflecting mainly a speeding-up of short and medium-term credits to the private sector. The public authorities continued to increase rapidly their borrowing at medium and long term, which in the three years to the end of 1965 rose by over DM 16 milliard, as against only DM 7 milliard in the preceding three-year period.

The credit institutions' continued high rate of lending last year was facilitated partly by a high rate of deposit formation. The marked rise in savings deposits, which came to 17½ per cent. compared with 15½ per cent. in 1964, reflected the higher ratio of household savings and the uncertainties on the capital market. The money supply increased by 7.5 per cent., which compares with a rise in gross national product of 8.4 per cent. at current prices.

The large scale of the credit institutions' lending in 1965 was also made possible by substantial drawings upon their liquid resources. The external deficit, it is true, occasioned a loss of bank liquidity of only DM 1.3 milliard, which was small compared with the basic deficit of DM 5.5 milliard, partly because tight credit induced residents to borrow abroad at short term. Moreover, the drawing-down by public authorities of their deposits with the Bundesbank provided the credit institutions with DM 1.1 milliard of additional liquidity. Nevertheless, other factors, including the growth of required reserves and the increase in the currency circulation, caused a considerable liquidity drain, so that on balance bank liquidity declined by DM 3.7 milliard. In covering this, the credit institutions drew mostly from domestic sources of liquidity, reselling DM 1.9 milliard of open-market paper to the Bundesbank and increasing their central-bank borrowing by DM 1.6 milliard. Owing to the continuation of selective incentives to hold funds abroad, only DM 150 million was obtained through the repatriation of money-market assets.

Against this background, the Bundesbank took measures which reinforced the growing market pressures on bank liquidity. In January 1965 the discount rate was raised from 3 to 3½ per cent. and the central bank's selling rate for money-market paper by ½–¾ per cent. Subsequently, in May, the Bundesbank announced a structural modification of rediscount quotas, equivalent to a reduction of up to 25 per cent., which was to become effective in October. In August the discount rate was further raised from 3½ to 4 per cent., while the selling rates for short-term money-market paper were increased by ¾ per cent. and those for longer-term paper by ⅝ per cent. However, because pressures on bank liquidity had intensified from other sources, one-half of the scheduled reduction in rediscount quotas as from October was postponed.

Public-sector developments in 1965 seriously aggravated the financial strains emanating from the private sector. With public current expenditure accelerating because of higher salaries and social benefits and revenues increasing more slowly because of the earlier tax cuts, the public authorities' combined current-account surplus (in national income terms) declined. Moreover, whereas in 1964 the sector had realised a financial surplus (excess of saving over its own investment) of DM 5.6 milliard, this gave way in 1965 to a deficit of DM 1.6 milliard. The cash deficit of the central authorities (excluding the communes) rose from DM 3.0 milliard in 1964 to DM 6.1 milliard in 1965. This deficit was financed partly by a drawing-down of cash reserves, but even more by increased recourse to the credit markets, including a notable rise in the placing of short-term money-market paper. Another striking development has been the accelerated growth over the past two years in communal debt, which increased in 1965 by DM 4.6 milliard, as against DM 3.5 milliard in 1964 and DM 2.4 milliard in 1963. In July 1965 the Federal Government took several steps to curb its own expenditure, and these were followed in December by legislation to cut back previously approved expenditure by DM 3.2 milliard. In addition, railway tariffs and the tax on alcoholic beverages were raised. Moreover, in August 1965, on the initiative of the government, the various public authorities agreed to hold periodic "round-table" meetings in order to harmonise their new issue plans.

The brunt of financial pressures was borne by the securities market, where the yields on public-authority loans, after rising by ½ per cent. during 1964, increased in the course of 1965 by well over one percentage point. The decline in bond prices was continuous, persisting even after the authorities ceased temporarily from July onwards to grant permits for new issues of bearer bonds. In the aggregate the market's net absorption of securities, at DM 17.8 milliard, compared favourably with the 1964 total of DM 16.6 milliard (see page 50). However, this increase reflects in part the bigger volume of foreign issues, two-thirds of which, because they are not subject to the withholding tax, were taken up by foreigners. Moreover, the market for fixed-interest-bearing securities was particularly weak, partly because of the reduced support from the credit institutions and partly because of the attraction to the public of the larger volume of company share issues. In consequence, net issues of domestic bonds declined by DM 1 milliard to DM 12.5 milliard last year.

In recent months the economy has remained under stress. Although private investment has decelerated, exports have gained speed, the housing boom has continued and costs and prices are still rising. Moreover, although the Federal Government's budget is expected to show better results than in 1965, it has appeared that public-sector expenditure as a whole will rise in 1966 by about 8 per cent. Early in 1966 the Bundesbank, in addition to raising the selling rates on its money-market paper, decided to put into effect as from May the previously postponed cut in rediscount quotas. Subsequently, with public-sector financing requirements continuing to weigh heavily on security prices, the Federal Government announced in May its intention to abstain from further recourse to the capital market in 1966. In addition, the Länder and communes agreed to cut back as far as possible their extra-ordinary budgets for this year and next and to abstain from bond issues up to the end of June. Finally, towards the end of May, monetary policy was made more restrictive. The Bundesbank, basing its action on both domestic and external grounds, raised its discount rate from 4 to 5 per cent. and, among other related changes, its rate on secured advances from 5 to 6¼ per cent.

Switzerland. Economic activity in 1965 and early 1966 was largely shaped by the stabilisation measures introduced early in 1964. These consisted principally of quantitative controls, designed to affect both the supply of and the demand for funds while reducing upward pressures on interest rates. Briefly, they comprised further restrictions on the entry of foreign capital, a prolongation of the ceiling on bank credit expansion, capital issues control, limitations on building starts and a reduction in the foreign labour supply. Together, their effects on private demand were pronounced, causing industrial investment and housing activity, in particular, to ease and the external current-account deficit to decline. But aggregate demand, shored up by buoyant exports and rising public expenditure, continues to be strong.

Total credit-granting by the sixty-two representative banks rose last year by Sw.fr. 4.5 milliard, which amounted as in 1964 to almost 9 per cent. This increase fell within the prescribed margins, which remained unchanged for ordinary loans to the private sector but were relaxed somewhat for mortgage credits and loans to public authorities. Indeed, credit to the public sector showed the biggest relative change last year, rising by 19 per cent. (Sw.fr. 510 million) as against 14 per cent. in 1964. Longer-term funds placed with the banks grew by over Sw.fr. 4.7 milliard, or by almost 11 per cent. as in 1964. Purchases of savings certificates accelerated owing to the higher rates paid on them by the end of 1964, thereby enabling the banks to issue fewer bonds. On the other hand, in consequence of both higher interest rates and the external deficit, the money supply (currency and demand deposits) expanded by only 4 per cent., as against over 6 per cent. in 1964 and an average of 11 per cent. in 1961–63.

As a result of capital inflows, associated partly with pressures on sterling, the banks began 1965 with their liquidity on the rise. In order to absorb most of this liquidity, the National Bank carried out with the banks in January foreign currency swaps amounting to about Sw.fr. 500 million. In the following months bank liquidity fell in conjunction with a decline in the official exchange reserves. Pressures both on bank liquidity and on the capital market were eased somewhat in June, when the Confederation decided to scale down an impending conversion issue so as to repay some Sw.fr. 100 million to the market. Then, in July, the National Bank reversed the greater part of its January swap operation, thereby providing the banks with some Sw.fr. 445 million in domestic currency. About this time, moreover, renewed capital inflows, again related partly to the position of sterling, caused bank liquidity to improve. As a partial offset, the BIS, at the request of the Swiss authorities, placed Sw.fr. 100 million of its own promissory notes with the banks. In subsequent months the external deficit acted as a drain on bank liquidity, although this was relieved to some extent by government financing requirements. To cover its increasing cash outlays and maturing debt, the Confederation drew upon its central-bank deposits last year and liquidated investments abroad. On balance, the banks' liquidity margins narrowed in 1965, and this development has continued in 1966, as reflected in an increase in rediscounts with the central bank.

The controls exercised over new issues, based on a system of quarterly quotas, strongly conditioned capital-market developments in 1965. Domestic bond issues (see page 50) were about 10 per cent. below the 1964 level, but this was attributable largely to a 30 per cent. decline in bank issues, facilitated by the accelerated growth of longer-term bank deposits. Industrial bond flotations, on the other hand, rose by 13 per cent., while those by local authorities were 14 per cent. higher. Foreign issues on the Swiss market, which were curtailed further in 1965, remained much below the levels attained in earlier years. The volume of share issues was about the same as in the two preceding years, while share prices continued their previous decline. Despite the control over new issues, interest rates came under pressure in the spring of 1965 and the nominal rate on new flotations rose by about ¼ per cent. The rates on mortgages increased by about the same amount during the year.

Although the pace of economic activity is now much calmer, strong demand and rising prices have necessitated an extension of the government's stabilisation policies along much the same lines as before. While the building restrictions imposed two years earlier were removed in March 1966, employers have been asked to reduce the foreign labour force by a further 5 per cent. in 1966. With regard to external capital transactions, the National Bank authorised the big banks as from April 1966 to participate with a share of up to 10–15 per cent. in international consortia for "Euro-issues". At about the same time foreigners were granted permission to purchase mortgage bonds and a limited proportion of certificates issued by real-estate unit trusts. Although inflationary pressures in the private sector are under better control, public-sector developments have given increasing cause for concern. The Confederation's budget, which over a number of years had recorded substantial surpluses, was balanced in 1965 and is expected to move into deficit in 1966. With expenditure estimated to rise by over 21 per cent., against a 15 per cent. increase in revenue, the deficit is expected to come to Sw.fr. 238 million, compared with a surplus of Sw.fr. 420 million in 1964. Local-authority expenditure has also grown rapidly and almost all the cantons and a large number of communes have budgeted for sizable deficits in 1966.

France. In the spring of 1965, against the background of a large external current-account surplus, economic expansion was resumed and gradually gathered momentum. Although fixed investment by private industry was slow to show signs of recovery, exports rose buoyantly, and domestic demand was stimulated by house-building, public investment and, late in the year, restocking. The stabilisation programme, although modified in some respects so as to encourage the transition to renewed growth, was retained in the interests of its primary aim: to put an effective stop to France's long history of inflation. Essentially this implied the continuation of direct controls over prices, a public-sector incomes policy, a balanced budget and monetary measures to limit liquidity creation.

The budget has played a major rôle in helping to restrain demand and to raise the overall rate of saving. After being brought down from a deficit of Fr.fr. 8.2 milliard in 1963 to one of only Fr.fr. 1.6 milliard in 1964, the budget has since been kept in approximate balance. While this was achieved partly through the shifting of certain expenditures outside the budget, the improvement is due mainly to curbs on public consumption, which in money terms has over the last two years been kept in line with the rise in the gross national product. In 1965 the ordinary budget showed a surplus of about Fr.fr. 4.3 milliard, which was just offset by a deficit on extraordinary account, representing mostly loans to the Fund for Economic and Social Development and for low-cost housing.

With the budget position strong and private credit demands moderate, the Bank of France lowered its discount rate in April 1965 from 4 to 3½ per cent. In addition, earlier in January and again at the end of April, the authorities reduced the so-called "T" rate, which has been the basis for determining the banks' minimum interest charges. Moreover, in June the 10 per cent. ceiling on the permissible rate of bank credit expansion was suspended, although the banks were asked not to depart too much from this limit. For 1965 as a whole the banking system's credits to the economy rose by Fr.fr. 12.9 milliard, or more than 12 per cent. Within this total, medium-term credits rose by Fr.fr. 3.1 milliard, or 17 per cent.

In spite of the larger external surplus, bank liquidity was brought under pressure last year. In consequence of the net inflow of foreign exchange, bank liquidity increased by about Fr.fr. 5.9 milliard, but this effect was largely offset by an expansion of Fr.fr. 4.6 milliard in the note circulation. In addition, the Treasury, with the surplus funds accruing to it from postal accounts, correspondents' accounts, etc., absorbed liquidity to the extent of Fr.fr. 4.0 milliard. For, whereas in 1964 the Treasury had used such funds mainly to repay indebtedness to the banks, in 1965 it reduced its debt with the central bank and repaid foreign debt. On balance, therefore, in order to accommodate their lending activity, the banks increased their rediscounts with the Bank of France by Fr.fr. 2.7 milliard, of which Fr.fr. 0.3 milliard consisted of medium-term paper. In December 1965 the Treasury further lowered the banks' minimum Treasury bill ratio, within the "coefficient de trésorerie", from 7½ to 5 per cent., thus giving the banks greater scope to satisfy their compulsory liquidity requirements by holding medium-term paper.

As a result of these developments the money supply and quasi-money held with the banking system went up last year by Fr.fr. 18.0 milliard, or

10.1 per cent., compared with rises of 9 per cent. in 1964 and 13.7 per cent. in 1963. Liquid savings in other forms (mostly deposits with the savings banks) increased similarly — by Fr.fr. 9.5 milliard or about 10.8 per cent. Together, total liquid assets rose from 57.1 per cent. of the gross national product in 1964 to 58.5 per cent. in 1965. This increase, although still reflecting a certain preference for liquidity, is substantially smaller than it was in the years from 1958 up to 1963, when the stabilisation programme was launched.

Net capital issues, at Fr.fr. 12.2 milliard in 1965, did not rise much above the Fr.fr. 11.3 milliard recorded in 1964. Once again last year, however, an increasing proportion of savings appears to have gone directly into investment in housing, thus limiting the flow of funds to the securities market. Another consideration is that the Treasury, after issuing a public loan for Fr.fr. 1.5 milliard in 1964, did not borrow on its own account in 1965. In October it floated a 5½ per cent. National Equipment Loan for Fr.fr. 1 milliard, but this was specifically for lending to public and private enterprises for investment purposes. In effect, therefore, bond issues on behalf of borrowers other than the Treasury increased in 1965 by about 25 per cent. At the same time, taking account of the tax credit which raised effective yields, long-term interest rates remained relatively steady.

The money market, on the other hand, was at times characterised by tightness. However, the authorities continued to use the "coefficient de trésorerie" partly as a money-market regulator (from 36 per cent., its normal level, it was temporarily lowered several times to reach 32 per cent. in December, and was then brought up in January to 35 per cent., its new normal level) and increased their open-market operations. These actions made it possible to keep the day-to-day money rate between 4 and 4½ per cent., thus helping to avoid unwanted inflows of funds from abroad.

The favourable results achieved by the stabilisation programme have also enabled further progress to be made towards structural improvements in the financial system. Along lines proposed in the 1966 budget, several measures were taken to establish a more appropriate interrelationship, undistorted by differences in fiscal treatment, between the yields on long, medium and short-term savings in order to encourage the placement of funds at longer term and to give the banks the same opportunity as other public institutions, and the Treasury itself, to collect savings. One significant measure, in particular, concerned shares held by residents, the effective yield on which was increased as from 1st January 1966 by a tax credit equivalent to 50 per cent. of dividends received. Various steps were also taken to spur competitiveness between banking and other financial institutions. From February 1966 onwards the deposit banks were authorised to accept deposits at two years or more, while the investment banks (banques d'affaires) were similarly granted permission to take deposits at under two years. Moreover, the "T" rate governing minimum bank charges, after being reduced twice early in 1965, was abolished altogether in March 1966. Housing finance has been facilitated as the result of a marked increase in the limits for loans granted by the Crédit Foncier and the introduction of a new housing savings system. In addition, the financing of productive investment has been made easier by the lengthening from five to seven years of the maximum duration for medium-term credits eligible for rediscounting at the Bank of France. This facility is to be limited, however, to paper having not more than three years to run to maturity.

The economy's renewed upswing has in recent months strengthened the possibility of an acceleration in private industry's fixed investment. In this connection, besides the measures taken to increase the availability of longer-term credit, the government introduced in February 1966 a tax credit equivalent to a 10 per cent. subsidy on investment goods purchased or ordered during the year. The prospect of greater demand pressure, reinforced by private fixed investment, suggests the need to continue with efforts to stabilise costs and prices.

Italy. Economic recovery in Italy, after a hesitant start in the spring of 1965, became more firmly based as time went on. But, in spite of an impressive rise in exports and the prevalence of easy credit conditions, the upswing has been inhibited by weakness in investment, both industrial and housing. Gross domestic investment, after declining in real terms by over 8 per cent. in 1964, dropped by another 7½ per cent. in 1965. Thus, as a proportion of gross national product, it fell from 24.8 per cent. in 1963 to 19.8 per cent. in 1965, reflecting almost entirely a decrease in productive as distinct from social investment. The recovery of capital outlays, which were unusually high when the downturn began, has been impeded by a cost/price disequilibrium and excess capacity, both of which are gradually disappearing. Last year, indeed, the expansion of wages, although still pushed forward by cost-of-living indexation, slowed down substantially. Externally, these developments were accompanied by a further widening of the current surplus over most of 1965, but later in the year rising imports halted this movement.

With the economy's saving not fully utilised, the government sought to reactivate the economy by means of a series of budgetary measures, most of which were enacted in March 1965. It was decided, among other things, to enlarge and speed up the execution of public works and the investments of government-controlled companies. Moreover, after taking over part of employers' social security charges in September 1964, the government extended this relief in 1965, which came for the year to Lit. 277 milliard. A Lit. 100 milliard fund was created to provide new credit facilities for machinery purchases by small firms, and housing was to be stimulated by tax concessions, grants for low-cost dwellings and interest rate subsidies. Finally, following upon improvements in family allowances in 1964, old-age pensions were increased retroactively from the beginning of 1965.

As a result of these measures, the Public Administration (including the central government, local authorities and social security) increased its net indebtedness in 1965 by Lit. 1,165 milliard, as against a rise of only Lit. 90 milliard in 1964. This change reflects predominantly an expansion of over Lit. 1,000 milliard (24 per cent.) in current transfer payments, mostly in the social security field, and one of Lit. 200 milliard (58 per cent.) in capital transfer payments to enterprises. The public authorities' own investment, slow to respond to planned increases, was about the same as in 1964. With regard to financing, the Treasury obtained in 1965 from the Bank of Italy and the Exchange Office close on Lit. 300 milliard, consisting partly of compulsory bank reserves invested in government securities. In addition, the government increased its direct and indirect borrowing through new issues from Lit. 229 milliard in 1964 to Lit. 662 milliard in 1965, a large part of which was taken up by credit institutions.

The public authorities' deficit, together with the larger external surplus, was associated with a sharp increase in liquid-asset formation. Rising by Lit. 1,985 milliard, or 16 per cent., the money supply (currency and demand deposits) increased by twice as much as in 1964. Similarly, quasi-monetary assets, going up by Lit. 1,890 milliard, showed a rise of 15 per cent., as against about 10 per cent. in the preceding year. Thus, total liquid assets expanded from 70.5 per cent. of the gross national product in 1964 to 74.0 per cent. in 1965.

On the other hand, reflecting the weakness of private credit demand, the credit institutions' domestic loans rose by only Lit. 935 milliard, or 7 per cent., after an even smaller increase of 3 per cent. in 1964. Hence their loan/deposit ratio, which at the end of 1963 had been 78.6 per cent., declined from 74.4 per cent. in December 1964 to 67.7 per cent. in 1965. With plentiful resources at hand, the banks moved mainly in two other directions. First, with the co-operation of the central bank, they added substantially to their foreign assets, thereby helping to reduce their net foreign indebtedness from Lit. 508 to 111 milliard over the year. Secondly, they added Lit. 1,150 milliard to their securities portfolio, which was more than twice as much as in 1964. These acquisitions, which exclude securities used to satisfy reserve requirements, consisted largely of bonds issued by the government, special credit institutions and public enterprises. On balance, the banks' liquidity, including their margin for advances from the central bank, rose last year by Lit. 68 milliard to Lit. 1,116 milliard.

Net capital issues, after growing from Lit. 1,485 milliard in 1963 to Lit. 2,005 milliard in 1964, went up further to Lit. 2,345 milliard last year. These changes reflect mostly the increased borrowing of the central government, which shifted from net debt repayment in 1963 to net issues of Lit. 660 milliard in 1965, and of the public enterprises, the volume of whose issues in 1965, at Lit. 555 milliard, was twice as great as in 1963. Borrowing by both the special credit institutions and private industry dropped off somewhat over the two years. On the lending side, reflecting the public's strong liquidity preference, the banking system's security acquisitions rose by more than the increase in total new issues. Most long-term interest rates continued to fall, with the yield on industrial bonds, which had stood as high as

8.57 per cent. in June 1964, declining from 7.63 per cent. in December 1964 to 6.88 per cent. in December 1965.

The revival in private demand for credit observable in late 1965 appears to have continued in the early months of 1966. The external surplus has remained a source of liquidity creation. On the other hand, the Treasury, whose net financing requirement early in 1966 was higher than in the corresponding period of 1965, stepped up its long-term borrowing even in excess of need, thereby absorbing some liquidity from the market. However, in keeping with the need to stimulate productive investment, the yield on industrial bonds declined further from 6.88 to 6.60 per cent. between December and March.

Netherlands. In 1965 the economy once again showed a rise in money incomes and expenditure considerably in excess of the growth in output. Reflecting mainly a sharp expansion of private consumption, residential building and public expenditure, gross national expenditure increased in money terms by about 11½ per cent., or more than twice the rise in the real national product. Interrelated with this development, wages and salaries in the private sector went up by approximately 11 per cent. and in the public sector by 15 per cent. None the less, the external position improved, largely as the result of a slowing-down in industrial fixed investment and a marked decline in stock-building.

Public-sector developments over the last two years have been highly expansionary. The combined public authorities' financial deficit (their saving minus their own investment) rose on a cash basis from Fl. 1,750 million in 1963 to Fl. 3,080 million in 1965. On the other hand, the financial surplus of the private sector (including institutional investors) went up only from Fl. 2,730 to 2,970 million. As the counterpart of these changes, the external current balance, which in 1963 had been in substantial surplus, showed a modest deficit in 1965.

The central government's financial deficit increased from Fl. 730 million in 1964 to Fl. 1,040 million in 1965. This deterioration was attributable partly to a cut in income taxation as from the middle of 1965 but mostly to a large increase in expenditure, particularly on wages and salaries and housing subsidies. Moreover, because of the heavy demand for funds from other borrowers, the central government departed from its principle of neutral financing, i.e. covering its deficit through funds raised on the capital market. Instead, it moderately reduced its long-term borrowing, while substantially increasing the amount of funds taken up from the banking system, particularly from the central bank.

The local authorities' financial deficit, after rising sharply from Fl. 1,440 million in 1963 to Fl. 2,230 million in 1964, dropped off to Fl. 2,040 million in 1965. While this improvement was partly due to a substantial rise in revenue, it mainly reflected a flattening-out of fixed investment (excluding housing) following an increase of well over 30 per cent.

the preceding year. Thus, the government's continued efforts to restrain the local authorities' investment outlays, largely by means of a ceiling on their overall borrowing and limits on their short-term indebtedness, showed results last year. Moreover, with the central government withdrawing somewhat from the capital market, the local authorities were able to borrow at long term on a sufficient scale to cover their financial deficit and to consolidate some short-term debt.

Short-term bank credit to the private sector increased in 1965 by Fl. 670 million, or just over 9 per cent., compared with a rise of 12 per cent. in 1964. This expansion was approximately in line with the official ceiling, which for 1965 was set at 11 per cent., taking the first half of 1963 as a base. Again last year, however, the banks sharply increased their lending at longer term, as this was not subject to the ceiling. Thus, the outstanding volume of their medium-term credits, which showed a rise of Fl. 480 million after one of Fl. 310 million in 1964, more than doubled in the space of two years. Moreover, their capital-market investments increased in 1965 by Fl. 570 million, or 15 per cent., following a rise of 18 per cent. in the preceding year. This development led the central bank in June 1965 to request the commercial banks henceforth to keep their longer-term lending in line with the growth of their longer-term liabilities. Together, private and public-sector borrowing was associated with an increase in domestic liquid assets (including holdings of short-term government securities) of Fl. 1,920 million, or 8½ per cent., i.e. somewhat less than in 1964 and appreciably less than the expansion of the gross national product in money terms. Within this total, however, the money supply went up by 11 per cent., while secondary liquid assets rose by only 3 per cent.

New borrowing on the capital market, including security issues and private and mortgage loans, amounted in 1965 to Fl. 7.2 milliard, representing an increase of 13 per cent. after one of 19 per cent. in 1964. Just as in the two preceding years, private-sector borrowing accounted for about three-fifths of the total. A feature on the supply side was the growing volume of funds coming from business firms and households, which invested Fl. 1,230 million on the market in 1965 and Fl. 900 million in 1964, as against an average of only Fl. 215 million over the years 1959–63. Rising long-term interest rates have thus been instrumental in attracting lenders to the capital market. The average yield on long-term government bonds rose by over one and three-quarter percentage points between the autumn of 1963 and the end of 1965.

For 1966 the authorities have made efforts to moderate the impact of public-sector expansion. The central government's total expenditure, after going up by 18 per cent. in 1964 and almost 13 per cent. in 1965, is expected to rise by a further 10 per cent. this year. However, as a result mostly of increases in indirect taxes, revenue is to rise still more, so that the overall deficit is estimated to decline by Fl. 400 million to Fl. 1,080 million. From December 1965 onwards, moreover, the efforts to control local-authority investment by means of borrowing ceilings were dropped in favour of a system of centralised financing through the Bank for Netherlands Municipalities and another public credit institution. In spite of these developments overall demand continued early in 1966 to expand rapidly, accompanied by a widening of the external deficit, and by April the yield on long-term government bonds was over 6½ per cent. In consequence, the Nederlandsche Bank, after keeping its discount rate unchanged since June 1964, raised it in May from 4½ to 5 per cent. In addition, the ceiling on short-term bank credit was made more restrictive for the period up to August. Shortly after, the government initiated further measures to restrain inflation, including economies in budget expenditure, a limit of 7½ per cent. on wage increases and a system of prior approval for price rises.

Belgium. The expansion of demand began to taper off in the course of 1964, and from the spring of 1965 onwards production flattened out. Tension on the labour market eased and wholesale prices rose more slowly, but consumer prices and wages and salaries, which are closely index-linked, continued to increase fairly sharply. However, with demand more moderate and the external position moving into substantial surplus, the authorities deemed it appropriate gradually to relax some of the restraint measures imposed in 1963 and 1964.

In the monetary sphere, the terms of rediscounting were eased from January 1965 onwards for certain branches of activity, in particular textiles. In April financial institutions were authorised to grant credits for investment, as well as for the replacement of dollar credits from US banks, without regard to the existing quantitative limitations on lending. In July the 10 per cent. ceiling on credit expansion was suspended altogether and the 1 per cent. cash reserve requirement was rescinded. At the same time, the National Bank, regarding the lull in activity as transitory, stressed that moderation in lending should continue. In particular, it recommended the banks to avoid any acceleration in credit-granting for real-estate and consumption purposes, to moderate the extension of non-mobilisable credits and to finance longer-term lending only by appropriate longer-term resources. Moreover, the National Bank's discount rate, which had been raised over the twelve months up to July 1964 from 3½ to 4¾ per cent., was not reduced.

The budget acted as a stimulus to the economy. In the spring of 1965 public investment was speeded up somewhat, while for the year as a whole revenue was less buoyant and public-service remuneration, also index-linked, rose substantially. Net of debt repayment, the Treasury's financial requirement came to B.fr. 22.1 milliard, as against B.fr. 15.0 milliard in 1964. At the same time, however, the Treasury increased its recourse to the Belgian market from B.fr. 13.9 milliard in 1964 to B.fr. 26.9 milliard in 1965. Borrowing on this scale enabled it to rechannel abroad B.fr. 4.8 milliard in repayment of its foreign indebtedness.

The slower increase in demand, in combination with the external surplus and budget deficit, was accompanied by a high rate of liquid-asset formation. Reflecting, in particular, a faster growth of time and savings deposits, the banking system's monetary and quasi-monetary liabilities went up by B.fr. 33 milliard, or 9 per cent., after an increase of 7½ per cent. in 1964. As a lending counterpart, the monetary institutions increased their claims against the public sector by B.fr. 12.2 milliard, compared with a rise of B.fr. 9.8 milliard in 1964. The private sector's demand for bank credit, though rising more slowly over most of 1965, continued to be fairly strong, owing partly to rising costs and shrinking profit margins. Towards the end of the year, as a restocking movement got under way, bank credit accelerated markedly. For 1965 as a whole, the monetary institutions' lending to the private sector increased by B.fr. 14.3 milliard, or about 14½ per cent., compared with 10½ per cent. in 1964. However, as there was a slowing-down in lending by other financial intermediaries, in particular the public credit institutions, total credits to the private sector increased by almost 12½ per cent., i.e. at about the same rate as in 1964.

The larger budget deficit, although it served at first to sustain activity, loomed later in 1965 as a growing threat to stability. In presenting its budget for 1966, the government, envisaging a further substantial increase in expenditure, decided last December to raise various indirect taxes, including the turnover tax (from 6 to 7 per cent.) and the petrol tax. As a result, the overall budget deficit (excluding debt amortisation) was estimated for 1966 at approximately B.fr. 16 milliard, which compares with an originally estimated deficit for 1965 of about B.fr. 4 milliard and an actual deficit of some B.fr. 14 milliard.

In the spring of 1966 economic activity picked up considerable speed. In consequence, the National Bank in late April renewed its recommendation concerning the quantitative limitation of bank credit, requesting the financial institutions to keep the expansion of their lending in 1966 to not more than 12 per cent. of the amount outstanding at the end of 1965. Within this ceiling priority is to go to productive investment, especially for rationalisation purposes, while restraint is to be exercised as regards credits for consumption, construction and stock-building. Moreover, in early May the government announced a series of stabilisation measures, including plans to slow down public expenditure and to impose a three-month freeze on the prices of goods and services. This was followed on 2nd June by an increase in the National Bank's discount rate from 4¾ to 5¼ per cent.

Austria. Following the acceleration in 1964, the rate of economic expansion slowed down appreciably in 1965, although demand was kept strong by wage increases averaging about 10 per cent. Prices rose and imports speeded up, shifting the external current account into modest deficit. Moreover, the basic external deficit increased still more, largely because the Federal Government and other public authorities, in line with recommendations previously made by the National Bank, reduced their long-term borrowing from abroad. Within the context of these developments, budget policy played a stabilising rôle. As a result of cuts in various expenditure appropriations, the deficit in the internally-effective budget (i.e. excluding debt redemption and net foreign transactions) was reduced from Sch. 1.7 milliard in 1964 to Sch. 0.5 milliard in 1965.

In the circumstances the monetary authorities saw no reason to impede the expansion of credit. On the one hand they regarded the price rises as partly due to special factors and the growth of demand as not excessive, while on the other they wished to facilitate the economy's shift from foreign to domestic sources of credit. Hence, with interest rates rising abroad, the National Bank kept its discount rate unchanged and in April 1965 requested the banks to reduce their rate on advances by ½ per cent. to 8 per cent. In October, moreover, the central bank eased its terms for advances against security.

As a result, and despite the slower rate of economic expansion, the loans of the credit institutions went up markedly last year — by Sch. 14.8 milliard, or almost 19 per cent., compared with rises of 17 per cent. in 1964 and 11½ per cent. in 1963. Their deposits, however, with a growth of Sch. 12.6 milliard, increased by about 14 per cent., the same rate as in the previous year. The monetary authorities, while refraining from action to reinforce the effects of contractive market forces on bank liquidity, did allow these forces to have full play. In consequence, the banks' total liquidity, after rising by Sch. 4.7 milliard in 1964, increased last year by only Sch. 1.0 milliard, and their liquid assets/deposits ratio dropped, largely in consequence of a decline of Sch. 1.1 milliard in their deposits with the National Bank, from 39.5 to 35.7 per cent. Over the same period, moreover, the credit institutions increased their borrowing from the central bank from about Sch. 360 million to nearly Sch. 1.5 milliard. In the summer of 1965, upon the expiry of an arrangement that had obliged certain banks to hold foreign assets to the extent of some Sch. 1.4 milliard, the National Bank took action to prevent the reflux of funds from offsetting the contractive effects of the external deficit. Minimum reserve requirements were increased by half a percentage point to absorb Sch. 400 million, while the sale of money-market paper, to be held by the banks for a year, took up another Sch. 1 milliard.

Although the demand outlook is broadly favourable, rising prices and wages have continued to be a problem. Following the resignation of the government after failure to reach agreement on the 1966 budget, a provisional budget was subsequently adopted for the first six months of 1966. While it provides that 1965 appropriations should serve as a guide for expenditure, it tends in fact, by way of limitations on borrowing, to reduce investment outlays. For the year as a whole the new government aims to achieve a balanced budget.

Spain. While continuing its rapid growth, the Spanish economy was subjected to mounting strains in 1965, emanating from both the public and the private sector. The fast expansion of demand, linked partly with wage adjustments, led to a further substantial rise in prices and a sharp acceleration in imports, particularly of manufactured goods and foodstuffs. Although tourism receipts and emigrants' remittances recorded further sizable gains, this was not enough to offset the larger trade deficit and a reduction in the inflow of long-term capital, with the result that the external reserves declined from early 1965 onwards. At the same time, however, the external deficit brought the banks increasingly under liquidity pressure, leading late in 1965 and early this year to a certain slowing-down in the high rate of expansion of bank credit.

In 1965 total lending (including security purchases) by all credit institutions to the private sector increased by over Pesetas 125 milliard, or 24 per cent., after a rise of 21 per cent. in 1964. Their lending to the public sector, going up by Pesetas 37 milliard, showed a rise of almost 19 per cent., compared with one of 17 per cent. in the preceding year. On the other hand, reflecting the shift from external surplus to deficit, the expansion of total bank deposits decelerated somewhat, registering a rise of 20 per cent. after one of almost 24 per cent. in 1964. Thus, in speeding up their lending the banks had greatly to increase their recourse to the Bank of Spain, where their net indebtedness rose over the year from Pesetas 15.4 to 41.2 milliard. In November 1965, in an attempt to discourage such borrowing, the central bank raised its rates on secured advances by ½ per cent.

Public-sector developments, far from mitigating the boom, were themselves expansionary. The central government's cash deficit, which averaged Pesetas 1.5 milliard in the years 1960–63, rose to Pesetas 18.7 milliard in 1964 and to Pesetas 33.3 milliard in 1965. This deterioration, it would appear, is attributable less to investment under the government's four-year plan than to increases in consumption expenditure, including wages and social benefits. In covering its financing requirement last year, the government raised Pesetas 5.7 milliard through the increase in the currency circulation and direct borrowing from the central bank and Pesetas 27.5 milliard through security issues, which were taken up mostly by the credit institutions.

Bond and share issues amounted in 1965 to Pesetas 97.3 milliard, as against Pesetas 63.4 milliard in 1964 and Pesetas 53.6 milliard in 1963. The private sector, whose share of the total dropped from 74 per cent. in 1963 to 62 per cent. in 1965, shifted more towards the issue of equities last year. The credit institutions, increasing their holdings of private as well as public securities, acquired well over 40 per cent. of all issues in 1965.

In order to quell the inflationary trend, the government is reported to have taken several measures towards the end of 1965. As regards the budget, it was laid down that expenditure on major items in the first quarter of 1966 should not exceed that authorised for the corresponding period of 1965, and that no contract for work or supplies should be entered into if the cost were to exceed that in the same period of the preceding year. Moreover, the average wage level should not be allowed to rise by more than 8 per cent. over the year. Finally, lending by the commercial and savings banks to the private sector was not to be increased by more than 17 per cent. during 1966. In March 1966 the Bank of Spain also twice increased the rate on its secured advances by ½ per cent. Although it is too early to assess their full effects, these measures appear to have contributed to a lessening of pressures in recent months.

Denmark. Aggregate demand, which had accelerated sharply in 1964 under the impulse of heavy investment outlays, continued to rise rapidly until the summer of 1965, thereafter advancing more slowly. In consequence, the external current-account deficit, which had emerged in 1964 as the economy ran up against capacity limits, remained large in the first half of 1965 but then became smaller. A new complication last year, stemming from the labour-market situation and cost-of-living adjustments, was a rise in private incomes of close on 15 per cent., which in turn contributed to a marked upsurge in prices. Impinging also on public-sector budgets, rising prices and wages, together with improved social benefits, led to a big increase in public expenditure. In the spring of 1965 the government raised corporate taxes and the general turnover tax, as well as various excises and charges, but legislative delays prevented the implementation of its proposed new value-added tax. It also acted to slow down its own construction programme and those of the municipalities. On balance, however, the government's cash surplus declined from over D.kr. 1.1 milliard in the fiscal year to March 1965 to less than D.kr. 0.6 milliard last year.

Against this background, monetary policy was further tightened in 1965. Already in June 1964 the Nationalbank's discount rate had been raised from 5½ to 6½ per cent., and in August a penal rate, 6 per cent. above the discount rate, was introduced for central-bank credit beyond certain limits. In October long-term borrowing abroad by public bodies was restricted. Subsequently, however, with the credit expansion, fuelled partly by an increase in the banks' foreign liabilities, continuing unabated, the Nationalbank found it necessary, in February and March 1965, to enter into voluntary credit agreements with the banks. Accordingly, the banks undertook to deposit with the Nationalbank or abroad 20 per cent. of the increase in their customers' deposits and the full equivalent of any increase in their foreign liabilities.

The effectiveness of these steps is clearly seen in the behaviour of the banks' lending activity relative to their deposits. The expansion of total deposits with the commercial and major savings banks declined only slightly, from 11 per cent. in 1964 to 10 per cent. in 1965, reflecting among other things the smaller sterilisation of funds with the Nationalbank via the central government's cash surplus. These banks' total loans, however, rose by only 9 per cent., as against 15 per cent. in 1964, and their investments in securities increased hardly at all. Thus, the early 1965 measures induced the banks to curtail their lending and improve their liquidity position, notably by cutting back their net foreign liabilities from D.kr. 730 to 135 million over the year. This reduction, which followed an expansion of D.kr. 350 million in 1964, was facilitated partly by the banks' increased borrowing from the Nationalbank and by the latter's open-market purchases of longer-term securities.

On the capital market, reacting to the heavy demand for mortgage funds, interest rates moved up by the spring of 1965 to peaks ranging from almost 9 to well over 10 per cent. In order to ease market pressures, the National-bank in June entered into a credit agreement with the mortgage institutions, under which they were to limit the expansion in different categories of lending to fixed proportions (e.g. 110 per cent. for house-building) of the increase in the year up to March 1965. Because of prior lending commitments, these institutions did not immediately cut back their new issues, and the National-bank had over the year as a whole to cushion the market with large purchases of bonds. Altogether, new bond and share issues amounted in 1965 to D.kr. 5.1 milliard, as against D.kr. 3.7 milliard in 1964, with the National-bank's purchases rising to almost D.kr. 1.4 milliard from D.kr. 0.4 milliard in the preceding year.

Although demand pressures lessened a little after the middle of 1965, wages and prices continued to rise. As a contribution to domestic stability, and also to take some of the load off monetary policy, the government has sought to strengthen its budget position. In February 1966 the taxes on alcoholic beverages and tobacco were raised, which will help to bring the cash surplus for 1966–67 up to about D.kr. 800 million. Early in 1966, moreover, the bond market eased somewhat, thanks to the growing effectiveness of the June agreement, and the mortgage institutions were permitted from April onwards to work to slightly higher credit ceilings.

Norway. With demand remaining strong, particularly investment and public-sector expenditure, productive capacity continued to be fully utilised in 1965. However, price pressures eased somewhat and, leaving out of account larger ship imports, the external current deficit also diminished.

As economic policy for 1965, apart from stimulating house-building, gave priority to public services, government expenditure was budgeted 16 per cent. higher than in 1964. Thus, although indirect taxation had been raised in December 1964, the 1965 budget yielded the smallest surplus (before loan transactions) for many years. To provide scope for this policy, non-residential construction was treated more restrictively, while monetary restraint was tightened further by new rules regarding borrowing from the central bank and by fixing the ceiling for bank credit expansion below the actual growth rate in 1964. In practice, although the expansion of the banking sector's loans and advances slowed down from 8.1 per cent. in 1964 to 6.6 per cent. in 1965, it slightly exceeded the 5½–6 per cent. limit for last year. As a result of the government's overall cash deficit and — thanks to capital inflows — an increase in the official exchange reserves, the money supply and bank liquidity both increased appreciably.

For 1966 the budget is somewhat better adjusted to economic conditions. Although expenditure is to go up by 6½ per cent., the budget surplus (before loan transactions) is to be increased. However, the government's financial requirements will come down only by some N.kr. 50 million to roughly

N.kr. 1.3 milliard. About N.kr. 800 million of this will be covered by government loans on the domestic market, while non-state bond issues are to be limited to N.kr. 1.0 milliard. As regards monetary policy, legislation adopted in June 1965 gave new instruments to the authorities. As a result, the previous system of guiding principles for lending, jointly agreed to by the banks, is this year replaced by central-bank recommendations and government decrees based on them. The provisions for 1966 include the recommendation that bank credits to the private sector should not increase by more than 6–7 per cent., and the banks have been asked to reduce their foreign borrowing. It has also been decreed that with effect from January 1966 the banks should hold minimum reserves, which have been fixed at 5 per cent. for commercial banks and, depending on their size, at 10 or 13 per cent. for savings banks. In addition, an agreement has been reached with institutional investors regarding their purchases of government and other bonds. Moreover, the authorities have indicated that the present level of interest rates, ranging from 5 per cent. (for first mortgages) to 6 per cent. (for banks' cash credits), is to be maintained and have stated that bond issues with interest rates other than those specified will not be approved.

Sweden. With domestic demand continuing to expand rapidly as productive margins narrowed, and with exports rising much more slowly, a sizable external current-account deficit emerged in 1965. Moreover, whereas the upswing in demand since early 1963 had previously been led by exports, public expenditure and housing, in 1965 plant and equipment outlays began to accelerate after several years of relative stagnation. In these circumstances both fiscal and monetary policy aimed at moderating demand while facilitating the shift in the composition of investment towards productive industrial outlays.

In the public sector policy became more restrictive at both the central and local levels of government. The central government's cash budget, after having fallen into deficit in 1964, was brought back into surplus by the middle of 1965. This was due largely to a spacing-out of government investment and an increase in the general sales tax from just over 6 to 10 per cent. (partly compensated by a reduction in income taxes). In addition, local authorities' access to the new issues market was restricted and they were asked, if their revenue/expenditure ratio was below average, to raise their tax rates. Despite these measures, public-sector consumption expenditure and local-authority gross investment (excluding housing) each rose in money terms by 14.5 per cent. in 1965, compared with a 3½ per cent. increase in the real gross domestic product.

Bank liquidity came under considerable pressure during 1965. The basic external deficit of about S.kr. 1.0 milliard was largely offset by an inflow of short-term capital associated with domestic credit scarcity. None the less, the external drain on liquidity, which amounted to S.kr. 167 million, represented a big change from 1964, when the foreign exchange inflow had augmented liquidity by S.kr. 838 million. Moreover, the central government's budget surplus caused a decline in bank liquidity of S.kr. 245 million, as against a deficit-induced liquidity accrual of over S.kr. 260 million in 1964. In view of these changes, the monetary restraint imposed by the government through its borrowing outside the banking system declined, from S.kr. 654 million in 1964 to S.kr. 183 million in 1965. Taking these and other factors into account, bank liquidity went down by S.kr. 478 million in 1965 after having increased by S.kr. 651 million in 1964. There was, in consequence, a S.kr. 756 million reduction in the commercial banks' holdings of Treasury bills — which were taken up mostly by the Riksbank — and a big increase in their direct borrowing from the central bank. In April 1965, for the fourth time during the present expansionary phase, the Riksbank's discount rate was raised by ½ per cent., to 5½ per cent., and at the same time the penalty rate for borrowing beyond certain limits was increased from 10 to 11 per cent.

The progressive squeeze on liquidity resulted in a marked deceleration in the commercial banks' total lending, which expanded in 1965 by S.kr. 2.2 milliard, as against S.kr. 2.9 milliard in 1964. However, by reducing their liquid claims, mainly those against the government, the banks were able in response to strong credit demand to speed up their lending to the private sector (excluding housing), which rose by over S.kr. 1.8 milliard, thus exceeding the 1964 figure by more than one-quarter. The expansion of credits to the housing sector, on the other hand, fell off by 4 per cent. to S.kr. 1.2 milliard. Indirectly this was because the authorities acted last year to slow down the granting of new issue permits to mortgage institutions, thus making the banks reluctant to add to their already large volume of building credits, which otherwise would have been partially consolidated.

The total extension of credit via the organised financial markets, including commercial-bank lending, rose in 1965 by S.kr. 10.3 milliard, compared with S.kr. 9.2 and 8.5 milliard in 1964 and 1963 respectively. The proportion of credits channelled through the capital market (including loans from institutional investors) came in 1965 to about 80 per cent., i.e. the same figure as in the preceding year. However, as bond and share issues were subject to control, institutional investors turned more to direct loans, which, at S.kr. 3.9 milliard, were 43 per cent. greater than in 1964. The policy aim to favour productive investment is reflected in lending to the various sectors. Thus, the expansion of credit to the public sector and housing declined from S.kr. 6.1 milliard in 1964 to S.kr. 5.8 milliard in 1965, while the rise in credit to the business and household sectors increased from S.kr. 3.1 to 4.4 milliard.

Although so far in 1966 local-authority investment and residential construction have further slackened, the economy continues to be marked by a high pressure of demand. One aggravating factor in this development has proved to be the introduction, as from January 1966, of a cut in income taxation which had been proposed in the 1965–66 budget. This reduction, the aim of which was to provide a certain delayed compensation for the increase in the general sales tax in the previous July, will be equivalent to

S.kr. 1.2 milliard for 1966 as a whole. Because of subsequent developments, however, the government found it necessary early in 1966 to raise excise taxes on cars and petrol, and it envisages further increases in indirect taxes in the 1966–67 budget. None the less, with expenditure estimated to increase by about 5½ per cent., the new budget is expected to shift over to a deficit of S.kr. 209 million. A further obstacle to equilibrium must be seen in negotiated wage agreements, which provide for an increase in the wage bill by about 8½ per cent. in 1966 and for similar increases over the two succeeding years. In the spring of 1966, in order to facilitate the conversion of building credits, the Riksbank authorised the issue of S.kr. 500 million of mortgage bonds, but at the same time it concluded an agreement with the commercial banks designed to limit the extension of new credits. In addition, the government scaled down certain of its building plans and made all "inessential" building subject to a special licensing procedure.

Finland. In the earlier part of 1965 economic developments were strongly conditioned by the events of 1964, when an admixture of demand and cost inflation had led to a 10 per cent. rise in prices, an almost 25 per cent. increase in imports and a sharp deterioration in the external current account. After the turn of the year aggregate demand remained strong, while capital inflows dropped off, with the result that the external deficit widened further and the official exchange reserves recorded big losses.

With revenue lagging behind government expenditure, another budget deficit emerged and state borrowing again assumed considerable proportions. However, as a selective curb on imports of motor-cars, the excise duty on liquid fuels was raised in January, while in June the import tax on motor-cars was adjusted so as to increase their market prices by 5–15 per cent. In addition, hire-purchase terms for cars — already tightened in November 1964 — and for some other durables were made more restrictive in April. In May the monetary authorities, while relaxing the limitations on rediscounts with the central bank, instructed the banks not to increase their advances in the period January–October 1965 by more than 9 per cent. of the amount outstanding at the end of 1964. Subsequently, in September 1965 the banks were requested to limit their lending so that outstanding credits in April 1966 should not exceed 113 per cent. of the base period figure. In addition, while the discount rate was kept unchanged at 7 per cent., a reduced rate of 6 per cent. was applied as from November for banks observing their lending limits. As a further step, banks were allowed to raise their interest rates so as to discriminate against import and consumer credits.

The expansion of bank credit slowed down from 13½ per cent. in 1964 to 11½ per cent. in 1965. The banks remained well within the prescribed lending limits, although this outcome must be attributed partly to last year's sharp decline in bank liquidity, due in particular to a fall of F.mk. 200 million (about 20 per cent.) in official foreign exchange reserves. In consequence, the banks turned increasingly to credit from the central bank, which rose by F.mk. 238 million to stand at F.mk. 620 million at the end of the year.

After the middle of 1965 domestic demand slackened and prices showed greater stability. However, although the reserve loss was stopped for a time, there were no strong signs of external recovery. In November exchange allowances for travel were cut and in January 1966 limitations were placed on imports of passenger cars. In April 1966 monetary policy was tightened further when the authorities requested that bank credits should not rise by the end of October 1966 to more than 115 per cent. of their end-1964 level. Budget proposals for 1966, however, again provide for a substantial deficit, while wage increases, apart from possible index adjustments, are scheduled to amount to about 5½ per cent. in 1966 and even more in 1967 and 1968.

Japan. Between late 1964 and the middle of 1965, with the external payments position showing strength while the domestic economy faced deepening recessionary tendencies, the authorities progressively removed the monetary restraints that had been imposed about a year earlier. The Bank of Japan's discount rate was lowered in January, April and June 1965, by 0.365 per cent. each time, bringing it down to 5.48 per cent. In addition, the banks' reserve requirements were reduced in December 1964 and again in July 1965, while the ceiling on the permissible rate of bank credit expansion was eased in early 1965 and then suspended altogether by the middle of the year.

The relaxation of monetary policy was not quickly followed by a renewed upswing in economic activity. The principal reason is to be found in the behaviour of investment in plant and equipment, which for the year to March 1966 was about 7 per cent. below the previous year's level. In some industries the decline appears to have been the virtually inevitable result of the high rate of investment over many years, which ultimately led to an over-extension of capacity. However, like certain western European countries, Japan has also been increasingly faced with specific labour shortages and rising costs, and these have adversely affected the profitability of investment.

At all events, the stagnant trend of demand, reflected in the involuntary accumulation of finished-goods inventories and a number of business failures, led the authorities to move towards a more flexible use of fiscal policy. For the first half of the year, however, fiscal developments remained such as to aggravate the weakening of demand. For earlier, while trying to adhere to the principle of a balanced budget at a time when revenue was losing its buoyancy, the government had taken action which caused budgetary disbursements to be delayed, especially in the period from April to September 1965. But during the summer the government decided that the economy needed the stimulus of larger public expenditure, to be financed as far as necessary by the flotation of government bonds. For the fiscal year to March 1966 original plans called for the issuing of bonds to an amount of Yen 200 milliard ($0.6 milliard), of which a first loan of Yen 70 milliard was floated in January 1966. The public was offered 10 per cent. of the bonds, while the rest was to be taken up by the banks and institutional investors. In the same month the government presented its 1966–67 budget, which aims further to stimulate the economy. The General Account budget provides for an 18 per cent. increase, and the Treasury expects to issue in 1966–67 government bonds to a total of Yen 730 milliard, to be used exclusively to finance public works.

Bank credit in 1965 rose by 14.2 per cent., compared with 15.6 per cent. in 1964 and 26.7 per cent. in 1963. The growth of bank deposits, on the other hand, accelerated from 14.3 per cent. in 1964 to 17.4 per cent. in 1965. Demand for credit remained fairly subdued throughout the year, while the relatively faster growth of deposits was ascribable mainly to the private sector's strong demand for liquidity. Accordingly, the banks' liquidity position improved during the year, and the Bank of Japan absorbed their surplus funds through its selling operations, though the Bank increased its loans towards the end of the year. As far as the public is concerned, there was a marked rise in bank deposits and a decline in holdings of shares. Net security issues other than shares rose substantially, and the greater part of them was purchased by the banks and institutional investors. Share issues fell off sharply, from Yen 860 milliard in 1964 to about Yen 277 milliard in 1965. However, share prices made a good recovery late in 1965 and early in 1966, thereby enabling the monetary authorities to arrange for the resale of some of the shares previously bought to support the market.

II. WORLD TRADE AND PAYMENTS.

The expansion of world trade, which has steadily accelerated in recent years, slowed down somewhat in 1965. A principal factor in the slower rate of expansion has been the shift in the impetus of the industrialised world's economic growth away from western Europe towards North America, where the ratio of imports to the national product is much lower. World exports, measured in current values, rose by 8 per cent., against 13 per cent. in the previous year. Owing to a prolonged dock strike in US ports, world exports in the first quarter of 1965 were only 5 per cent. higher than in the corresponding quarter of 1964. The increase in the remaining three quarters of the year, however, averaged 10 per cent., although the pace slackened slightly towards the end of the year.

The rise in the value of international trade in 1965 was attributable almost entirely to an expansion in volume. For the world as a whole the volume of exports went up by 7 per cent., those of developed countries increasing by 8 per cent. and those of developing areas by a little less than

International trade.

Areas	Exports			Imports			Changes in volume of	
							exports	imports
	1963	1964	1965	1963	1964	1965	1964–65	
	in milliards of US dollars						in percentages	
Developed areas								
Western Europe								
EEC	37.5	42.6	47.9	40.4	44.9	49.0	+ *11.8*	+ 7.2
EFTA	22.2	24.4	26.6	26.4	30.7	32.2	+ *5.6*	+ *4.3*
Other countries	4.0	4.6	5.0	6.7	7.6	8.8	+ *7.0*[1]	+ *14.5*[1]
Total for western Europe	63.7	71.6	79.5	73.5	83.2	90.0	+ *9.8*	+ *6.6*
United States	23.4	26.6	27.4	18.6	20.3	23.2	+ *0.7*	+ *13.4*
Canada	6.8	8.1	8.5	6.6	7.6	8.7	+ *3.2*	+ *13.6*
Japan	5.5	6.7	8.5	6.7	7.9	8.2	+ *24.8*	+ *1.1*
Other areas[2]	5.1	5.6	5.5	5.6	6.6	7.5	+ *8.6*	+ *15.3*
Total for developed areas	104.5	118.6	129.4	111.0	125.6	137.6	+ *8.1*	+ *8.2*
Developing areas								
Latin America	9.2	9.9	10.4	7.8	8.6	8.7	+ *6.4*[1]	+ *3.8*[1]
Other areas	21.1	23.3	24.8	23.8	25.8	27.0	+ *5.4*[1]	+ *6.3*[1]
Total for developing areas	30.3	33.2	35.2	31.6	34.4	35.7	+ 5.7	+ 5.6
Grand total[3]	134.8	151.8	164.6	142.6	160.0	173.3	+ *7.1*	+ *7.6*

[1] Estimates. [2] Australia, New Zealand and South Africa. [3] Represents roughly 90 per cent. of world trade, as the trade of centrally-planned economies is not included except in so far as it is reflected in the imports and exports of their partners in the West.

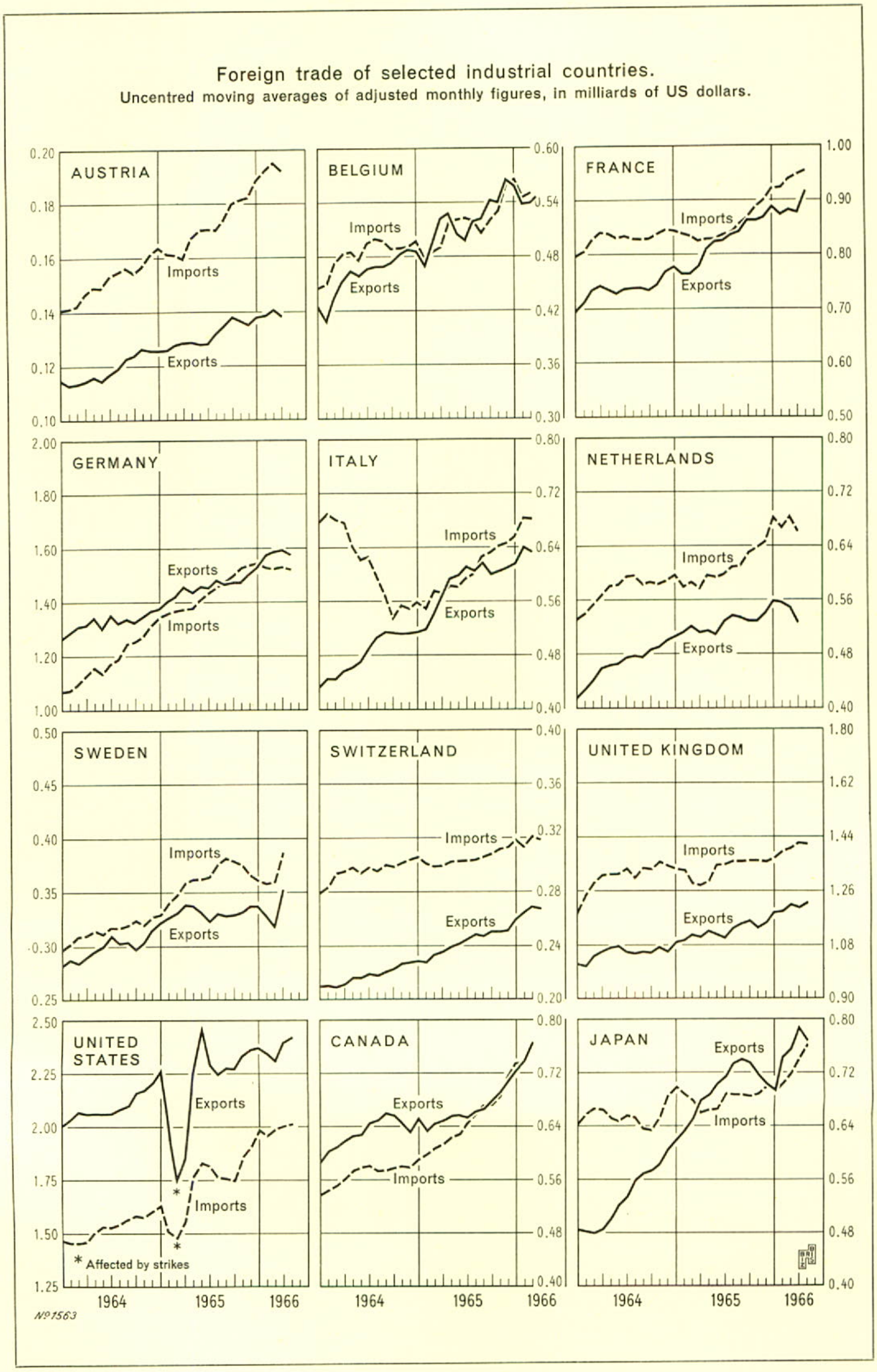
6 per cent. Imports also grew more quickly in the developed countries than in the rest of the world.

Over the last three years the terms of trade have remained stable in both the developed and the developing parts of the world, unit values of both imports and exports having risen by about 1 per cent. annually. This overall stability, however, conceals widely divergent movements. Thus, in 1965 prices of primary products declined by 5 per cent., reflecting a 13 per cent. fall in prices of foodstuffs, headed by cocoa and sugar. On the other hand, prices of non-ferrous metals, led by tin, went up by 20 per cent., against 27 per cent. in 1964. Depending on the composition of their exports, the individual developing countries were affected to a greater or lesser extent by these price changes. Among developed countries the United States, Canada and the EFTA group improved their terms of trade by 2 per cent. in 1965, as export prices rose more than import prices. There was no change in those of the EEC countries. Japan's showed a slight deterioration, while those of Australia, New Zealand and South Africa, taken together, worsened by 8 per cent. because of a sharp fall in wool prices and, in South Africa, also low export prices for foodstuffs and cattle.

In terms of value, exports in 1965 rose more than imports in the EEC and EFTA groups and in Japan. In the United States and Canada the reverse situation caused an appreciable deterioration in the balance of trade. In the group comprising Australia, New Zealand and South Africa exports actually declined, while imports rose substantially. For developing countries as a whole the balance of trade improved.

Trade between EEC countries increased by 13 per cent., compared with 15 per cent. in 1964. In the Belgium-Luxemburg Economic Union, France and the Netherlands exports to the Community rose more than imports from it. In Italy imports from other EEC countries actually fell by 3 per cent., whereas its exports to them went up by 28 per cent. Thus, for the first time since 1958, Italy achieved an export surplus vis-à-vis the Community, amounting to $600 million. In Germany, on the other hand, trade with other EEC countries resulted in a deficit of $355 million owing to a rise in imports of 31 per cent. (47 per cent. in imports from Italy), against an increase in exports of only 7 per cent., the smallest annual rise since 1958. EEC exports to third countries again increased by 12 per cent., Italy and the BLEU recording the fastest advances. Imports rose by 6 per cent. — slightly less than in 1964 — most of which was accounted for by Germany. In all, the EEC trade deficit vis-à-vis third countries was reduced from $2.7 to 1.5 milliard.

The EFTA countries' imports rose by only 5 per cent., against 16 per cent. in 1964; exports again increased by nearly 10 per cent. Two distinct tendencies were apparent. In the United Kingdom, which accounts for half the trade turnover, and in Switzerland, whose imports had soared in 1964, the rise in imports slowed down considerably last year in response to policy measures. As at the same time exports accelerated, the trade deficit was cut


Foreign trade of selected industrial countries.
Uncentred moving averages of adjusted monthly figures, in milliards of US dollars.
AUSTRIA
Imports
Exports
BELGIUM
Imports
Exports
FRANCE
Imports
Exports
GERMANY
Exports
Imports
ITALY
Imports
Exports
NETHERLANDS
Imports
Exports
SWEDEN
Imports
Exports
SWITZERLAND
Imports
Exports
UNITED KINGDOM
Imports
Exports
UNITED STATES
Exports
Imports
* Affected by strikes
CANADA
Exports
Imports
JAPAN
Exports
Imports
1964
1965
1966
Nº 1563

by $755 million in the United Kingdom (on a balance-of-payments basis) and by $235 million in Switzerland. In the other five countries, by contrast, the trade deficits widened in 1965.

During recent months there have been some significant changes in the foreign trade of the main industrial countries. In France exports have moved up sharply again and the trade gap, which had been widening since last autumn, has narrowed in spite of a further rise in imports. In Germany exports have soared again, while imports have tended to level off. In Austria, Italy, the Netherlands and Switzerland both imports and exports have lately turned downwards, while in Sweden there has been a sharp upsurge. UK imports, after having remained stable during the greater part of 1965, have resumed climbing.

Canadian imports went up very fast in the course of 1965. As exports gathered speed in the second half of the year, the balance was practically in equilibrium. During the greater part of last year US trade fluctuated substantially. With imports rising sharply towards the end of 1965, the export surplus contracted and continued to do so in early 1966, when exports declined. In March, however, they picked up again. In Japan the mounting trend of exports was reversed last autumn, but it swung sharply round again in 1966, so that despite rising imports the trade balance continued to show a surplus.

The general pattern of world payments can be seen in the table showing the world balance of payments for the last three years. In 1965 the US current surplus declined by $1.5 milliard; one-third of the corresponding improvement in other countries occurred in western Europe and the remainder in the rest of the world. The US capital outflow diminished by $1.6 milliard but this occurred entirely at the expense of western Europe. Whereas on current account western Europe improved its position by $0.5 milliard — its deficit being reduced from $1.9 to 1.4 milliard — its net capital receipts declined by $1.6 milliard as a result of the US measures, although, at $1.9 milliard, they were still substantial and allowed an increase of $0.5 milliard in reserves.

The rest of the world was able to reduce its current deficit by $1 milliard owing to a cut of $0.7 milliard in its deficit vis-à-vis the United States and to the emergence of a $300 million surplus in its accounts with western Europe, which had been in equilibrium in 1964.

The improvement in the current balance of the rest of the world was entirely attributable to developing countries, whose deficit fell by $1.7 milliard to just under $1 milliard. The five developed countries, viz. Australia, Canada, Japan, New Zealand and South Africa, increased their combined deficit by $0.7 milliard; Japan was the only one that improved its position. The net capital flow to the rest of the world totalled $3.5 milliard, about the same as in the previous year. Whereas the five developed countries obtained $50 million more, the developing countries received $150 million less.

World balance of payments.[1]

	United States	Western Europe	Rest of the world
	Balance of		
	in milliards of US dollars		
1963			
Current account with United States	—	— 1.2	— 2.0
western Europe	+ 1.2	—	— 0.3
rest of the world	+ 2.0	+ 0.3	—
Total current account[2]	+ 3.2	— 0.9	— 2.3
Capital account, errors and omissions	— 5.3	+ 2.6	+ 3.1
Overall balance, corresponding to change in official gold and foreign exchange holdings and net IMF position	— 2.1	+ 1.7	+ 0.8
Monetary gold sales	—	—	+ 0.8
1964			
Current account with United States	—	— 1.9	— 3.9
western Europe	+ 1.9	—	0
rest of the world	+ 3.9	0	—
Total current account[2]	+ 5.8	— 1.9	— 3.9
Capital account, errors and omissions	— 7.0	+ 3.5	+ 3.6
Overall balance, corresponding to change in official gold and foreign exchange holdings and net IMF and GAB position	— 1.2	+ 1.6	— 0.3
Monetary gold sales	—	—	+ 0.8
1965			
Current account with United States	—	— 1.1	— 3.2
western Europe	+ 1.1	—	+ 0.3
rest of the world	+ 3.2	— 0.3	—
Total current account[2]	+ 4.3	— 1.4	— 2.9
Capital account, errors and omissions	— 5.4	+ 1.9	+ 3.5
Overall balance, corresponding to change in official gold and foreign exchange holdings and net IMF and GAB position	— 1.1	+ 0.5	+ 0.6
Monetary gold sales	—	—	+ 0.2

[1] The overall balances for the different areas correspond to the changes in countries' official gold and exchange holdings and in their net IMF and GAB positions. They are affected by differences in statistical presentation and by movements of official dollar reserves into or out of the Euro-dollar market. Reserves of the USSR, other eastern European countries, mainland China and North Korea are excluded. US reserves are shown net of short-term dollar liabilities to foreign authorities and of foreign official holdings of non-marketable US Government bonds and notes. UK reserves are shown net of sterling liabilities to overseas monetary authorities. If the overall balance figures are added across, a positive net result is obtained. In the absence of inconsistencies in the statistics of exchange holdings, this figure would equal the rise in monetary gold stocks for the year in question. [2] Data for the current account include unilateral transfers.

Balances of payments.

United States. The US balance-of-payments position was strongly influenced in 1965 by two opposing developments. On the one hand, the private capital outflow contracted from $6.5 to 3.5 milliard following the introduction of the voluntary credit restraint programme. On the other hand, the trade surplus was reduced from $6.7 to 4.8 milliard. Thus the balance-of-payments deficit, as measured on a liquidity basis, declined from \$2.8 to 1.3 milliard; on an official settlements basis, however, there was virtually no improvement. In the first quarter of 1966 the deficit on a liquidity basis, seasonally adjusted, was running at an annual rate of \$2.3 milliard.

The deterioration in the trade balance in 1965 — which occurred almost entirely in commercial transactions — resulted from a much faster rise of imports than of exports. Merchandise exports, in fact, increased by only \$1.0 milliard, or 4 per cent.; they had risen by 14 per cent. in 1964 and by an annual average of 7 per cent. during the preceding ten years. The two main reasons for the falling-off were a slowing-down of foreign demand and the buoyancy of domestic demand. There had, moreover, been an acceleration of shipments at the end of 1964 in anticipation of the dock strike that occurred in early 1965. But even if allowance is made for this, exports weakened in the first half of 1965. In the second half of the year, however, there was a revival, and in the final quarter exports were 8 per cent. higher than a year before.

Reflecting the economic slow-down in western Europe and Japan, US exports to these areas advanced by only about 4 per cent. in each case, whereas in 1964 the rise had exceeded 10 per cent. Exports to the developing countries — which account for one-third of the US total — showed no increase, but those to Canada rose by 15 per cent. Agricultural exports declined slightly, chiefly because of smaller wheat shipments to the developing countries and to eastern Europe. Non-agricultural exports rose by \$1.1 milliard, or about 6 per cent., and those of manufactured products alone by 5.5 per cent.

Imports, by contrast, increased by \$2.9 milliard, or 15.5 per cent. — their highest growth rate since 1959. As in other years of exceptionally rapid expansion, such as 1959 and 1962, imports rose about twice as fast as the gross national product. Approximately 80 per cent. of the rise in 1965 was accounted for by manufactured goods. Leaving aside steel imports — which, because of an impending strike, rose by \$450 million — imports of industrial supplies increased by 12 per cent. Imports of consumer goods, including motor-cars, went up by 22 per cent., and those of capital equipment by as much as 41 per cent. Food imports showed very little advance. As regards sources of supply, US purchases from Japan increased by 38 per cent., those from western Europe and Canada by 20 and 15 per cent. respectively and those from the developing countries by only 7 per cent.

The surplus on non-military invisible items increased again, from \$3.1 to 3.3 milliard. Tourist expenditure continued to go up but this increase was more than offset by the rise in interest and dividend receipts, boosted by the growth in US foreign investment, high interest rates abroad and an unusually high rate of repatriation of earnings. A small decline was recorded in net military expenditure, but the Vietnam war makes it unlikely that this trend will continue.

Largely in response to the voluntary credit restraint programme introduced in February 1965, the outflow of private US capital declined by

United States: Balance of payments.

Items	1964	1965[1] Year	1965[1] 1st quarter	1965[1] 2nd quarter	1965[1] 3rd quarter	1965[1] 4th quarter	1966 1st quarter
	in millions of dollars						
Goods and services							
Exports (f.o.b.)							
Government-financed	+ 2,815	+ 2,715	+ 575	+ 745	+ 715	+ 680	.
Commercial	+ 22,475	+ 23,570	+ 5,050	+ 6,055	+ 6,115	+ 6,350	.
Total exports . . .	+ 25,290	+ 26,285	+ 5,625	+ 6,800	+ 6,830	+ 7,030	+ 7,115
Imports (f.o.b.)	— 18,620	— 21,490	— 4,660	— 5,480	— 5,595	— 5,755	— 6,010
Trade balance . . .	+ 6,670	+ 4,795	+ 965	+ 1,320	+ 1,235	+ 1,275	+ 1,105
Investment income, including fees and royalties	+ 4,810	+ 5,330	+ 1,390	+ 1,455	+ 1,335	+ 1,150	.
Military expenditure less receipts	— 2,060	— 2,025	— 490	— 475	— 520	— 540	.
Pensions and remittances	— 840	— 980	— 225	— 290	— 230	— 235	.
Other services	— 860	— 1,020	— 310	— 265	— 230	— 215	.
Total services . .	+ 1,050	+ 1,305	+ 365	+ 425	+ 355	+ 160	.
Balance on goods and services . .	+ 7,720	+ 6,100	+ 1,330	+ 1,745	+ 1,590	+ 1,435	.
Private capital movements							
US capital							
Long-term							
Direct investment .	— 2,375	— 3,265	— 1,160	— 890	— 515	— 700	.
Portfolio	— 680	— 720	— 210	— 15	— 290	— 205	.
Bank loans	— 940	— 215	— 485	+ 180	— 65	+ 155	.
Other	— 355	— 55	+ 15	— 5	— 5	— 60	.
Total long-term .	— 4,350	— 4,255	— 1,840	— 730	— 875	— 810	.
Short-term							
Banks	— 1,525	+ 310	+ 45	+ 185	+ 10	+ 70	.
Non-banks.	— 585	+ 420	+ 255	+ 230	+ 45	— 110	.
Total short-term .	— 2,110	+ 730	+ 300	+ 415	+ 55	— 40	.
Total private US capital . . .	— 6,460	— 3,525	— 1,540	— 315	— 820	— 850	.
Foreign non-liquid capital[2]							
Purchases of US corporate securities	— 85	— 425	+ 35	— 255	— 235	+ 30	+ 150
Other	+ 310	+ 375	+ 240	+ 10	+ 40	+ 85	.
Total foreign non-liquid capital . .	+ 225	— 50	+ 275	— 245	— 195	+ 115	.
Balance on private capital account.	— 6,235	— 3,575	— 1,265	— 560	— 1,015	— 735	.
Government grants and loans, net of repayments, and miscellaneous non-liquid capital transactions . .	— 3,120	— 3,165	— 715	— 845	— 775	— 830	.
Errors and omissions . .	— 1,165	— 660	— 10	— 80	— 315	— 255	.
Balance of payments (on a liquidity basis) .	— 2,800	— 1,300	— 660	+ 260	— 515	— 385	— 580
less: seasonal adjustment items	—	—	— 475	+ 70	+ 455	— 50	.
Balance of payments before seasonal adjustment . .	— 2,800	— 1,300	— 185	+ 190	— 970	— 335	.

[1] Quarterly figures are seasonally adjusted. [2] Foreign private and official investments in US private non-liquid instruments.

$2.9 milliard, or almost half. Practically the whole of the improvement occurred on short-term account, which switched from a net outflow of $2.1 milliard in 1964 to a net inflow of $0.7 milliard. To a certain extent the shift represented the repatriation of idle funds placed abroad for slightly higher yields, and it is likely that, under the present tight US credit conditions, some of these assets would have been drawn upon to finance longer-term investments even in the absence of the programme.

The government's directives to the banks and other financial institutions in February 1965 resulted in a sharp drop in foreign lending. As the year progressed the banks steadily reduced their claims on foreigners and hence enlarged the unused portion of their lending authority. At first this reflected primarily the desire to maintain some margin for future commitments. Towards the end of the year the banks seem to have shifted some of their lending from foreign to domestic borrowers. As a result the inflow of short and long-term funds reported by banks came to $0.1 milliard, against an outflow of $2.4 milliard in the preceding year: the $1.5 milliard outflow of short-term funds in 1964 was succeeded by a $0.3 milliard inflow, while the increase in long-term lending fell back from $0.9 to 0.2 milliard. This retrenchment continued in the early months of 1966, and by the end of March the banks' total claims on foreigners had been reduced by an additional $260 million and their "leeway" had increased to $715 million.

Long-term private capital exports, at $4.3 milliard, were almost as high as in 1964, despite the decline in bank loans. Direct investment, although within the scope of the voluntary restraint programme, increased from $2.4 to 3.3 milliard and was particularly substantial during the first quarter, when corporations accelerated their capital exports in anticipation of subsequent restrictions. The programme nevertheless has had some effect: some direct investment plans were pared down, while others were financed by substantial foreign borrowing at higher interest rates There was also a marked geographical shift that partly reflected the official priorities; new direct investment in Europe increased by only one-tenth, while that in Canada trebled and that in the oil-producing countries of Asia and Africa more than doubled. Nevertheless, the sharp rise in direct investment abroad was clearly at variance with official policy. In prolonging the guide-lines last December for a further year, the government set a target for the rise in the total of the direct-investment outflow plus retained earnings in developed and certain mineral-producing countries. This, together with the extension of the programme to 400 additional corporations, is aimed at achieving an improvement of almost $1 milliard.

There was little change last year in the outflow from US portfolio investment. New issues of foreign securities — virtually all tax-exempt, and predominantly Canadian — rose by nearly $150 million and would have gone up twice as much had the transfer of the proceeds of some Canadian issues not been postponed. The larger outflow on account of new issues was offset by increased net US sales of outstanding foreign securities. Foreign sales of long-term US corporate securities increased substantially in 1965 to $0.4 milliard. They represented primarily the liquefaction of the British Treasury's dollar security portfolio and were thus of a rather exceptional and non-recurring nature. Even so, there was a considerable improvement on private capital account, which was probably larger than that shown by recorded data, since the negative balance in respect of "errors and omissions" was reduced by $0.5 milliard.

Net grants and capital transactions of the US Government were virtually unchanged in 1965. Fresh assistance to developing countries remained, as in the last few years, fairly steady at around $4 milliard.

Canada. While the Canadian economy continued to expand vigorously in 1965, the balance of payments deteriorated. Since 1959, when it reached a peak of $1.4 milliard, the current deficit had declined fairly steadily, as exports had increased more rapidly than imports. Last year this trend was reversed under the impact of growing demand pressures on the domestic market and of a decline in wheat sales. The deficit vis-à-vis the United States widened and the traditional surplus in relation to overseas countries contracted sharply.

Imports increased by $1 milliard, or 15 per cent., the same rate as in 1964, with a spurt in the fourth quarter. Heavy purchases of industrial materials, investment goods, motor-cars and other durable consumer goods contrasted with smaller expenditure on foodstuffs due to the fall in the sugar price.

Exports went up by $455 million, or 6 per cent., compared with 16 per cent. in 1964. While sales to the United States and continental Europe expanded by 14 per cent., shipments to the United Kingdom and the rest of the world fell off slightly. Exports of non-ferrous metals showed one of the largest gains, increasing by $165 million. Automobile exports rose by about the same amount, partly as a result of a bilateral free-trade agreement concluded with the United States in January 1965. Sales of wheat and flour were some $160 million lower than in 1964, largely because of a decline in shipments to the USSR and eastern European countries. In August 1965 a new contract was concluded with the USSR, valued at $370 million; one-half was delivered in 1965.

The deficit on services increased by $95 million, mainly owing to larger interest and dividend payments, and the current-account deficit came to $1,050 million.

The inflow of long-term capital, at $560 million, was the lowest recorded in the past decade and $230 million smaller than in 1964. A rise in direct foreign investment in Canada was more than offset by a decline in portfolio investment and by withdrawals in respect of other transactions. Portfolio investment, the main source of capital, declined between 1964 and 1965 from $680 to 495 million. Foreign sales of outstanding Canadian securities rose

Canada: Balance of payments.

Items	1964	1965	1964 4th quarter	1965 1st quarter	1965 2nd quarter	1965 3rd quarter	1965 4th quarter
	in millions of US dollars						
Merchandise trade (f.o.b.)							
Exports	7,625	8,080	1,970	1,690	2,025	2,090	2,275
Imports	6,975	7,985	1,820	1,730	2,050	1,945	2,260
Trade balance	+ 650	+ 95	+ 150	— 40	— 25	+ 145	+ 15
Services							
Interest and dividends	— 615	— 680	— 175	— 160	— 155	— 150	— 215
Other	— 435	— 465	— 125	— 170	— 160	+ 15	— 150
Total	—1,050	—1,145	— 300	— 330	— 315	— 135	— 365
Current balance	— 400	—1,050	— 150	— 370	— 340	+ 10	— 350
Long-term capital							
Portfolio investment							
Net new Canadian issues	+ 710	+ 700	+ 425	+ 195	+ 120	+ 220	+ 165
Transactions in outstanding Canadian securities	— 20	— 165	— 15	— 75	— 60	+ 10	— 40
Foreign security transactions	— 10*	— 40*	— 10	— 35	— 5	— 20	+ 20*
Direct investment	+ 105	+ 255	+ 60	+ 35	+ 105	+ 45	+ 70
Other	+ 5	— 190	— 5	— 10	— 75	— 60	— 45
Total	+ 790	+ 560	+ 455	+ 110	+ 85	+ 195	+ 170
Balance on current and long-term capital account	+ 390	— 490	+ 305	— 260	— 255	+ 205	— 180
Short-term capital	+ 195	+ 230	+ 60	— 75	+ 85	+ 45	+ 175
Total balance (= changes in monetary items)	+ 585	— 260	+ 365	— 335	— 170	+ 250	— 5

* Including net receipts of $50 million in 1964 and $30 million in the fourth quarter of 1965 under the Columbia River Treaty.

from $20 to 165 million and Canadian purchases of foreign securities from $10 to 40 million. Net new issues of Canadian securities abroad, at $700 million, were about the same as in 1964. But for a decision in November 1965 to defer until 1966 delivery of the proceeds of certain Canadian issues placed in the United States late last year, net proceeds from new issues abroad would have been substantially higher than in 1964.

Net foreign direct investment in Canada, which had been declining for four consecutive years, turned upwards in 1965, increasing from $235 to 360 million. About four-fifths came from the United States and was not yet affected by the voluntary limitation of US direct investment; the remainder originated in overseas countries other than the United Kingdom. Canadian direct investment abroad declined from $130 to 105 million and was about equally divided between the United States and overseas countries other than the United Kingdom. The net figure for direct investment therefore rose from $105 to 255 million.

"Other" long-term capital movements, which had been about in balance in 1964, produced a net outflow of $190 million last year. The actual outflow corresponded roughly to the volume of new export credits granted. But the change in this item between the two years came from reductions in long-term bank loans, mortgage investments in Canada and movements in insurance funds.

The combined deficit on current and long-term capital account was $490 million, compared with a surplus of $390 million the year before. Short-term capital movements, excluding those of Canadian banks, covered $230 million of the deficit, so that monetary movements were negative to the extent of $260 million.

Western European countries. The combined current-account deficit of western European countries was reduced from $1.7 milliard in 1964 to $1.4 milliard last year. The surplus of the EEC countries nearly doubled, amounting to $715 million, while the deficit of the EFTA countries was reduced from $1.6 to 1 milliard. These improvements were partially offset by a worsening of $530 million in the balance of the six countries outside the EEC and EFTA groups.

The outstanding features of 1965 were the large Italian and French surpluses, the sharp contraction of the UK deficit and the emergence of substantial current deficits in Germany and Spain.

United Kingdom. Following a period in which emphasis was laid on economic growth, UK economic policy has, since the fourth quarter of 1964, had to be ruled increasingly by balance-of-payments considerations. In addition to the 15 per cent. import surcharge introduced in October 1964 (cut to 10 per cent. in the spring of 1965), the April 1965 budget increased taxes and was accompanied by specific measures to restrict the capital outflow and to facilitate export finance. When the balance of payments, after improving early in 1965, worsened during the second quarter, additional measures to restrain domestic demand and capital exports were introduced in July.

The payments deficit declined from $2,150 million in 1964 to $990 million last year, or from $2,090 to 700 million if unrecorded transactions are included. Although the pressure on resources has remained intense, the restraints on demand brought about a reduction in the current-account deficit from $1,135 to 380 million, while the exchange control measures contributed to the decline in the net long-term capital outflow from $1,015 to 610 million.

The improvement in the current-account balance resulted from a narrowing of the visible trade deficit from around $1,500 to 740 million. Merchandise exports went up by $860 million, while the surcharge held the rise in imports to only $105 million.

At 7 per cent., the increase in exports was quite satisfactory if compared with a yearly average of only about 4.5 per cent. over the previous ten years, but it was still markedly lower than the 10 per cent. increase for the rest of western Europe. In terms of volume the growth in exports amounted to 5 per cent. Although the relatively satisfactory performance of exports in 1965 may to some extent have been due to the tax rebate on exports (averaging

Western European countries: Balances of payments.

Countries	Years	Trade balance (f.o.b.)	Services[1]	Current balance	Net capital movements (inflow+)[2]		Overall balance[3]
					Long-term	Short-term	
		in millions of US dollars					
Belgium-Luxemburg. . .	1964	— 175	+ 175	— 0	+ 190	— 15	+ 175
	1965	— 35	+ 185	+ 150	— 15		+ 135
France	1964	— 90	+ 175	+ 85	+ 445	+ 265[4]	+ 795
	1965	+ 390	+ 130	+ 520	+ 290[5]	+ 330[4]	+ 1,140
Germany	1964	+ 2,415	— 2,295	+ 120	— 205	+ 180	+ 95
	1965	+ 1,275	— 2,830	— 1,555	+ 175	+ 1,100	— 280
Italy	1964	— 1,490[6]	+ 1,815	+ 325	+ 465	+ 10	+ 800
	1965	— 475[6]	+ 2,105	+ 1,630	— 40	— 15	+ 1,575
Netherlands	1964	— 765	+ 650	— 115	+ 90	+ 90	+ 65
	1965	— 670	+ 640	— 30	— 35	+ 35	— 30
Total EEC	1964	— 105	+ 520	+ 415	+ 985	+ 530	+ 1,930
	1965	+ 485	+ 230	+ 715	+ 1,825		+ 2,540
Austria.	1964	— 415[6]	+ 475	+ 60	+ 35		+ 95
	1965	— 500[6]	+ 490	— 10	— 50		— 60
Denmark	1964	— 215	+ 160	— 55	+ 170		+ 115
	1965	— 285	+ 175	— 110	+ 130		+ 20
Norway.	1964	— 705[6]	+ 630	— 75	+ 115		+ 40
	1965	— 775[6]	+ 675	— 100	+ 260		+ 160
Portugal	1964	— 185	+ 200	+ 15	+ 115	— 25	+ 105
	1965	— 305	+ 290	— 15	+ 80	+ 20	+ 85
Sweden	1964	— 180[6]	+ 160	— 20	+ 210		+ 190
	1965	— 405[6]	+ 115	— 290	+ 315		+ 25
Switzerland.	1964	— 945[6]	+ 535	— 410	+ 555		+ 145[7]
	1965	— 710[6]	+ 580	— 130	+ 190		+ 60[7]
United Kingdom	1964	— 1,495	+ 360	— 1,135	— 1,015	+ 60	— 2,090
	1965	— 740	+ 360	— 380	— 610	+ 290	— 700
Total EFTA . . .	1964	— 4,140	+ 2,520	— 1,620	+ 220		— 1,400
	1965	— 3,720	+ 2,685	— 1,035	+ 625		— 410
Finland	1964	— 220[6]	+ 45	— 175	+ 155	+ 60	+ 40
	1965	— 225[6]	+ 40	— 185	+ 35	+ 65	— 85
Greece	1964	— 575[6]	+ 375	— 200	+ 190	— 35	— 45
	1965	— 700[6]	+ 435	— 265	+ 205	+ 35	— 25
Iceland	1964	— 10	+ 0	— 10	+ 15		+ 5
	1965	— 10	+ 5	— 5	+ 10		+ 5
Ireland	1964	— 355[6]	+ 265	— 90	+ 105		+ 15
	1965	— 415[6]	+ 290	— 125	+ 75		— 50
Spain	1964	— 995	+ 1,055	+ 60	+ 265	+ 40	+ 365[7]
	1965	— 1,670	+ 1,280	— 390	+ 200	+ 85	— 105[7]
Turkey	1964	— 125[6]	+ 20	— 105	+ 120		+ 15[7]
	1965	— 110[6]	+ 30	— 80	+ 90		+ 10[7]
Grand total. . . .	1964	— 6,525	+ 4,800	— 1,725	+ 2,650		+ 925
	1965	— 6,365	+ 4,995	— 1,370	+ 3,250		+ 1,880

[1] Including unilateral transfers. [2] Calculated as the difference between the current balance and the overall balance. Long-term capital movements are shown separately where possible. Total figures or figures for short-term capital movements include errors and omissions. [3] Equal to changes in net official assets and the net position of commercial banks. [4] Including the balance of French overseas territories vis-à-vis the non-franc area. [5] Excluding official debt prepayments. [6] Imports c.i.f. [7] Net official assets only.

1.5 per cent.) introduced in October 1964 and to various improvements in export credits and guarantees contained in the policy packages of April and July 1965, the geographical break-down of the increase suggests that demand developments abroad were the most important factor. Thus exports to North America and Germany advanced by 18 and 15 per cent. respectively, whereas those to France, Italy and Japan declined. On balance, there was very little rise in exports to EEC countries, while those to both the EFTA and the sterling area went up by 7 per cent. As regards the commodity structure, exports of manufactures expanded by 8 per cent. in value and by 4.5 per cent. in volume, the large increase in the unit value index reflecting partly the buoyancy of metal prices. Machinery exports rose by 7.5 per cent. and exports of road vehicles by 5 per cent., while exceptionally large aircraft deliveries were the principal factor behind the 38 per cent. gain in exports of other transport equipment. Exports of metals were up 12 per cent. and of chemicals 6.5 per cent.

Imports, whose rapid expansion had already been broken by the middle of 1964, edged up by about 1 per cent. in terms both of value and of volume. The very large discrepancy between this figure and the 6 per cent. increase in gross domestic expenditure is explained mainly by the import surcharge, the lower level of stock-building, and the excellent 1964 harvest. Imports of food, beverages and tobacco declined by 3 per cent. and those of basic materials by 1 per cent. On the other hand, imports of fuels and non-ferrous metals went up by 6 and 12 per cent. respectively (the latter mainly as a result of higher prices). On balance, imports of goods not subject to the surcharge registered a slight rise. Imports subject to the surcharge, on the other hand, showed no change. Those of chemicals and finished manufactures went up by 12 and 5 per cent. respectively, whereas imports of semi-manufactures (excluding non-ferrous metals) contracted by 3 per cent. Within the group of finished manufactures, the effect of the surcharge was most clearly reflected in imports of consumer goods, which, despite the fact that consumption rose by 5 per cent. at current prices, declined by 11 per cent.; on the other hand, capital goods imports went up by 14 per cent.

The surplus on invisibles remained unchanged at \$360 million. In spite of the higher UK Bank rate, net capital earnings went up by \$135 million and there was a substantial increase in net receipts from transportation. These improvements were offset mainly by larger current official payments and by increases in travel expenditure.

At \$385 million, the net outflow of private long-term capital was \$305 million down on 1964, but still large by comparison with previous years. In the first quarter of 1965 the net outflow amounted to \$145 million, but it fell to \$60 million in the second quarter following the introduction of the restraint measures. In July the restrictions on capital movements were reinforced by a ban on direct investment outside the sterling area through the official exchange market and a further narrowing of the supply channels to the investment dollar market. Moreover, the Bank of England was asked to exercise tighter control over borrowing in the United Kingdom by non-

United Kingdom: Balance of payments.[1]

Items	1964	1965 Year	1965 1st quarter	1965 2nd quarter	1965 3rd quarter	1965 4th quarter
	in millions of US dollars					
Merchandise trade (f.o.b.)[2]						
Imports	14,015	14,120	3,375	3,550	3,600	3,595
Exports and re-exports	12,520	13,380	3,265	3,220	3,395	3,500
Trade balance	— 1,495	— 740	— 110	— 330	— 205	— 95
Services[2]	+ 360	+ 360	+ 60	+ 135	+ 50	+ 115
Current balance[2]	—	—	— 50	— 195	— 155	+ 20
Current balance before adjustment	— 1,135	— 380	— 105	— 15	— 330	+ 70
Long-term capital						
Official	— 325	— 225	— 40	— 30	— 70	— 85
Private						
UK	— 1,115	— 875	— 275	— 200	— 195	— 205
Foreign	+ 425	+ 490	+ 130	+ 140	+ 5	+ 215
Total	— 1,015	— 610	— 185	— 90	— 260	— 75
Balance on current and long-term capital account	— 2,150	— 990	— 290	— 105	— 590	— 5
Errors and omissions	+ 60	+ 290	— 5	+ 130	+ 15	+ 150
Total balance (= changes in monetary items)	— 2,090	— 700	— 295	+ 25	— 575	+ 145

[1] On a transactions basis. [2] Quarters seasonally adjusted.

resident-controlled companies registered there. Despite these measures, the net private capital outflow jumped to $190 million in the third quarter, but there was a small inflow in the fourth.

The effects of the restraints on long-term capital movements were most clearly reflected in UK portfolio investment abroad, which shifted from a $25 million outflow in 1964 to a $250 million inflow in 1965. Net foreign investment by oil companies, which had been swollen in 1964 by the Shell-Montecatini transaction, fell substantially. On the other hand, other net direct investment continued to increase.

Official long-term capital exports declined from $325 to 225 million. Net lending under the foreign aid programme was smaller, and there was in 1965 no counterpart to the $50 million Swiss loan repayment in 1964. As in 1964, the United Kingdom again availed itself of the right to defer the $85 million repayment on the post-war North American loans.

The improvement in the balance of payments in 1965 was progressive during the year. Thus, on a seasonally adjusted basis, the current-account deficit fell from $245 million in the first half of 1965 to $135 million in the second half. The increase in merchandise exports during the last quarter over the level a year earlier amounted to as much as 10 per cent. and, at $95 million, the visible trade deficit was 25 per cent. of that in the fourth quarter of 1964.

However, the available trade figures for the first quarter of 1966 do not seem to indicate a continuation of this trend. Exports, which, after stagnating during the first nine months of 1964, had picked up towards the end of that year and whose advance had accelerated in the second half of 1965, showed only a 1 per cent. increase in the first quarter of 1966. Imports, on the other hand, which had remained on a plateau during the last three quarters of 1965, expanded quite vigorously thereafter — by about 4 per cent. As a result, the trade deficit (on a seasonally adjusted basis) widened from $95 to 200 million in the first quarter of 1966, and, at $805 million on an annual basis, was slightly larger than the $740 million deficit in 1965.

Although the significance of figures for one quarter should not be overestimated, there can be little doubt that the renewed buoyancy of imports reflected the continued strength of domestic demand. This was accentuated by the very heavy consumer spending in advance of the budget, as well as by the bringing-forward of company dividend payments before the coming into force of the new corporation tax. In his budget speech in May this year the Chancellor of the Exchequer promised to remove the import surcharge in November and announced a voluntary restraint programme for direct investment in the developed sterling-area countries, details of which are given on page 136.

France. The overall surplus on France's balance of payments amounted to roughly $800 million in 1964 and to $1,140 million in 1965. Whereas in 1964 it resulted mainly from the large volume of foreign private investment, in 1965 it was chiefly due to a substantial export surplus. In both years the French overseas territories contributed appreciably to the surplus.

The trade balance shifted from a deficit of $90 million in 1964 to a surplus of $390 million last year. This was the result both of keen demand abroad and of stabilisation measures at home, which, by putting a brake on consumption, slowed down French import demand while encouraging enterprises to expand their sales on foreign markets. This expansion was further facilitated by the fact that French prices rose less than those of the country's main European competitors.

Exports to countries outside the franc area rose from $7,400 to 8,450 million in 1965 (as measured by customs statistics), or by 14 per cent., slightly more than in the previous year. Sales of industrial consumer goods showed the greatest advance — 16 per cent., against 7 per cent. in 1964. The rise in exports of foodstuffs slowed down, but wheat sales, especially to eastern bloc countries, were much higher. As regards imports from outside the franc area, their rate of increase slackened from 17 to 4.5 per cent. last year. In value they rose from $8,400 to 8,800 million. Imports of investment goods and semi-manufactures, which had expanded by 20 and 23 per cent. respectively in 1964, increased by only 4 and 5 per cent., while the growth rate of consumer goods imports was reduced from 23 to 9 per cent. Imports of foodstuffs went up by 8 per cent., against 27 per cent. in 1964, as the shortage of meat, which was the main reason for their previous expansion, France: Balance of payments.[1]

Items	1964	1965 Year[2]	1965 1st quarter	1965 2nd quarter	1965 3rd quarter	1965 4th quarter
	in millions of US dollars					
Merchandise trade (f.o.b.)						
Exports	7,625	8,600	2,030	2,075	2,125	2,235
Imports	7,715	8,210	1,985	2,020	1,880	2,260
Trade balance	— 90	+ 390	+ 45	+ 55	+ 245	— 25
Services						
Transportation	+ 25	+ 40	— 0	+ 15	+ 25	+ 10
Travel	+ 35	— 30	+ 25	+ 75	— 100	+ 10
Workers' remittances	— 230	— 275	— 50	— 60	— 65	— 65
Other	+ 345	+ 395	+ 90	+ 95	+ 80	+ 120
Total	+ 175	+ 130	+ 65	+ 125	— 60	+ 75
Current balance	+ 85	+ 520	+ 110	+ 180	+ 185	+ 50
Long-term capital						
Official	— 80	— 70[3]	— 10	— 5	— 25[3]	— 30
Private	+ 525	+ 360	+ 105	+ 110	+ 60	+ 85
Total	+ 445	+ 290	+ 95	+ 105	+ 35	+ 55
Balance on current and long-term capital account	+ 530	+ 810	+ 205	+ 285	+ 220	+ 105
Short-term capital and adjustments	+ 5	+ 60	— 15	+ 10	— 40	+ 70
Rest of French franc area	+ 260	+ 270	+ 100	+ 55	+ 55	+ 90
Total balance (= changes in monetary items)	+ 795	+ 1,140	+ 290	+ 350	+ 235	+ 265

[1] On a cash basis. [2] The sum of the quarters does not tally with the annual figure, as revisions are included in the yearly total but not in the quarterly figures. [3] Excluding the debt prepayment of $179 million to the Export-Import Bank.

became less acute. Imports of raw materials — excluding fuel — continued to decline and their share in total imports was only 15 per cent. last year, against 22 per cent. in 1961. The export surplus in respect of manufactured goods went up from $390 to 930 million and in respect of foodstuffs from $150 to 250 million. The trade deficit vis-à-vis countries outside the franc area was reduced from $1 milliard in 1964 to $350 million last year. Most of the improvement took place in relation to a few of France's main trading partners, Germany accounting for $300 million, the United States for $170 million and the Netherlands for $90 million. Imports from the franc area declined by $110 million last year, mainly owing to a reduction in purchases of foodstuffs. As exports remained at their 1964 level, the balance of trade shifted from a deficit of $55 million to a surplus of the same magnitude.

Net receipts from services continued to contract, amounting to $130 million, against $175 million in 1964 and the peak of $540 million attained in 1960. The balance on tourist account deteriorated by $65 million and for the first time showed a deficit. Remittances abroad by foreign workers increased from $230 to 275 million, reflecting partly an influx of some 100,000 new foreign workers last year.

The net private long-term capital inflow fell from $525 to 360 million last year, owing mainly to a rise in French investment abroad and to some extent to a reduction of foreign investment in France. French net investment abroad increased from $75 to 175 million, principally because of the sharp rise in direct investment from $160 to 235 million but also because of a decline in sales of foreign securities held by French residents. Net private foreign investment in France, which had increased to $600 million in 1964, fell back last year to $535 million, still a high figure compared with previous years. Loans at over one year (they are still subject to authorisation if their maturity exceeds two years) declined by $50 million and portfolio investment by $20 million, probably owing to the depressed state of the French stock exchange. Direct investment remained at the same level, in spite of US Government pressure on enterprises to limit their investment abroad.

From 1959 to 1963 the French authorities used part of the balance-of-payments surplus for making advance repayments of the external debt. In 1964 no such repayments took place, but they were resumed last year. On 1st July a final payment of $179 million was made in respect of a loan obtained in 1945 from the Export-Import Bank. The total external government debt, which had amounted to $2,080 million at the end of 1958, was thus reduced to $454 million at the end of 1965.

Germany. The balance on current account swung round from a small surplus in 1964 to a deficit of $1.5 milliard last year, owing principally to a decline in the export surplus. However, a large net inflow of private capital, much of it short-term, offset about half of the current deficit.

The strong expansion of demand in 1965 pushed imports up by 20 per cent. to $17.6 milliard, while exports increased only half as much and amounted to $17.9 milliard. The export surplus, which in each of the preceding two years had reached $1.5 milliard, fell to $300 million.

Imports of manufactured goods went up by 30 per cent. in 1965, reflecting the high demand at home and the greater competitiveness of foreign products. Purchases of defence equipment rose at about the same rate as those of civilian goods. Imports of foodstuffs went up by 20 per cent., partly as a result of poor crops in Germany, while those of raw materials and semi-manufactured goods taken together increased by 7 per cent. However, in the second half of 1965 these imports were only 2.5 per cent. higher than in the corresponding period of 1964, as Germany entered the downward phase of the stock cycle and the rise in output of manufacturing industries slowed down.

Exports grew by 10 per cent. in 1965, more or less in line with those of other industrial countries. Exports to EEC countries rose by 7 per cent. and imports from them by as much as 30 per cent. Thus Germany for the first time recorded a trade deficit, of $355 million, vis-à-vis its EEC partners, compared with a surplus of $800 million in 1964. It was due essentially to a worsening, by $550 and 300 million respectively, of the trade balance in

Germany: Balance of payments.[1]

Items	1964	1965 Year	1965 1st quarter	1965 2nd quarter	1965 3rd quarter	1965 4th quarter	1966 1st quarter
	in millions of US dollars						
Merchandise trade							
Exports (f.o.b.)	16,230	17,910	4,345	4,350	4,310	4,905	4,740
Imports (c.i.f.)	14,710	17,610	4,070	4,360	4,425	4,755	4,530
Trade balance	+ 1,520	+ 300	+ 275	— 10	— 115	+ 150	+ 210
Services	— 165	— 400	— 0	— 195	— 215	+ 10	— 85
Unilateral transfers	— 1,235	— 1,455	— 340	— 445	— 340	— 330	— 360
Current balance	+ 120	— 1,555	— 65	— 650	— 670	— 170	— 235
Long-term capital							
Private							
Security transactions	— 80	— 70	— 125	+ 15	+ 20	+ 20	— 110
Other	+ 190	+ 565	+ 230	+ 115	+ 105	+ 115	+ 210
Total private	+ 110	+ 495	+ 105	+ 130	+ 125	+ 135	+ 100
Official	— 315	— 320	— 45	— 85	— 80	— 110	— 85
Total	— 205	+ 175	+ 60	+ 45	+ 45	+ 25	+ 15
Balance on current and long-term capital account	— 85	— 1,380	— 5	— 605	— 625	— 145	— 220
Short-term capital							
Private[2]	+ 45	+ 210	+ 70	+ 5	+ 75	+ 60	+ 95
Official[3]	— 260	+ 335	+ 90	— 30	+ 145	+ 130	— 25
Total	— 215	+ 545	+ 160	— 25	+ 220	+ 190	+ 70
Errors and omissions	+ 395	+ 555	+ 260	+ 340	+ 135	— 180	+ 210
Total balance (= changes in monetary items)	+ 95	— 280	+ 415	— 290	— 270	— 135	+ 60

[1] On a transactions basis. [2] Excluding changes in the net foreign position of the commercial banks. [3] Excluding IMF gold tranche position and Bundesbank assets which are included in monetary items.

relation to Italy and France. Exports remained stable during the first three quarters of 1965 and soared in the last quarter. Imports, on the other hand, increased fairly regularly during the year, causing the unusual phenomenon of a trade deficit in the period March-September; in the last quarter there was again a surplus. This grew to $210 million in the first quarter of 1966.

Germany's current-account position also suffered from a further increase in the deficit on services from $165 to 400 million. The biggest change was the rise in net expenditure on travel from less than $500 million to $665 million. There was also an increase of $50 million in net out-payments of investment income. Net payments for transportation, on the other hand, fell by $65 million despite the big rise in imports. Unilateral transfers, which had remained unchanged at $1,235 million in the preceding two years, rose by $220 million in 1965; this was due about equally to increases in reparations payments and in workers' remittances. The number of foreign workers increased by 231,000 between September 1964 and September 1965 and remittances amounted to $425 million in 1965, of which $150 million went to Italy, $75 million each to Greece and Spain, and $65 million to Turkey.

Private foreign investment in Germany, which had declined sharply in 1964, was resumed on a large scale last year. Despite some increase in German private investment abroad, the net long-term capital inflow rose from $110 million to nearly $500 million.

Foreign purchases of German bonds were again at a low level, but the banks sold foreigners substantial amounts of loan claims and other domestic assets. Direct foreign investment, the largest source of foreign funds, rose from $480 to 760 million. Not all of this amounted to an influx of new funds, as some $200 million represented the consolidation of short-term credits and $125 million the reinvestment of profits. Other foreign long-term capital transactions increased from $90 to 210 million.

German direct investment abroad amounted to $295 million in 1965, compared with $235 million in the previous year. Portfolio investment, on the other hand, declined from $220 to 180 million. About $100 million of this was accounted for by German subscriptions to foreign loans issued on the German market. Thirteen such loans denominated in Deutsche Mark, totalling $325 million, were issued last year. At $320 million, the net outflow of official capital, mostly to developing countries, was slightly larger than in the previous year.

The balance on short-term capital account shifted from a net outflow of $215 million to a net inflow of $545 million. Most of the change occurred in the official sector, as, in contrast to 1964, deliveries of foreign armaments exceeded German payments for them. As regards the private sector, German enterprises borrowed increasingly abroad in order to evade the domestic credit squeeze. Net financial credits obtained rose from $45 to 210 million. In 1965 "errors and omissions" yielded the largest surplus ever recorded, viz. $555 million, against $395 million in the previous year.

Italy. The overall balance-of-payments surplus increased from $800 million in 1964 to $1,575 million last year. For the second year in succession the trade deficit was cut by $1 milliard, exports having expanded rapidly, while the import total, which had declined in 1964, showed almost no change. Net receipts from invisible items rose by some $300 million. On capital account, however, a net inflow of $475 million in 1964 was followed by a net outflow of $55 million.

Imports as registered by customs statistics, which had reached a peak in the first quarter of 1964, declined sharply in the following two quarters, after which the trend was reversed. They advanced throughout 1965 until in the fourth quarter they were 16 per cent. higher than in the corresponding period of 1964. This reflected a rise of 23 per cent. in purchases of foodstuffs, which account for roughly one-quarter of total imports, and one of 13 per cent. for other commodities. Among non-food products, imports of raw materials climbed sharply in the second half of the year, followed by

Italy: Balance of payments.[1]

Items	1964	1965 Year	1965 1st quarter	1965 2nd quarter	1965 3rd quarter	1965 4th quarter	1966 1st quarter
	in millions of US dollars						
Merchandise trade							
Imports (c.i.f.)	7,070	7,130	1,705	1,715	1,760	1,950	1,970
Exports (f.o.b.)	5,580	6,655	1,510	1,610	1,750	1,785	1,845
Trade balance	— 1,490	— 475	— 195	— 105	— 10	— 165	— 125
Services							
Travel	+ 825	+ 1,060	+ 115	+ 245	+ 490	+ 210	+ 135
Workers' remittances	+ 550	+ 675	+ 115	+ 175	+ 195	+ 190	+ 135
Transport	+ 330	+ 360	+ 80	+ 95	+ 100	+ 85	+ 90
Other	+ 110	+ 10	+ 0	— 5	+ 15	— 0	+ 10
Total	+ 1,815	+ 2,105	+ 310	+ 510	+ 800	+ 485	+ 370
Current balance	+ 325	+ 1,630	+ 115	+ 405	+ 790	+ 320	+ 245
Capital movements							
Repatriated bank-notes	— 575	— 315	— 135	— 50	— 40	— 90	— 170
Investment by non-residents[2]	+ 1,090	+ 390	+ 115	+ 140	+ 55	+ 80	
Investment by residents[2]	— 110	— 135	— 60	— 5	— 40	— 30	
Other (including official capital)	+ 70	+ 5	+ 30	— 25	+ 30	— 30	
Total	+ 475	— 55	— 50	+ 60	+ 5	— 70	— 170
Total balance (= changes in monetary items)	+ 800	+ 1,575	+ 65	+ 465	+ 795	+ 250	+ 75

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

consumer goods, while capital goods lagged behind. For the year as a whole imports amounted to $7,350 million, only about 1 per cent. more than in 1964. Exports rose by 21 per cent. to $7,200 million, mainly in response to strong demand from EEC countries.

The net balance of services improved by nearly $300 million in 1965, four-fifths of this being due to larger net receipts from tourism. The number of nights spent by foreign tourists in Italy, which had declined slightly in 1964, rose again last year. Remittances from emigrants and Italian workers temporarily employed abroad amounted to $675 million, a rise of 22 per cent. on the 1964 figure. This was due both to higher earnings and to a larger number of Italian workers abroad. Net receipts from transportation went up by $30 million, whereas the $110 million surplus on other invisible items was virtually wiped out.

In 1964 the capital account had recorded a swing of $800 million from deficit to surplus, partly thanks to large-scale direct investment by foreign business in Italy. Last year the capital balance moved back into deficit with a swing of $530 million, almost entirely owing to the sharp fall in foreign investment in Italy and to large contractual repayments of earlier foreign borrowing by Italian business.

In the first quarter of 1966 the current surplus amounted to $245 million, a rise of $130 million on the figure for the corresponding period of 1965. This was due more or less equally to a reduction in the trade deficit and to the growth of net invisible receipts.

Belgium. In 1965 Belgium's current balance moved from equilibrium to a surplus of $150 million. The balance on capital account, on the other hand, shifted from a surplus to a small deficit.

As the pressure of internal demand lessened last year, imports, on the basis of customs statistics, rose by only 7.5 per cent., compared with 16 per cent. in 1964. The slow-down was particularly marked in the first half of the year, when imports of raw materials and capital goods were little higher than in the previous year. Imports of durable consumer goods, by contrast, went up by 18 per cent. Exports expanded by 14 per cent., nearly as much as in 1964. Sales of engineering products, non-ferrous metals and chemicals rose by about 20 per cent., while those of iron and steel products and textiles went up by 10 and 6 per cent. respectively.

In balance-of-payments terms the trade deficit was reduced from $175 to to 35 million. In the first six months a surplus of $40 million was recorded. Net receipts from services increased by $10 to 185 million owing to a cut in military expenditure abroad.

The total net capital inflow, which had amounted to $175 million in 1964, shifted to a deficit of $15 million. This reflects chiefly a turn-round in official capital movements from a net inflow of $30 million to a net outflow of $110 million due to repayments of government debt, amortisation of the Congo debt under the agreement signed in February 1965 and a decline in public borrowing abroad. Other ascertained net capital imports, which had risen markedly in 1964, declined by $30 million.

Netherlands. The overall balance of payments of the Netherlands shifted from a surplus of $65 million in 1964 to a deficit of $30 million last year, owing to a decline in the net private capital inflow.

The trade deficit, which had reached a peak of $765 million in 1964, was roughly $100 million less last year, as exports rose faster than imports. The rate of increase of imports — measured on the basis of customs statistics — dropped from 18 to 6 per cent. This reflected to a great extent a normalisation of stock-building, which had been exceptionally large in 1964. In response to the growth of incomes, on the other hand, imports of consumer goods rose by some 20 per cent. Towards the end of the year purchases of motor-cars and of radio and television sets soared in anticipation of an increase in turnover tax. The expansion of exports slowed down from 17 to 10 per cent. because of an easing of demand for industrial products — in particular for engineering products, exports of which went up by only 1 per cent., against 28 per cent. in 1964. Sales by the chemical and oil-refining industries, on the other hand, continued to rise steeply.

Netherlands: Balance of payments.*

Items	1964	1965 Year	1965 1st quarter	1965 2nd quarter	1965 3rd quarter	1965 4th quarter	1966 1st quarter
	in millions of US dollars						
Merchandise trade (f.o.b.)							
Imports.	6,130	6,655	1,545	1,650	1,645	1,815	1,720
Exports	5,365	5,985	1,370	1,500	1,485	1,630	1,500
Trade balance . . .	— 765	— 670	— 175	— 150	— 160	— 185	— 220
Services							
Investment income . . .	+ 205	+ 200	+ 60	— 10	+ 100	+ 50	+ 10
Other.	+ 445	+ 440	+ 115	+ 85	+ 120	+ 120	+ 75
Total	+ 650	+ 640	+ 175	+ 75	+ 220	+ 170	+ 85
Current balance. . .	— 115	— 30	+ 0	— 75	+ 60	— 15	— 135
Capital movements							
Private long-term							
Dutch	— 145	— 280	— 45	— 95	— 60	— 80	— 130
Foreign	+ 285	+ 305	+ 85	+ 95	+ 80	+ 45	+ 95
Banks	— 20	— 25	— 5	— 15	— 0	— 5	— 20
Private short-term. . . .	+ 90	+ 35	+ 15	+ 15	— 20	+ 25	+ 35
Total private capital .	+ 210	+ 35	+ 50	— 0	+ 0	— 15	— 20
Official	— 30	— 35	— 5	— 10	— 10	— 10	— 5
Balance on capital account	+ 180	+ 0	+ 45	— 10	— 10	— 25	— 25
Total balance (= changes in monetary items) . . .	+ 65	— 30	+ 45	— 85	+ 50	— 40	— 160

* On a cash basis.

If the small decline in net invisible receipts is taken into account, the current deficit was reduced from $115 to 30 million in 1965.

The total net inflow of private long-term capital shrank from $120 million to nil. The inflow of foreign capital, which since 1958 has averaged some $270 million, rose to $305 million in 1965 owing mainly to larger foreign purchases of Dutch securities. The outflow of Dutch capital, on the other hand, increased from $145 to 280 million; over two-thirds of the increase was due to an expansion of credit to non-residents and the remainder to larger purchases of foreign securities.

Austria. The balance on current account shifted in 1965 from a surplus of $60 million to a small deficit, while the net outflow of capital was somewhat larger than in the previous year. The overall balance therefore shifted from a surplus of $95 million to a deficit of $60 million.

The deterioration in the current account was entirely due to the rise in imports, which accelerated in the last quarter of 1965. For the year as a whole imports rose by 13 per cent., slightly more than in 1964. The biggest increases were those in food imports, accounted for by bad weather, and in purchases of machinery and transport equipment, which went up by 16 per cent. Exports rose by 11 per cent., slightly more than in the previous year. However, exports of semi-manufactured and manufactured goods, including machinery and transport equipment (which represent three-quarters of the total), expanded somewhat less than in 1964. Exports of foodstuffs, on the other hand, which had fallen in that year, rose sharply in 1965.

The import surplus increased from $415 to 500 million. For the first time since 1961 it was not fully offset by invisible receipts, which amounted to $490 million. Net earnings from tourism went up from $385 to 420 million, or by 9 per cent., against 23 per cent. in 1964, while net receipts from other services and unilateral transfers declined from $90 to 70 million.

After a number of years in which Austria had been a net capital importer, the trend was reversed in 1964 and last year there was a net outflow of $50 million. This was mainly due to a rise in credits to foreign borrowers — notably credits to eastern European countries — and to large repayments of credits obtained from abroad. While net lending to foreign customers rose from $50 to 110 million, net borrowing declined from $75 to 10 million. Foreign investment in Austria was somewhat larger than in the previous year, with a shift from portfolio to direct investment.

Switzerland. The anti-inflationary policy introduced in 1964 bore fruit in 1965. The moderation of demand pressures was most clearly reflected in the current-account deficit, which, after steadily widening over the previous four years, was reduced from $410 to 130 million last year.

Merchandise imports, which were already growing more slowly in mid-1964, remained virtually stable throughout the first three quarters of 1965 but rose towards the end of the year. Their increase on the 1964 level amounted to less than 3 per cent.; imports of investment goods actually declined slightly. The rise in exports accelerated from 10 to 12 per cent., so that the trade deficit was reduced from $945 to 710 million. About 40 per cent. of the $325 million increase in exports went to Germany and North America; the remainder was fairly widely distributed.

Net receipts from services are estimated to have gone up from $535 to 580 million. As a result of the officially induced reduction in the foreign labour force, workers' remittances abroad showed no increase. On the income side, the bad weather in 1965 seems to have led to some reduction in tourist receipts, while net investment income from abroad continued its upward trend.

Among ascertained capital movements, net foreign issues in Switzerland declined from $65 to 60 million, while official capital exports in the form of development aid increased somewhat. The net inflow of short and long-term capital, measured as the difference between changes in official reserves and the balance on current account, contracted from $555 million in 1964 to $190 million last year. The 1964 measures to check the inflow of foreign funds, the somewhat easier internal liquidity situation at certain times of the year and smaller Swiss sales of securities on the German and US capital markets were probably the main reasons for this decline.

The current accounts of the four northern countries deteriorated last year but, except in the case of Finland, the net inflow of capital more than offset the current deficit.

In *Denmark* economic expansion, which had continued almost without interruption since 1958, persisted last year. The trade deficit, which had amounted to $215 million in 1964, widened to $285 million in 1965, the deterioration occurring entirely in the first half of the year. Imports rose by 8 per cent. over the year, compared with 23 per cent. in 1964. The growth rate of exports slackened from 11 to 9 per cent. Whereas exports of manufactured goods went up by 11 per cent., those of agricultural produce rose by only 4 per cent.

Net receipts from invisibles rose by $15 million to $175 million. Higher freight earnings were partly offset by a decline in tourist receipts and an increase in transfer payments.

The net capital inflow contracted from $170 to 130 million. As bond issues by local authorities and public companies were prohibited from June 1964 to June 1965 and were subsequently subject to authorisation, official borrowing abroad fell from $120 to 20 million. On the other hand, foreign direct investment in Denmark increased by $25 million and net commercial credits obtained were $40 million higher as a result of the restrictive domestic credit policy.

Finland. In both 1964 and 1965 Finland's deficit on current account amounted to some $180 million, but, whereas in 1964 it had been offset by a substantial capital inflow, this was not the case in 1965, because the US balance-of-payments programme reduced Finland's borrowing possibilities not only in the United States but also, indirectly, in European capital markets.

As always, Finnish exports were smaller in the first half of the year but, as in 1964, they increased at a fairly even pace throughout the year. The growth rate of imports, on the other hand, declined sharply. The import surplus rose from $155 to 185 million in the first half-year but contracted from $65 to 40 million in the second half. This was due to a tightening of credit policy in the spring and, to an even greater extent, to specific measures such as a rise in the tax on motor-cars and stricter hire-purchase terms. The terms of trade continued to improve, as export prices rose by 6.5 per cent. and import prices by 3 per cent. Whereas in 1964 long-term loans issued abroad totalled $155 million, last year they amounted to only $55 million. In all, the long-term capital inflow was reduced from $155 to 35 million.

Norway's current deficit increased from $75 to 100 million last year, but it was amply covered by the capital inflow. The import surplus went up from $705 to 775 million, over half the rise being accounted for by net purchases of ships. Other imports increased by \$140 million, or 8 per cent., and exports by \$115 million, or 10 per cent. Over a third of the rise in exports was in respect of fish and fish products, as the 1965 catch was particularly good. Net receipts from shipping rose by \$60 million and accounted for the entire increase in net invisible receipts.

In addition to a positive figure for errors and omissions, there was a recorded capital inflow of \$230 million, nearly \$100 million more than in 1964. \$45 million was accounted for by an increase in borrowing by shipping companies and by a decline in their amortisation payments. Other private borrowing rose by \$65 million, while that of the public sector declined by \$20 million.

Sweden. The balance on current account, which had in previous years been in approximate equilibrium, showed a deficit of \$290 million in 1965. This was largely due to a widening of the trade deficit from \$180 to 405 million. Under the pressure of strong internal demand, imports again rose by 13.5 per cent. last year, while the expansion of exports slowed down from 15 to 8 per cent., reflecting a weakening in foreign demand for pulp, paper and iron ore. Net invisible receipts declined further from \$160 to 115 million. For a number of years shipping earnings have risen much less than expenditure on other service items, in particular travel, so that net invisible receipts have been halved since 1960.

The current deficit was more than compensated by a net capital inflow and by a surplus in respect of unrecorded transactions that together amounted to \$315 million. The net recorded capital inflow increased from \$55 to 95 million, reflecting mainly a decline in Swedish direct investment abroad, and the "errors and omissions" item, which includes a fairly large and stable amount of net current receipts, went up from \$155 to 220 million.

Spain. The continuing rapid growth of the Spanish economy, accompanied by a sharp decline in agricultural production over the last two crop years, due both to difficulties of adaptation and to unfavourable weather, produced a serious deterioration in Spain's balance of payments during 1965. The pattern in recent years has been a widening trade deficit more than covered by growing receipts from services and remittances and by a steady inflow of long-term capital. The rate at which imports expanded last year, however, coupled with the stagnation of exports and a decline in the long-term capital inflow, led to a basic deficit of \$190 million, compared with a surplus of \$325 million in 1964.

Imports, as registered by customs statistics, soared by 34 per cent. to \$3 milliard. The upsurge occurred in the second quarter and was the direct result of the government's policy to increase imports in order to check the rise in food prices. In that quarter imports of foodstuffs were 70 per cent. higher than in the corresponding quarter of 1964 and total imports 45 per cent. higher. The growth rate, though still extremely rapid, abated somewhat

Spain: Balance of payments.[1]

Items	1964	1965 Year	1st quarter	2nd quarter	3rd quarter	4th quarter
	in millions of US dollars					
Merchandise trade (f.o.b.)						
Imports	1,995	2,715	595	640	735	745
Exports	1,000	1,045	300	260	225	260
Trade balance	− 995	−1,670	− 295	− 380	− 510	− 485
Services	+ 860	+ 980	+ 125	+ 200	+ 415	+ 240
Unilateral transfers[2]	+ 195	+ 300	+ 75	+ 80	+ 85	+ 60
Current balance	+ 60	− 390	− 95	− 100	− 10	− 185
Long-term capital	+ 265	+ 200	+ 70	+ 20	+ 50	+ 60
Balance on current and long-term capital account	+ 325	− 190	− 25	− 80	+ 40	− 125
Short-term capital and errors and omissions	+ 40	+ 85	+ 20	+ 25	+ 30	+ 10
Overall balance (= changes in official reserves)	+ 365	− 105	− 5	− 55	+ 70	− 115

[1] On a cash basis. [2] Chiefly workers' remittances.

in the second half of the year, food imports being 50 per cent. and total imports 37 per cent above the previous year's level.

Imports of manufactured products expanded by 38 per cent. Capital goods imports went up by 27 per cent., while the pressure of higher incomes together with further liberalisation measures pushed up imports of other manufactured goods by 50 per cent., so that, for the first time for five years, they exceeded those of capital goods. The slower growth of the latter may also be connected with the reverses suffered by agriculture and the textile industry. In all, imports of manufactured products amounted to 58 per cent. of the total in 1965, against 42 per cent. in 1961.

Exports, also on the basis of customs figures, fell off slightly, from $955 to 945 million. Whereas exports of manufactured goods rose by 19 per cent., agricultural exports, mainly olive oil, declined sharply.

The net surplus on services account went up from $860 to 980 million last year, a rather modest increase by recent standards. Services receipts rose from $1,150 to 1,425 million, while expenditure increased from $290 to 440 million, or by over 50 per cent. Unilateral transfers, mainly workers' remittances, rose from $200 to 300 million, owing both to the larger number of workers abroad and to higher earnings. The current-account balance, therefore, swung round from a surplus of $60 million to a deficit of $390 million. At the same time net receipts of long-term capital fell from $265 to 200 million. Although receipts from short-term capital inflows and unidentified items increased from $40 to 85 million, Spain's monetary reserves fell by $105 million.

In *Greece* the rapid growth of imports widened the trade deficit from $575 to 700 million. Receipts from services and transfers, which had fallen in 1964, went up last year from $375 to 435 million. As the net capital inflow did not cover the current deficit, official reserves declined by $25 million.

Iceland's trade deficit in 1965, at exactly $8 million, was smaller than in the previous year, exports having developed satisfactorily, whereas, owing to a decline in purchases of fishing vessels and aircraft, the growth of imports was more moderate. Although the increase in net receipts from services was offset by a decline in capital imports, reserves showed a rise of $7 million — somewhat more than in 1964.

Ireland's imports continued to expand in 1965, while its exports levelled out, mainly owing to a fall in sales of cattle. Despite higher tourist receipts the current deficit increased from $90 to 125 million. As the net capital inflow, which, at $105 million, had been rather high in 1964, declined to $75 million, the overall balance swung round from a small surplus to a deficit of $50 million, which was financed by drawing down the reserves.

In *Turkey* exports rose faster than imports and the trade deficit decreased somewhat. As, moreover, net invisible receipts were swelled by an increase in workers' remittances, the current deficit was reduced from $105 to 80 million and, notwithstanding a decline of $30 million in the net capital inflow, the reserve position improved by $10 million.

Japan. Japanese balance-of-payments developments in 1965 were dominated by the domestic recession. The deceleration of demand moderated the rise in imports and, at the same time, acted as a potent incentive to exports. Thus the rate of growth of imports, on a f.o.b. basis, fell from 14 to 2 per cent., while exports forged ahead by 24 per cent. and pushed up the trade surplus from $365 million in 1964 to the unprecedentedly high level of $1,900 million. Two-thirds of the rise in exports was accounted for by machinery, transport equipment, metals and metal manufactures. At nearly 35 per cent., the expansion was largest vis-à-vis the United States and Africa but exports to western Europe also went up, by 25 per cent.

Increased transport costs and higher interest and dividend payments were the main factors behind a further widening of the deficit on invisibles from $845 to 970 million, which did not, however, prevent a shift in the current account from a deficit of $480 million to a surplus of $930 million.

In connection with the slack in domestic investment, a $110 million net long-term capital inflow in 1964 was followed by a $405 million outflow. Despite this outflow, the basic payments surplus, at $525 million, was the largest ever recorded. Owing to the liquid state of the economy, part of this surplus was offset by short-term capital outflows, largely in the form of export credits, so that the overall balance showed a surplus of $410 million.

Japan: Balance of payments.[1]

Items	1964	1965 Year	1965 1st half	1965 2nd half
	in millions of US dollars			
Merchandise trade (f.o.b.)				
Imports	6,330	6,430	3,290	3,140
Exports	6,695	8,330	3,875	4,455
Trade balance	+ 365	+ 1,900	+ 585	+ 1,315
Services (net)				
Transportation	— 475	— 550	— 245	— 305
Investment income	— 195	— 190	— 100	— 90
Other[2]	— 175	— 230	— 130	— 100
Total	— 845	— 970	— 475	— 495
Current balance	— 480	+ 930	+ 110	+ 820
Long-term capital account	+ 110	— 405	— 125	— 280
Balance on current and long-term capital account	— 370	+ 525	— 15	+ 540
Short-term capital account	+ 250	— 65	+ 30	— 95
Errors and omissions	+ 10	— 50	+ 15	— 65
Total balance (= changes in monetary items)	— 110	+ 410	+ 30	+ 380

[1] On a transactions basis. [2] Including transfer payments.

Commercial policy.

Little progress was made in 1965 in the field of international trade co-operation. Disagreements within the EEC hindered the progress of the Kennedy round of tariff negotiations and an increasing number of regional and bilateral arrangements are gnawing at the GATT principle of non-discrimination.

The rapid advance towards closer economic integration among the EEC countries was halted at the end of June 1965, when the Council of Ministers failed to agree on the financing of the common agricultural policy and on increasing the powers of the European Parliament. Nevertheless, the joint marketing organisations for agricultural produce continued to function and the 10 per cent. reduction in the Community's internal tariffs previously agreed upon became effective on 1st January 1966. It brought customs duties on industrial products down to 20 per cent. of their original level and those on agricultural products for which there is no joint marketing organisation to 40–45 per cent.

On 11th May 1966 an agreement was reached concerning the further dismantling of tariffs and the financing of agricultural policy. A 5 per cent. reduction in the Community's internal tariffs for industrial goods will be made on 1st July 1967 and the remaining 15 per cent. will be abolished a year later. With regard to agricultural policy, it was decided that unified markets for all important products should be set up between mid-1967 and mid-1968 and that compensatory payments for sales of agricultural produce outside the Community at world prices and for the cost of market support should be paid out of the European Orientation and Guarantee Fund as from mid-1967.

Adjustments to the common external tariff of the Community have so far been based on a level 20 per cent. below the final tariff. In April 1966 the Council of Ministers decided that as from 1st July this 20 per cent. reduction will no longer apply to some 1,200 items which are not subject to linear reductions in the Kennedy negotiations. In the field of external relations, negotiations on the association of Nigeria, as a result of which Nigeria's exports to the Community would receive the same privileged treatment as those of the eighteen African states under the Yaoundé Convention, were concluded in July 1965. Negotiations with Austria for a possible link with the EEC began in March 1965 but have not yet been completed.

Tariff reductions among the EFTA countries are proceeding according to plan; internal customs duties were cut by 10 per cent. on 1st January 1966. The remaining 20 per cent. of the duties on industrial products is due to be abolished at the end of this year. As from 1st January 1967 industrial goods may not enjoy both exemption from customs duties and the reimbursement of certain indirect taxes. Thus the UK Government announced on 21st January 1966 its intention of modifying the UK export rebate scheme. In May 1966 the Chancellor of the Exchequer also announced that the 10 per cent. import surcharge would be removed in November.

The GATT now numbers sixty-seven contracting parties, including Switzerland, which attained full status in April 1966. In its twenty-third session in March-April 1966 the Contracting Parties took note of the agreement signed between Australia and New Zealand on 31st August 1965 on the establishment of a free trade area and of a similar agreement concluded in December between the United Kingdom and Ireland; the latter, however, is not a member of the GATT. At the same session Australia was granted a waiver from the most-favoured-nation rule, thus enabling it to give tariff preferences to developing countries.

As regards the Kennedy round, the participating countries presented in November 1964 the lists of industrial products which are to be excluded from the proposed 50 per cent. linear tariff reduction. Discussions on such items have not yet produced any tangible results. Talks on chemicals and steel started in May 1966; the main point of contention is the calculation of the US tariffs for chemicals on the basis of the domestic selling price rather than on the value of the imported product itself. As for agricultural products, talks on grains took place in May 1965, and last September thirteen countries — but not the EEC — tabled the concessions they are willing to make for products other than grains. As the authority to negotiate tariff reductions given to the US President under the Trade Expansion Act expires in mid-1967, the time for reaching an agreement is running short.

III. GOLD, RESERVES AND FOREIGN EXCHANGE.

In the field of international liquidity, the increase in countries' total external monetary assets slowed down to $0.9 milliard during 1965, after a rise of $3.9 milliard in 1964. There were a number of reasons for this slower rate of growth.

Firstly, the very high level of non-monetary demand for gold, which left only $250 million's worth available for adding to western countries' official reserves. The 1964 increase was $0.9 milliard. The US gold stock declined by $1.7 milliard in 1965, whilst the gold reserves of western Europe rose by $1.9 milliard.

Secondly, the reduction in the US payments deficit and the fact that monetary authorities in surplus countries showed an increasing tendency to convert dollars into gold cut down the rise in countries' foreign exchange holdings (including non-marketable US Government bonds in the hands of foreign monetary authorities) to only $0.6 milliard, compared with $3.1 milliard in 1964. The main factor behind the 1965 increase in this category of international liquidity was a rise of $0.4 milliard in non-official dollar holdings.

Thirdly, the increase in total international liquidity was slowed down by the extent to which the payments deficits of the two reserve-currency countries, but principally the United Kingdom, were financed through IMF drawings. As changes in the total of member countries' Fund positions are calculated on a net basis, this method of financing deficits and surpluses has no effect on the statistical total of international liquidity.

Looked at from the point of view of its distribution between countries, the main changes in international liquidity during 1965 were that the positions of the United States and the United Kingdom declined by $1.2 and 0.3 milliard respectively, whilst those of continental western Europe and of other countries increased by $1.7 and 0.7 milliard respectively. For the third year in succession, developing countries added to their international liquidity. Their gains in 1965 were about $1.1 milliard, roughly $0.3 milliard more than in 1964.

Gross drawings on the IMF totalled $2.4 milliard, only slightly less than in 1961, while net drawings, at $1.7 milliard, were the largest ever. The United Kingdom's net IMF position deteriorated by $1.4 milliard during 1965, whilst the net IMF and GAB positions of continental western European countries increased by $1.1 milliard. There was virtually no change in the Fund positions of developing countries taken as a group.

Despite the improved showing of the dollar after the introduction of the US voluntary restraint programme, conditions in the gold and exchange markets were rather unsettled for much of the first nine months of 1965. Sterling came repeatedly under heavy pressure and non-monetary demand for gold was at times exceptionally heavy. Following the resumption of Russian gold sales in August 1965 the market price of gold declined, whilst the announcement early in September of fresh central-bank support arrangements produced a marked improvement in the position of sterling. Market conditions remained relatively quiet in the first months of 1966, but sterling came under renewed pressure in May and early June.

Gold production and markets.

World gold production (excluding the USSR, other eastern European countries, mainland China and North Korea) increased between 1964 and 1965 from 39.9 to 41 million ounces (see table on page 32). As usual, the dominant influence on the overall trend was South Africa, where output advanced from 29.1 to 30.5 million ounces. It is noteworthy, however, that the rate of expansion of South African gold output continued to decline. Thus the 1965 rise of 1.4 million ounces in production compares with increases of 2.6, 1.9 and 1.7 million ounces in 1962, 1963 and 1964 respectively. Of the other major western producers only the United States showed an increase in output, from 1.5 to 1.7 million ounces. This resulted from the opening of a new mine in Nevada, which is expected to lift US output by one-third. Elsewhere in the western world gold production continued to decline.

The 5 per cent. growth in South African gold output during 1965 was achieved with a roughly 2 per cent. smaller labour force. The amount of ore milled rose by about ½ per cent., while the average gold yield, reflecting mainly the increasing share of the new mines in total production, went up by 4½ per cent. Excluding those mines that are principally uranium producers, total profits rose by not quite 1½ per cent., their smallest increase since 1953. This was mainly due to lower earnings from uranium. Average profits per ounce of gold produced actually declined by nearly 4 per cent.

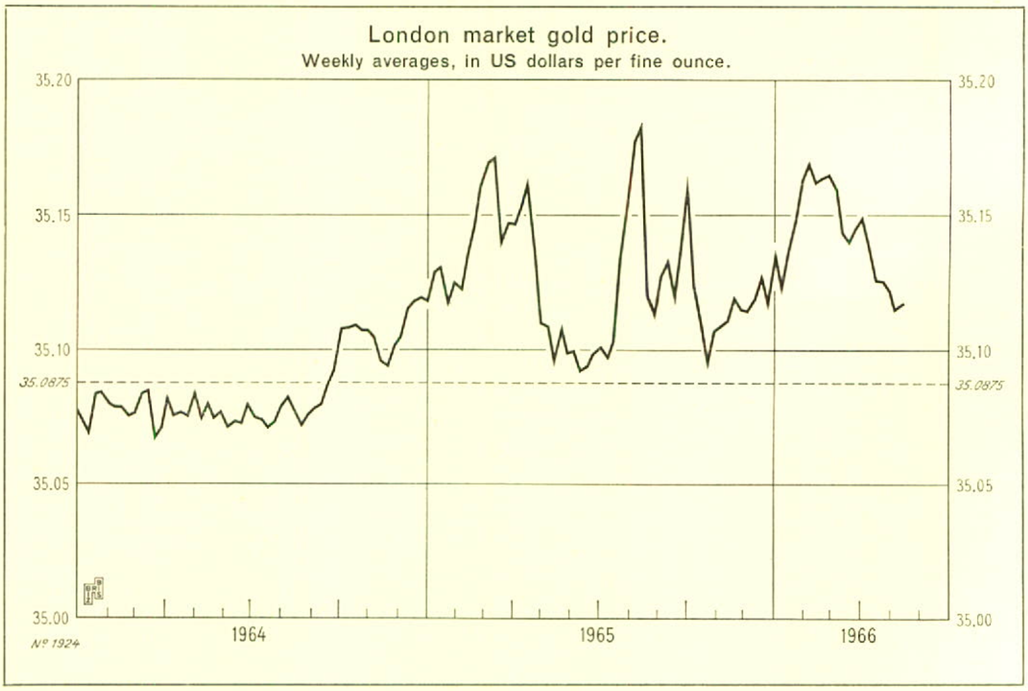
Valued at the official dollar parity, gold production in 1965 was worth $1,435 million. Total Russian gold sales in 1965 may be estimated at $550 million — $100 million more than in 1964. Total fresh gold supplies becoming available during 1965 may, therefore, be put at nearly $2 milliard, an increase of some $150 million on the 1964 figure. Despite this propitious supply situation, however, the balance between supply and demand deteriorated markedly. It may be estimated that non-monetary absorption of gold went up from $1,120 to 1,585 million, for reasons given on pages 33–36, to the point where for the first time since the war non-monetary demand exceeded western production. As Chinese gold purchases absorbed a further $150 million, only $250 million was left for additions to western official gold reserves.

Although strong throughout the whole of 1965, non-official demand for gold was particularly heavy in the first and third quarters. Thus official gold reserves fell by $250 million during the first quarter and then recovered by $215 million in the second quarter. The resumption of Russian sales prevented a fresh decline in the third quarter and was the main factor responsible for the $300 million gain in official gold reserves during the fourth quarter.

Turning to the course of events on the London gold market in 1965, the year began under rather unfavourable auspices. The sterling crisis seemed to have passed its peak, but uncertainties remained. The sharp deterioration in the US balance of payments in the second half of 1964 had increased uneasiness about the dollar. And these doubts were intensified by the widely publicised French decision to convert part of the country's exchange reserves into gold and by official French statements in favour of a return to the gold standard. Against this background, reassurances by the United States that the dollar's existing gold parity would be maintained, action to abolish the statutory gold cover for the Federal Reserve System's deposit liabilities and the announcement of the voluntary balance-of-payments restraint programme did little to dispel nervousness.

The London "fixing" price opened the year at about $35.12. Under the impact of heavy private buying it began to move up in February. Chinese purchases and demand from central banks outside the gold pool added to market pressure and despite sales by the gold pool the "fixing" price reached a peak of $35.17 in early March.

Conditions eased during the second half of April. Quotations fell to about $35.10 and moved around this level until the middle of July. During



the second half of that month, however, demand from China led to a renewed hardening of quotations. The situation in Vietnam and the continuing difficulties of sterling added to the upward momentum and on 6th August the "fixing" price reached $\$35.19^3/_8$ — its highest level for the year. Anticipation of renewed Russian gold sales soon led to an easing of the strain, however, and quotations dropped sharply to $35.11 during the second half of August. Following the outbreak of hostilities between India and Pakistan, market demand was heavy again during most of September.

Large Russian gold sales, together with the recovery of sterling, then led to a decline in quotations. The "fixing" price, which for a time in late September exceeded $35.16, fell below $35.09 at one point in October. Under the pressure of continuously heavy demand, however, the price began to go up again towards the end of October and it reached a new peak of more than $35.17½ at the beginning of February 1966. The trend was then reversed and quotations came gradually down to $35.11 by early May.

International liquidity.

The next table shows the principal changes in countries' international liquidity during 1965, that is to say, the movements in their gold reserves, their official and private exchange holdings (excluding the corresponding liabilities of the reserve centres) and their net IMF and GAB positions. Measured in this way, the statistical total of international liquidity increased by $0.9 milliard in 1965, compared with a rise of $3.9 milliard in 1964. If official assets only are taken, the increase was $0.2 milliard, as against $1.9 milliard the year before.

The main factor behind this change between the two years is to be found in the slower rise in gold reserves and dollar holdings. Together, these two items had increased by $3.4 milliard in 1964, whereas the corresponding figure for 1965 was only $0.5 milliard. So far as gold reserves are concerned, the very moderate increase recorded in 1965 was the result of much higher non-monetary demand for the metal. In the case of dollar holdings, the most important reasons were the reduction of the US payments deficit and conversions of dollar reserves into gold.

While it is a statistical fact that the total of liquidity went up much less in 1965, this does not mean that very little new liquidity was available to finance surpluses and deficits. What happened was that to a much greater extent than before liquidity was provided through the IMF. This, however, does not add statistically to the amount outstanding, since the assets acquired by the lending countries are matched by more or less fixed-term liabilities of those who borrow. Thus the total of the net IMF and GAB positions of Fund members did not change during 1965; but those of the United States and United Kingdom combined fell by $1.3 milliard, while those of other Fund members rose correspondingly.

International liquidity of countries.

Holders	Years and end of years	Gold	US dollars[1]	Non-marketable US Government bonds[2]	£ sterling	Other currencies[3]	Total	Net IMF and GAB positions[4]	Grand total
		in milliards of US dollars							
United States	1964, change	— 0.1			+ 0.2	— 0.0	+ 0.0	— 0.3	— 0.2
	1965, change	— 1.7			+ 0.4	— 0.0	— 1.3	+ 0.1	— 1.2
	End-1965, total	*13.8*			*0.8*	*0.1*	*14.8*	*0.9*[5]	*15.6*
United Kingdom	1964, change	— 0.3	+ 0.5				+ 0.1	— 1.0	— 0.9
	1965, change	+ 0.1	+ 1.0				+ 1.1	— 1.4	— 0.3
	End-1965, total	*2.3*	*3.3*				*+ 5.5*	*— 1.9*	*3.6*
Continental western Europe[6]	1964, change	+ 1.2	+ 1.0	+ 0.3	+ 0.1		+ 2.6	+ 0.7	+ 3.3
	1965, change	+ 1.8	— 1.5	+ 0.3	— 0.0		+ 0.6	+ 1.1	+ 1.7
	End-1965, total	*20.2*	*9.1*	*1.4*	*1.8*		*32.6*	*3.6*	*36.1*
Total	1964, change	+ 0.7	+ 1.4	+ 0.3	+ 0.3	— 0.0	+ 2.8	— 0.5	+ 2.3
	1965, change	+ 0.3	— 0.5	+ 0.3	+ 0.4	— 0.0	+ 0.3	— 0.2	+ 0.2
	End-1965, total	*36.3*	*12.4*	*1.4*	*2.7*	*0.1*	*52.9*	*2.5*	*55.4*
Other countries	1964, change	+ 0.2	+ 1.1	—	+ 0.1	— 0.1	+ 1.2	+ 0.4	+ 1.6
	1965, change	+ 0.0	+ 0.8	—	— 0.2	—	+ 0.6	+ 0.2	+ 0.7
	End-1965, total	*4.9*	*13.2*	*0.1*	*9.1*	*0.4*	*27.8*	*0.2*	*28.0*
Grand total	1964, change	+ 0.9	+ 2.5	+ 0.3	+ 0.4	— 0.1	+ 4.0	— 0.2	+ 3.9
	1965, change	+ 0.3	+ 0.2	+ 0.3	+ 0.1	— 0.0	+ 0.9	+ 0.0	+ 0.9
	End-1965, total	*41.2*	*25.6*	*1.5*	*11.8*	*0.5*	*80.7*	*2.7*	*83.4*
Grand total, official holders	1964, change	+ 0.9	+ 0.7[7]	+ 0.3	+ 0.3	— 0.1	+ 2.1	+ 0.2	+ 1.9
	1965, change	+ 0.3	— 0.2[7]	+ 0.3	— 0.1	— 0.0	+ 0.2	+ 0.0	+ 0.2
	End-1965, total	*41.2*	*14.2*[7]	*1.5*	*6.7*	*0.5*	*64.1*	*2.7*	*66.9*

[1] Foreign holdings of short-term dollars and marketable US Government securities with an original maturity of more than one year. [2] US Government non-marketable medium-term securities, except those issued to the Government of Canada in connection with transactions under the Columbia River Treaty. [3] US official holdings of convertible currencies, excluding sterling, and official franc balances of the French franc area. [4] Including gold payments to the Fund made in anticipation of quota increases. [5] Excluding a negative entry of $800 million representing the Fund's sales of gold for the acquisition of income-earning US securities. [6] Including the BIS and the European Fund. [7] These figures are reported by US sources. As some officially-owned foreign dollar balances are held with commercial banks outside the United States, they will be reported as belonging to non-official holders. Note: Figures may not add up to totals because of rounding.

International Monetary Fund.

In view of the moderate increase in world gold and exchange holdings, the operations of the IMF were of particular significance for the functioning of the monetary system in 1965. Gross drawings totalled $2,434 million, only slightly less than in 1961, while net drawings, at $1,732 million, were a record. These operations provided credit for countries in balance-of-payments difficulties and they also made a substantial contribution to the increase in external monetary assets of surplus countries. This contribution amounted to $1.7 milliard, of which $1.2 milliard represented an increase in gold tranche drawing rights and $0.5 milliard one in GAB creditor positions.

There were two principal reasons for the high level of the Fund's activity in 1965: the payments difficulties of the two reserve centres and the continuing needs of the developing countries.

International Monetary Fund: Exchange transactions in 1965.

Countries or areas	Drawings	Repurchases	Net drawings
	in millions of US dollars		
United States	435	282	153
United Kingdom	1,400	30	1,370
Other Europe	50	30	20
New Zealand	62	—	62
Developing countries	487	360	127
of which			
Argentina	*—*	*44*	*— 44*
Brazil	*75*	*55*	*20*
Chile	*36*	*37*	*— 1*
India	*200*	*75*	*125*
Indonesia	*—*	*39*	*— 39*
Pakistan	*54*	*—*	*54*
Total	2,434	702	1,732

The $1,400 million drawing made by the United Kingdom in May 1965 was the second largest in the history of the Fund and it brought the Fund's holdings of sterling up to 198 per cent. of the British quota.

The United States drew on the Fund three times during the year. In March and September there were further "technical" drawings, the proceeds of which were sold to other Fund members wishing to repay their own drawings. In addition, $300 million was drawn in July and used to absorb dollars held (some of them under swaps) by foreign monetary authorities. As a result of dollar drawings on the Fund, however, the net increase in the Fund's holdings of dollars during 1965 was only $165 million, leaving an unused gold tranche position of about $600 million at the end of the year.

Amongst other developed countries, New Zealand drew $62 million and Yugoslavia $50 million, the latter drawing on a $80 million stand-by credit given in support of a broad programme of exchange and economic reform.

The 1965 record also underlines the importance of the IMF for the developing countries. At $487 million, their gross drawings were the second highest since the establishment of the Fund. However, in accordance with the relatively short-term nature of these credits, their net recourse to the Fund's resources amounted to only $127 million. New stand-by facilities totalling $646 million were granted to twenty developing countries, of which $250 million's worth was still available at the year-end. On the other hand, little use has been made so far of the Fund's compensatory financing facility. This has been partly because of favourable commodity price trends; however, ways of improving its application are being studied.

Amongst the developing countries the main recipients of Fund assistance in 1965 were India and Pakistan, with net drawings of $125 million and $54 million respectively. Brazil and Chile repaid earlier drawings and made new ones, whilst substantial net repayments were made by Argentina and Indonesia, the latter country having ceased to be a member of the Fund in August 1965.

With its activities dominated for the second successive year by the credit requirements of the two members with the largest quotas, the Fund's usable gold and currency resources were again substantially reduced in 1965. Two-thirds of the UK drawing was met out of non-quota currency assets, $400 million coming from gold sales and $525 million from a further activation of the GAB. Nevertheless, the Fund's holdings of usable currencies other than dollars and sterling declined during 1965 from 43 to 24 per cent. of the quotas of the countries in question. Holdings of Austrian schillings and Deutsche Mark remained at less than 10 per cent. of these countries' quotas. Holdings of lire and pesetas fell below that level and holdings of French francs to 18 per cent. of France's quota. The principal currencies drawn during the year were (net) $435 million of lire, $358 million of French francs, $296 million of Deutsche Mark and $282 million of US dollars. Net drawings of Belgian francs, Canadian dollars and Dutch florins were each well over $100 million.

International Monetary Fund: Holdings of selected member currencies.

Currencies of	1958	1960	1962	1963	1964	1965	Fund holdings March 1966
	end-year figures as a percentage of member's quota						in millions of US dollars
Austria	75	75	65	50	3	4	78
Belgium	75	75	61	59	49	29	82
Canada	70	72	125	111	67	45	221
France	150	74	44	43	34	18	137
Germany	55	61	34	30	7	7	35
Italy	—	75	25	16	72	4	107
Japan	75	75	64	64	60	58	459
Netherlands	75	71	51	51	45	32	118
Spain	—	118	75	64	29	6	84
Sweden	75	75	68	65	52	27	91
United Kingdom	124	75	74	75	126	198	4,329
United States	29	62	74	75	81	85	4,431

In view of this drain on the Fund's liquidity, it was of particular importance that the GAB was prolonged for a further four years as from October 1966 and that the increase in Fund quotas, agreed on at the 1964 annual meeting and subsequently fixed by the Board of Executive Directors at 25 per cent. (with larger increases being approved for sixteen member countries), came into effect on 26th February 1966. The quota increases bring the total of all quotas up from $16 to about 21 milliard.

Total net drawings on the Fund in the first quarter of 1966 were $226 million. The United States drew $160 million in Canadian dollars and the United Kingdom $122 million in Deutsche Mark. The British drawing, which corresponded in amount to the increase in its Fund gold subscription, was used to purchase gold from the Deutsche Bundesbank. At the same time the Fund sold $130 million of gold to Germany against Deutsche Mark. Other Fund members repaid a net amount of $56 million during the quarter.

Gold reserves.

Official gold holdings of countries (excluding the USSR, other eastern European countries, mainland China and North Korea) and international institutions increased during 1965 by $250 million to a total of $43.3 milliard at the end of the year. This was their smallest increase in any year since 1952. The distribution of gold holdings showed a very large shift from the United States, whose gold stock declined by $1,665 million, to western Europe, where gold reserves went up by $1,945 million.

Of the decline in the US gold stock, $1,547 million was accounted for by sales and transfers to foreign monetary institutions and the remaining $118 million by sales to domestic users. The latter figure was approximately twice the value of US gold production for the year. The United States sold a net amount of $1,299 million of gold to western Europe, France accounting for $884 million, and transferred $225 million net to the IMF. The principal transaction with the Fund was a payment of $259 million in respect of the

World gold reserves.

Countries or areas	Changes in 1964		Changes in 1965		Amounts outstanding end-1965	
	in millions of US dollars					
United States		— 125		— 1,665		13,806
Western Europe		+ 830		+ 1,945		22,464
of which						
Austria	*+ 64*		*+ 100*		*700*	
Belgium-Luxemburg	*+ 80*		*+ 107*		*1,558*	
France	*+ 554*		*+ 977*		*4,706*	
Germany	*+ 405*		*+ 162*		*4,410*	
Italy	*— 236*		*+ 297*		*2,404*	
Netherlands	*+ 87*		*+ 68*		*1,756*	
Portugal	*+ 26*		*+ 53*		*576*	
Spain	*+ 43*		*+ 194*		*810*	
Switzerland	*— 95*		*+ 317*		*3,042*	
United Kingdom	*— 348*		*+ 129*		*2,265*	
Bank for International Settlements	*+ 229*		*— 508*		*—558*	
Other[1]	*+ 21*		*+ 49*		*795*	
Canada		+ 209		+ 125		1,151
Latin American republics		— 35		— 80		1,054
of which						
Brazil	*— 58*		*— 29*		*63*	
Other	*+ 23*		*— 51*		*991*	
Asia		+ 77		+ 76		1,716
Africa		— 85		— 111		718
of which						
South Africa	*— 56*		*— 149*		*425*	
Other	*— 29*		*+ 38*		*293*	
Other countries[2]		+ 16		— 4		249
International Monetary Fund		— 133		— 41[3]		2,138[3]
Other international institutions		— 1		+ 1		9
Total[2]		+ 753		+ 246		43,305

[1] Including gold to be distributed by the Tripartite Commission for the Restitution of Monetary Gold and gold held by the European Fund. [2] Excluding the USSR, eastern Europe, mainland China and North Korea. [3] Including $313 million gold subscription payments to the IMF, less $44 million gold deposited by the Fund with the United States and the United Kingdom.

gold tranche portion of the increase in the US Fund quota. On the other hand the Fund made a gold deposit of $34 million with the US Treasury in order to mitigate the impact on the US gold stock of purchases by foreign countries for gold subscription payments to the Fund.

The increase of $1,945 million in western European gold reserves was widely spread, many countries adding substantially to their holdings. France, with a gain of $977 million, accounted for one-half of the total increase. The next biggest rise was that of $317 million in the Swiss National Bank's gold reserve, but this was more than accounted for by end-year gold swaps of $380 million with the BIS, so that between January 1965 and January 1966 the National Bank's gold reserve actually declined by $41 million. These end-year operations also, therefore, account for the greater part of the decline of $508 million in the spot gold position of the BIS during 1965. The next largest change in western Europe was the increase of $297 million in Italy's gold reserves; most of this came from a transfer to the Italian Exchange Office of eastern European gold previously held by Italian commercial banks as collateral for credits to these countries. Taking western Europe as a whole, $1,299 million's worth was purchased from the US Treasury and $350 million's worth from the IMF; most of the remainder came from the Italian transaction already referred to.

Elsewhere in the world the biggest change was in South Africa, where the Reserve Bank's gold holding declined by $149 million. In fact South Africa's gold reserves fell by $232 million during the first nine months of the year, when the balance of payments was in deficit, and then were rebuilt to the extent of $83 million during the last quarter. Canada's gold reserves increased, for the third year running, by $125 million, and those of Asian countries by $76 million; Latin American holdings, on the other hand, fell by $80 million.

The table shows the IMF gold stock as having declined by $41 million during 1965. The Fund's usable gold reserve, however, actually went down by $310 million, sales of gold for currency having amounted to $400 million. In connection with the increase in quotas, the Fund received gold subscription payments from members during 1965 totalling $313 million. Furthermore, $44 million of this amount was deposited by the Fund with the United States and the United Kingdom in order to mitigate gold losses suffered by these countries in connection with other Fund members' gold subscription payments to the Fund. It was not until February 1966, when the increase in quotas came into effect, that the new gold subscription payments, excluding that part of them which had been deposited with the two reserve-currency countries, became part of the Fund's usable gold stock.

Although full data are not yet available, it would appear that world gold reserves increased during the first quarter of 1966. Despite purchases of $100 million from Canada and further deposits of $131 million made by the IMF in mitigation of gold sales arising out of other countries' gold subscriptions to the Fund, the US gold stock declined by $68 million. European gold holdings showed virtually no change during the quarter. Largely as a result of the unwinding of end-year operations between the Swiss National Bank and the BIS, western European countries' gold reserves declined by some $500 million whilst the spot gold position of the BIS improved by $528 million. South Africa's gold reserve rose by $95 million, while that of Canada, owing to the sales to the United States, fell by $65 million.

The gold stock of the IMF increased by $220 million during this quarter. Receipts from gold subscriptions, including those paid before the increase in quotas came into effect in February 1966, amounted to $813 million. However, $269 million had already been paid in during 1965, $198 million of gold was deposited by the Fund with the United States and the United Kingdom and $130 million of gold was sold to Germany.

Foreign exchange holdings.

Countries' holdings of exchange — the three principal components of which are US dollars, US Government non-marketable bonds and sterling — increased by $0.6 milliard in 1965, compared with a rise of $3.1 milliard the year before. Practically the whole of this change was in the dollar component. Reference has already been made to the factors which slowed down so markedly the rise in foreign countries' dollar holdings. The effects of one of the most important of these, viz. the US balance-of-payments measures, can be clearly seen from the figures for short-term loans made to foreigners by US banks. After increasing by $1.5 milliard in 1964, the outstanding total of such loans fell by $0.3 milliard last year.

Countries' dollar balances (leaving on one side for the moment their holdings of non-marketable US Government bonds, most of which are not denominated in dollars) rose, therefore, by only $245 million in 1965, officially-held balances actually declining by $175 million whilst private holdings went up by $420 million. The fact that private holdings of dollars continued to increase despite the reduction of US bank loans was due mostly to very large transfers of dollars from the Italian Exchange Office to the Italian commercial banks.

Looking at the geographical distribution of movements in dollar balances during 1965, those of western Europe declined by $535 million. Continental balances fell by $1,505 million, principally as the counterpart to the increase in their IMF positions, whilst UK-owned balances rose by $970 million. Some of this rise was in turn the counterpart to the decline in continental holdings and some resulted from the conversion into liquid form of dollar securities held by the UK Treasury.

Canada's US dollar balances declined in 1965 by $425 million following the introduction of the US voluntary restraint programme.

Elsewhere in the world, countries continued to add to their dollar balances. Those of Latin American republics increased by $485 million; rises

Changes in countries' dollar balances, 1965.

Country or area	Official	Private	Total
	in millions of US dollars		
Western Europe *	— 735	+ 200	— 535
Canada	— 80	— 345	— 425
Latin American republics	+ 260	+ 225	+ 485
Asia	+ 280	+ 315	+ 595
Africa	+ 35	+ 10	+ 45
Other countries	+ 65	+ 15	+ 80
Total	— 175	+ 420	+ 245

* Including the BIS and the European Fund.

were fairly widespread in this area, with the biggest occurring in Argentina and Brazil. Asian dollar balances rose by $595 million, of which Japan accounted for some 40 per cent. and Saudi Arabia, Thailand and the Philippines for most of the rest. In the group of "Other" countries, Australia's balances went up by $80 million.

Net issues of non-marketable bonds by the US Treasury increased by $0.3 milliard, as they had done in 1964. The whole of the increase in 1965 was taken by Italy, in transactions that have been described on page 24.

Countries' gross sterling balances rose by $125 million in 1965. After allowing, however, for an increase of $190 million in balances arising out of foreign assistance to the United Kingdom, there was a decline of some $60 million. Despite the rise in the "assistance" balances, total official sterling balances declined by $100 million during the year. This was because the outer sterling area reduced its official London balances by $395 million. Privately-owned balances rose by $225 million, mostly in the sterling area.

As in 1964, there were considerable fluctuations in sterling balances last year. So far as the sterling area is concerned, these resulted mainly from balance-of-payments changes. The area's balances fell by $520 million during the first nine months and then rose by $285 million in the last quarter. Net of these countries' sterling liabilities, the January-September decline was $445 million and the subsequent rise $180 million.

Excluding the effects of assistance, non-sterling-area countries' balances fell by only $25 million on a gross basis, whilst on a net basis they fell by $75 million. As the end of the confidence crisis came nearly a month before the end of the third quarter, however, these figures do not indicate the size of the outflow between January and August. In the last quarter of 1965 the non-sterling area increased its London balances by $200 million, of which $40 million had a counterpart in higher UK claims in these countries. At the end of 1965 the gross London balances of non-sterling-area countries were some $225 million below what they had been in June 1964, just before the crisis began. Those of the sterling area were $520 million lower.

European monetary movements.

In 1965 western European countries taken as a group were again in substantial balance-of-payments surplus. The changes in their external monetary positions which formed the counterpart of the surplus were, however, in a number of respects quite different from those of 1964. Firstly, a substantial part of the surplus was taken in the form of a reduction in the commercial banks' net foreign liabilities. Available statistics (the principal gaps in which are the absence of data for the Swiss banks and the limitation of the UK figures to the banks' foreign currency positions) show that the net foreign liabilities of the commercial banking systems of fifteen western European countries declined by $1 milliard in 1965, whereas during the previous year they had increased by $380 million. Secondly, and arising out of the turn-round in the banks' positions, official financing of the surplus was less important in 1965, both relatively and in absolute terms. The net official monetary assets of eighteen western European countries increased by $775 million during the year, compared with a rise of $1,640 million in 1964. Thirdly, the pattern of official financing was strikingly different. During 1964 by far the greater part of it took the form of an increase of $1,355 million in official foreign exchange holdings; in 1965, on the contrary, these declined by $1,440 million, whilst gold reserves went up by $2,440 million.

The contrast between the 1964 pattern of official monetary movements in western European countries and that of 1965 appears most clearly if the United Kingdom is excluded from consideration. Taking as a group the other seventeen countries of western Europe included in the table on page 127, it can be seen that there was a shift in official financing away from foreign exchange towards not only gold but also IMF and GAB positions. This shift may be attributed to two main factors. The first, an extraneous factor, was the size of the UK and US drawings on the IMF, whilst the second, which resulted from policy decisions by the countries concerned, was an increasing tendency to prefer gold to foreign exchange as a reserve asset.

So far as the first of these factors is concerned, the United Kingdom and the United States together drew $1,365 million in continental European

Western European countries: Monetary movements, 1964–65.

Items	1964		1965	
	Including United Kingdom	Excluding United Kingdom	Including United Kingdom	Excluding United Kingdom
	changes, in millions of US dollars			
Gold	+ 595	+ 945	+ 2,440	+ 2,310
Net foreign exchange	+ 1,355	+ 1,345	— 1,440	— 2,000
IMF and GAB positions	— 310	+ 695	— 225	+ 1,170
Total net official positions	+ 1,640	+ 2,985	+ 775	+ 1,480
Commercial banks' net foreign positions	— 380[1]	+ 30[2]	+ 1,005[1]	+ 920[2]

[1] Fifteen countries only: UK statistics refer only to the banks' foreign currency positions. [2] Fourteen countries only.

currencies from the IMF in 1965. These drawings, the effects of which on the lending countries' IMF positions were partially offset by Fund gold sales of $350 million, essentially account for the increase of $1,170 million in the IMF and GAB positions of the continental European countries last year. The British and American drawings therefore account for a considerable part of the decline of $2,000 million in the continental countries' official exchange holdings during 1965, since virtually the whole of what these two countries drew from the Fund in European currencies was used by them to purchase dollars from European monetary authorities.

The second principal feature of the continental countries' official monetary movements in 1965 was the increase of $2,310 million in their gold reserves. $350 million of this amount came from the Fund gold sales just mentioned. The main source of gold, however, was the US Treasury, from which these countries bought a total of $1,450 million's worth. Most of these purchases were made with dollars currently accruing from balance-of-payments surpluses; but there were in addition some countries, of which France and Spain were the most important, that converted into gold during 1965 dollars that they had acquired in earlier years. Such conversions of "old" dollar balances accounted for part of the decline in official continental exchange holdings last year. The third reason for the exceptionally large increase in these seventeen countries' gold reserves during 1965 was the size of the Swiss banks' end-year dollar operations with the Swiss National Bank. These amounted to $380 million, the whole of which was swapped into gold at the BIS by the Swiss National Bank.

Available data show that during the first quarter of 1966 western European countries' official gold and exchange holdings declined by $550 million, whilst their net IMF and GAB positions increased by $195 million. Their total net official assets, therefore, rose by $355 million. But for a transfer of $885 million's worth of dollars from the UK Treasury to the Exchange Equalisation Account, however, this figure would have shown a decline of $530 million. On the other hand, the net foreign liabilities of the commercial banks in the fourteen western European countries for which figures are available decreased by $720 million. As no figures are available regarding the position of Swiss commercial banks, which certainly improved considerably during the first quarter as a result of the unwinding of end-year operations with the Swiss National Bank, it is clear that western European countries taken as a group were still in substantial external surplus.

The positions of individual countries are examined in the following pages, except for those of France, Italy and the United Kingdom, which have been dealt with in Part I.

Germany. Despite a basic balance-of-payments deficit of $1,380 million, the largest of any European country last year, Germany's external monetary position deteriorated by only $280 million during 1965. Net official assets declined by $325 million, whilst the net foreign position of the banks improved by $45 million. Net official exchange holdings declined by $650 million, European countries, Canada and Japan: External monetary positions.

Countries	End of year	Gold and foreign exchange	Net IMF and GAB position	Total official assets	Commercial banks (net)	Total foreign assets	Changes (+ = increase in assets, decrease in liabilities): Total official assets	Changes (+ = increase in assets, decrease in liabilities): Commercial banks
		in millions of US dollars						
Austria	1964	1,235	70	1,305	— 5	1,300	+ 80	+ 15
	1965	1,225	70	1,295	— 55	1,240	— 10	— 50
Belgium-Luxemburg	1964	2,095	205	2,300	— 535	1,765	+ 250	— 75
	1965	2,145	315	2,460	— 560	1,900	+ 160	— 25
Denmark	1964	595	35	630	— 125	505	+ 170	— 55
	1965	510	60	570	— 45	525	— 60	+ 80
Finland	1964	345	15	360	— 50	310	+ 45	— 5
	1965	275	15	290	— 65	225	— 70	— 15
France	1964	4,930	620	5,550	— 365	5,185	+ 815	— 20
	1965	5,370	885	6,255	— 110	6,145	+ 705[1]	+ 255
Germany	1964	7,560	910	8,470	— 715	7,755	+ 110	— 15
	1965	7,070	1,075	8,145	— 675	7,470	— 325	+ 45[2]
Greece	1964	265	15	280	—	280	— 10	— 35
	1965	235	15	250	5	255	— 30	+ 5
Iceland	1964	40	5	45	— 5	40	+ 5	—
	1965	45	5	50	— 5	45	+ 5	—
Ireland	1964	435	10	445	260	705	+ 40	— 25
	1965	395	10	405	250	655	— 40	— 10
Italy	1964	3,850	145	3,995	— 815	3,180	+ 350	+ 450
	1965	4,400	550	4,950	— 195	4,755	+ 955	+ 620
Netherlands	1964	2,065	265	2,330	115	2,445	+ 250	— 185
	1965	2,045	360	2,405	10	2,415	+ 75	— 105
Norway	1964	355	25	380	— 60	320	+ 40	—
	1965	445	25	470	10	480	+ 90	+ 70
Portugal	1964	940	15	955	80	1,035	+ 115	— 10
	1965	995	15	1,010	110	1,120	+ 55	+ 30
Spain	1964	1,410	105	1,515	.	.	+ 365	.
	1965	1,270	140	1,410	.	.	— 105	.
Sweden	1964	865	90	955	70	1,025	+ 200	— 10
	1965	815	145	960	90	1,050	+ 5	+ 20
Switzerland	1964	3,640	—	3,640	.	.	+ 145	.
	1965	3,700	—	3,700	.	.	+ 60	.
Turkey	1964	50	— 35	15	.	.	+ 15	.
	1965	45	— 20	25	.	.	+ 10	.
Total	1964	30,675	2,495	33,170	—2,150[3]	25,850[3]	+2,985	+ 30[3]
	1965	30,985	3,665	34,650	—1,235[3]	28,280[3]	+1,480	+ 920[3]
United Kingdom	1964	2,315	— 515	1,800	— 440[4]	1,360	—1,345	— 410[4]
	1965	3,005	—1,910	1,095	— 355[4]	740	— 705	+ 85[4]
Total European countries	1964	32,990	1,980	34,970	—2,590[5]	27,210[5]	+1,640	— 380[5]
	1965	33,990	1,755	35,745	—1,590[5]	29,020[5]	+ 775	+1,005[5]
Canada	1964	2,625	195	2,820	330	3,150	+ 335	+ 250
	1965	2,605	355	2,960	— 70	2,890	+ 140	— 400
Japan	1964	1,775	220	1,995	—1,185	810	— 45	— 65
	1965	1,870	255	2,125	— 905	1,220	+ 130	+ 280

[1] Excluding an official debt prepayment of $179 million. [2] After elimination of statistical changes. [3] Fourteen countries only. [4] Foreign currencies only. Owing to differences in presentation, the figures for 1965 do not correspond to those used for the table on page 27 of Part I. [5] Fifteen countries only.

Note: For Group of Ten countries other than the United Kingdom, and including Switzerland, the figures for official assets are those used for multilateral surveillance. They do not in most cases correspond to published reserve figures.

this being partly offset by an increase of $165 million in the IMF and GAB position and of $160 million in the gold stock. It was, of course, quite natural that the official financing requirements should be met out of the exchange reserves; but the fact that these fell by roughly twice the overall decline in net official assets, whilst at the same time the gold reserve and the IMF position increased, was to a very large extent the consequence of the UK drawings on the IMF in May 1965. The amount drawn on this occasion in Deutsche Mark was the equivalent of $310 million and its subsequent conversion into dollars reduced the Bundesbank's exchange reserves correspondingly. At the same time the IMF sold $130 million of gold to the Bundesbank in order to replenish its holdings of Deutsche Mark. The net result of these two transactions on Germany's IMF and GAB position was to increase it by $180 million.

Considering that four-fifths of the basic balance-of-payments deficit in 1965 was covered by short-term capital inflows, it is, at first sight, surprising that the banks' net foreign liabilities actually declined by $45 million. That they did so must be attributed to the effectiveness of the measures that the Bundesbank had taken the year before to prevent an inflow of funds through that particular channel. The US dollar swap commitments of the Bundesbank vis-à-vis the banking system, which rose from $90 to 355 million in January 1965, subsequently declined rapidly and had run off completely by October 1965.

Reflecting mainly the unwinding of end-year operations, Germany's official monetary assets declined by $290 million during the first quarter of 1966 whilst the net foreign indebtedness of the banks was reduced by $345 million. $100 million of the decline in official assets took the form of a redemption of non-marketable US Government bonds held by the Deutsche Bundesbank, whilst in addition official holdings of convertible foreign exchange fell by $95 million.

Switzerland. Despite a substantial improvement in the basic balance of payments, net official monetary assets increased by only $60 million in 1965, compared with a rise of $145 million in 1964. Because of the influence on the official reserves of the Swiss banks' end-year operations, however, the annual changes in Switzerland's net official monetary position are better measured on a November-to-November or a January-to-January basis. Measured in either of these ways, the contrast between 1964 and 1965 was greater than if the end-year figures are taken. Net official assets declined by $150 million between November 1964 and November 1965, and by $305 million between January 1965 and January 1966. Between November 1963 and November 1964, on the other hand, they had risen by $280 million and between January 1964 and January 1965 by $360 million. Leaving end-year influences aside, therefore, Switzerland's reserves showed a marked decline in 1965 after a substantial increase the previous year.

The decline in Swiss reserves was concentrated in the first half of the year, when there was an outflow of money, only partly seasonal, through the banks. During the first five months of the year net official assets declined by

$265 million. In March and April the National Bank was able, for the first time since 1962, to sell dollars in the market. Mid-year window-dressing operations caused the reserves to go up by $145 million in June, but this movement was reversed in July and from then on until November there was little further change in their level. End-year repatriations of money by the banks raised the reserves by as much as $390 million in December, but they fell sharply in January 1966 and continued on a downward trend until the end of April 1966, when they stood at $3,170 million.

Belgium. Because of a reduction in the government's short-term foreign debt, the increase in Belgium's basic balance-of-payments surplus in 1965 was not reflected in monetary movements. The improvement in the total external monetary position actually slowed down from $175 to 135 million. As the banks' net foreign liabilities increased by $25 million, the monetary counterpart of the surplus came entirely in the form of a rise of $160 million in net official assets.

The gold reserve rose by $105 million, of which $30 million was purchased from the IMF. This purchase partly offset the effect on Belgium's IMF position of net franc drawings by other Fund members, which amounted to $135 million, so that the net IMF and GAB position increased by some $105 million. Official exchange holdings declined by $55 million. Convertible foreign exchange balances went down by $100 million, through conversion into dollars of francs drawn on the Fund; on the other hand, the National Bank's portfolio of export credits denominated in Belgian francs rose by $45 million.

The first quarter of 1966 saw a $60 million decline in Belgium's official monetary assets, while the banks' net foreign claims increased by $40 million.

Netherlands. The external monetary position of the Netherlands showed a deterioration of $30 million in 1965, compared with an improvement of $65 million the year before. Net official assets increased by $75 million, while the banks' net foreign assets fell by $105 million.

The pattern of changes in the official monetary assets was similar to that in most other western European countries. The gold reserve went up by $70 million, of which $35 million came from the IMF; the net IMF and GAB position increased by $95 million, net drawings of florins on the Fund totalling $125 million; and the exchange holdings were reduced by $90 million. Both the foreign assets and liabilities of the banks, and in particular their foreign currency positions, increased considerably during 1965. But as liabilities went up more than assets, their net foreign exchange position was reduced by $80 million.

The widening of the Dutch payments deficit in the first quarter of 1966 was reflected in a deterioration of $160 million in the external monetary position. $120 million of this amount took the form of larger bank borrowing abroad, official assets declining by only $40 million.

Spain. After Germany, Spain experienced the largest deterioration in its balance of payments of any western European country during 1965. Net official monetary assets, which had risen by $365 million in 1964, declined by $105 million last year. Despite this, the gold reserve increased by $195 million, nearly all of which was purchased from the US Treasury. The net IMF and GAB position increased by $35 million, net drawings of pesetas from the Fund amounting to $50 million. The conversions of official dollar balances into gold and the lending through the Fund, together with the financing requirements of the external deficit, brought about a reduction of $335 million in the exchange reserves. During the first quarter of 1966 the official exchange reserves declined by a further $145 million.

Austria. Austria, too, moved from balance-of-payments surplus to deficit in 1965. Its external monetary position declined by $60 million, of which an increase in the banks' net foreign liabilities accounted for $50 million. Despite the fact that net official assets hardly changed, the gold reserve increased by $100 million as a result of purchases from the US Treasury. Official exchange holdings were reduced by $110 million. During the first quarter of 1966 the official gold and exchange reserves declined by $80 million; the net IMF and GAB position, on the other hand, rose by $25 million and the net foreign indebtedness of the banks fell by the same amount.

Portugal. The balance of payments showed a surplus of $85 million in 1965, slightly less than in the previous year. Official monetary assets increased by $55 million, all of which was added to the gold reserve. In addition, the commercial banks' net foreign assets rose by $30 million.

Of the northern countries, Norway had a substantial external surplus, Denmark and Sweden were in moderate surplus, while Finland recorded a deficit.

Norway. Thanks mainly to a further substantial inflow of capital, Norway's external monetary assets rose by $160 million in 1965. $90 million of this was added to the official exchange reserves, Norway being the only European surplus country whose gold reserve showed no increase last year. Part of the net capital inflow was reflected in the foreign positions of the Norwegian banks, whose net foreign assets rose during the year by $70 million.

In *Denmark* a shift in the commercial banks' position from $55 million of net new borrowing in 1964 to $80 million of net lending in 1965 added to the negative impact on reserves of the deterioration in the basic balance of payments that occurred during 1965. Thus official foreign assets, which had shown a $170 million gain in 1964, fell by $60 million. The whole of this decline occurred during the first eight months, while there was a $130 million improvement during the rest of the year and a further gain of $35 million during the first quarter of 1966.

In *Sweden* official monetary assets rose by $95 million in the first quarter of 1965, but, parallel with the widening of the Swedish current-account deficit, declined by $90 million during the rest of the year. At $15 million, the gain in official gold reserves for the year 1965 as a whole was somewhat larger than the $5 million increase in official foreign assets, the difference being explained by a purchase of gold from the IMF.

In *Finland* the 1965 balance-of-payments deficit resulted in a decline of $70 million in official monetary assets, together with an increase of $15 million in the commercial banks' net foreign indebtedness.

Other monetary movements.

Canada. Canada's balance of payments, if changes in the short-term foreign position of the banks are included in monetary movements, showed a deficit of $260 million in 1965. Despite this, net official monetary assets rose by $140 million. Canada's net IMF and GAB position increased by almost $160 million, whilst official gold and exchange reserves declined by $20 million. The Canadian banks' net foreign assets, on the other hand, were drawn down by $400 million during the course of the year. Most of this occurred during the first part of the year in response to withdrawals of US funds from Canada. During the first quarter of 1966 the balance of payments on this same basis showed a small surplus of $10 million. Contrary to what happened in 1965, official assets fell by $120 million whilst the banks' net foreign position improved by $130 million.

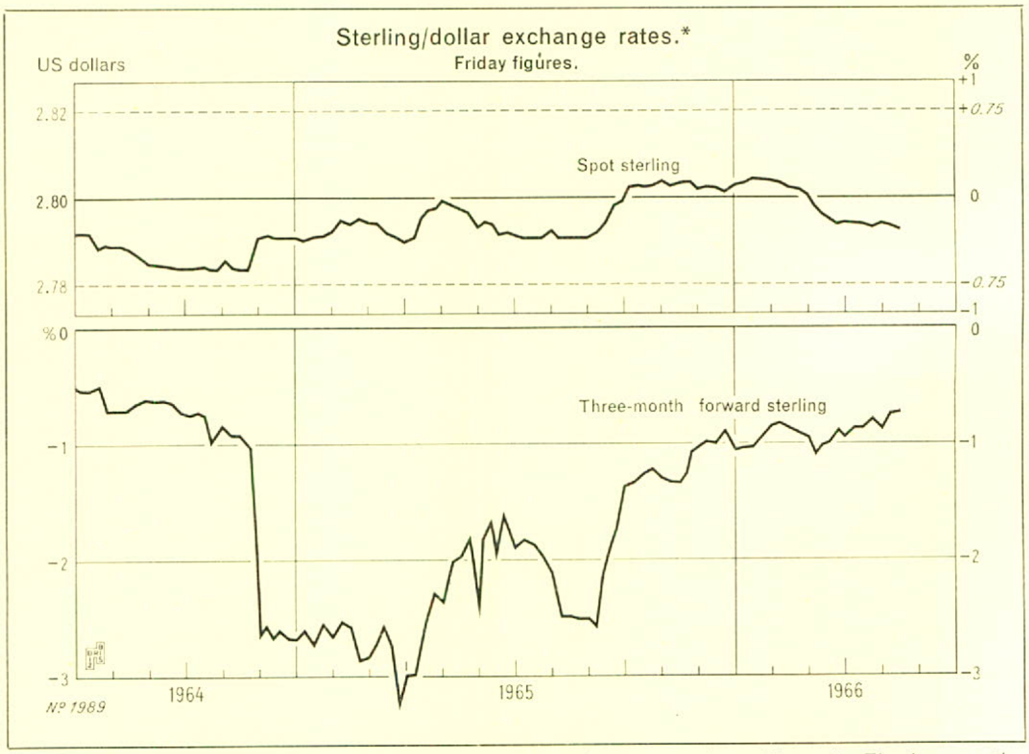
Japan. The overall balance-of-payments surplus for 1965 was $410 million. Most of this showed up in a decline of $280 million in the Japanese commercial banks' net foreign liabilities. In addition, the official monetary assets went up by $130 million, of which $70 million was added to the net exchange reserves, $35 million to the net IMF and GAB position and $25 million to the gold reserve.

Foreign exchange markets.

The period under review was an eventful one in the exchange markets. Its outstanding features were the continuation of the sterling crisis until the end of August 1965 and the marked recovery of that currency from September onwards. Less dramatic, but not less significant, was the strengthening of the dollar that occurred. This began in February 1965 as a result of the measures taken to limit capital outflows from the United States, and it was later sustained by changes in some European countries' balances of payments, as well as by a rise in US interest rates. On the Continent, while the French franc and the lira have continued to be very firm, other currencies, and in particular the Deutsche Mark, have eased against the dollar. Looking at the situation in May 1966, sterling was under some pressure again, whilst the dollar remained well above its lower limit against all European currencies except the French franc and the Swiss franc.

Sterling. At the beginning of 1965 pressure on sterling was considerable and the spot rate was still being held just above \$2.79, whilst substantial official intervention was also required to maintain orderly conditions in the forward market. In mid-January the pressure began to ease temporarily as a result of an inflow of funds through the Euro-dollar market to UK local authorities and by early February the spot rate had recovered to \$2.79½. Following the US balance-of-payments measures, however, the situation soon changed and, with market sentiment deteriorating in front of the UK budget, large-scale official intervention was again needed. By the end of March the spot rate had fallen nearly to \$2.79 and the three-month forward discount on the dollar had reached 3¼ per cent. per annum, at which level the interest arbitrage margins were in favour of New York.

Following the budget and official assurances that there would be no devaluation the position improved again, although by this time the local authorities were beginning to reduce their Euro-dollar borrowings. By the end of April spot sterling was almost at par against the dollar and the three-month forward discount went below 2 per cent. per annum in early May. One factor that was of some importance for the forward market at this time was the ceiling on bank lending, which discouraged switching out of dollars.



* The spot dollar rate for sterling is shown both in dollars and as a percentage of the parity. The three-month forward rate for sterling is shown as a discount on the spot rate, on a percentage per annum basis.

Once again, however, the recovery was short-lived and towards the end of May the spot rate was down to \$2.79¼, this being accompanied by a sharp increase in the forward discount.

During June and July sterling came under severe pressure and this continued into August, despite the announcement of fresh measures to correct the situation in late July. A substantial short-term capital outflow was superimposed on the weakness of the basic balance of payments. The spot rate was again held at about \$2.79, but the three-month forward discount on the dollar, which had narrowed to 1.7 per cent. per annum when Bank rate was reduced in June, had widened to 2½ per cent. by early August. At this level it provided a substantial arbitrage margin in favour of New York, which no doubt added to the outflow of funds from London.

Towards the end of August the selling of sterling began to ease off and early in September the spot dollar rate rose a little. Then the announcement of further central-bank support arrangements on 10th September produced a decisive change in market sentiment and by the end of the month the pound was comfortably above par on the dollar for the first time since early 1963, while in the forward market the three-month discount fell to 1.3 per cent. per annum by early October, turning the arbitrage margins in favour of London again.

Apart from some seasonal weakness near the end of the year, sterling remained firm during the last quarter of 1965 and in the early part of 1966. The spot rate, thus, moved rather narrowly around \$2.80¼ and the authorities used the inflow of exchange to repay short-term credits taken during the summer crisis and to start reinforcing the reserves. At the same time they were able to begin reducing their very large forward exchange commitments. The forward discount on the dollar continued to shrink and it went below 1 per cent. per annum when the US discount rate was put up in December 1965.

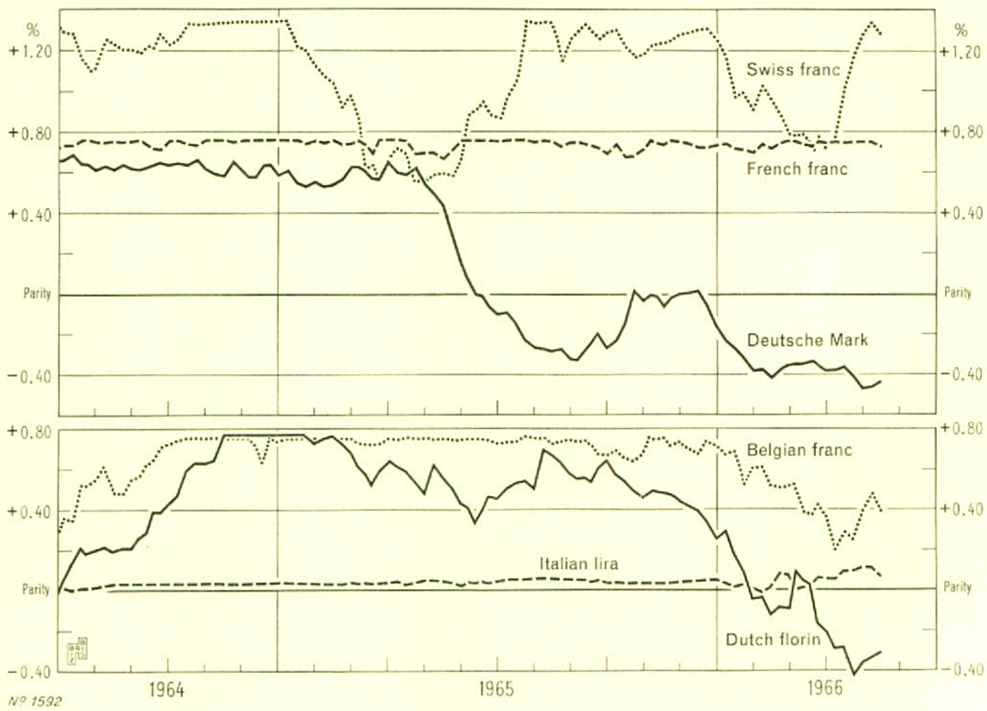
Towards the end of February 1966 sterling became less firm, following the publication of poor trade figures for January, and this trend continued as the general election approached. By the end of March the spot rate had slipped to \$2.79⅜. During the course of May the rate declined further under the impact of the British seamen's strike.

During the period under review a number of measures were taken with the object of reducing free-market supplies of foreign exchange available to residents of the United Kingdom. In particular, since April 1965 it has been required that 25 per cent. of the proceeds of foreign security sales by residents be surrendered to the Exchange Equalisation Account. While these measures reduced the capital outflow from the United Kingdom — during the last nine months of 1965 there was net portfolio disinvestment of \$180 million outside the sterling area — they also increased the premium of the investment dollar vis-à-vis the official parity. In March 1965, just before the budget which included these measures, the premium was about 8 per cent. By the end of May it had reached 11 per cent. and at the end of 1965 it was over 15 per cent. It increased further in the early months of 1966 and, despite measures in the 1966 budget to reduce residents' access to the investment dollar market, the premium stood at over 28 per cent. in late May 1966.

Swiss franc. Despite a marked improvement in Switzerland's basic balance of payments and the continuation of the sterling crisis, the Swiss franc was below its upper limit against the dollar for most of the period under review. At the beginning of 1965 there were substantial exports of money by the Swiss banks, partly representing the reversal of end-year operations and partly the result of ample domestic liquidity. In addition, dollars became relatively scarce following the US balance-of-payments measures. Consequently the spot dollar rate rose from the official intervention point of Sw.fr. 4.31½ at the end of 1964 to Sw.fr. 4.34½ in mid-March 1965, touching Sw.fr. 4.35 in late March and April. In these circumstances the Swiss National Bank was able, for the first time since 1962, to sell substantial amounts of dollars in the market.

In June 1965 the franc began to get firmer against the dollar, as the Swiss banks repatriated money for their mid-year balance sheets. With the sterling crisis flaring up again, the franc became much firmer in July 1965, reaching the upper limit of Sw.fr. 4.31½ against the dollar late in that month. From the middle of August onwards, however, it eased again a little and quotations moved around Sw.fr. 4.32 until November. Moreover,

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



thanks to the fact that the banks' end-year liquidity requirements were met by the Swiss National Bank through swaps of dollars against francs, the spot rate rose but did not reach the upper limit. In the early part of 1966 the franc eased and quotations in late March were just above Sw.fr. 4.34. By early May, however, the franc had risen again to about the upper limit.

Deutsche Mark. The market position of the Deutsche Mark weakened considerably during the period under review as a result of the deterioration in Germany's balance of payments. During the first quarter of 1965 the Deutsche Mark was still firm against the dollar, at about DM 3.97¾. As the current account moved further into deficit, however, it began to lose ground in April, and in June it went below par on the dollar. By early August the rate was at DM 4.01¼, its lowest level since November 1962.

Towards the end of August the trend changed. German monetary policy was tightened and there were substantial non-resident purchases of foreign bonds denominated in Deutsche Mark. This brought the mark up to its dollar parity in late October and quotations remained at about that level until the last week of the year, when it eased below par again and remained there during the first quarter of 1966.

The change in the position of the Deutsche Mark since a year ago has enabled the US authorities to purchase marks both directly from the Bundesbank and in the market, in order to reduce their outstanding Deutsche Mark commitments. Between June 1965 and March 1966 the reduction amounted to $300 million.

Other European currencies. During the whole of the period under review the French franc was quoted at, or very near to, its upper limit against the dollar. The lira, too, was very firm, though the Italian authorities continued to hold the rate only slightly above the dollar parity. The Belgian franc was close to its upper limit against the dollar during most of 1965; towards the end of the year, however, it began to ease and by late March 1966 stood 0.4 per cent. above par on the dollar. Following the introduction of the US voluntary restraint programme, the Dutch florin eased from its upper limit against the dollar to about 0.3 per cent. above parity; after strengthening again in the third quarter, it weakened once more and by May 1966 was 0.3 per cent. below par.

Other exchange developments.

Faced with continuing balance-of-payments difficulties, the two reserve-currency countries took further steps during the period under review to control outward capital movements.

The foreign exchange measures taken by the UK Government at the time of the April 1965 budget were described in last year's Annual Report. In July this policy was reinforced by the exclusion from the official exchange market of all direct investment outside the sterling area; at the same time the types of foreign exchange proceeds eligible for sale on the investment currency market were further restricted. The main items affected this time were proceeds from the sale of life insurances and of assets of immigrants reclassified as UK residents. Moreover, the Bank of England was asked to exert more uniform control over borrowing by foreign firms resident in the United Kingdom. Further steps were taken in May 1966 and in particular a voluntary restraint programme on investment in developed sterling-area countries was introduced.

The guide-lines for this programme recommend that UK companies planning investment projects in Australia, New Zealand, South Africa and Ireland should consider postponing them and should make every effort to finance overseas expenditure locally. Companies that nevertheless decide to continue with investment projects the foreign exchange cost of which exceeds £25,000 will be invited to submit their plans to the Bank of England. If a project does not promise quick, substantial and continuing benefit to the balance of payments, the Bank of England will urge its withdrawal or postponement. This screening procedure will also be applied to overseas direct investment outside the sterling area for which the necessary foreign exchange has to be provided from the investment-dollar pool. Voluntary restraint is likewise to be exercised in respect of portfolio investment in the sterling area by insurance companies, investment trusts and other institutional investors. Moreover, there will be restrictions on borrowing in the United Kingdom by sterling-area residents.

The US voluntary balance-of-payments restraint programme initiated in February 1965 was also described in last year's Annual Report. In December 1965 it was further elaborated. A ceiling was imposed on direct investment in developed countries with the recommendation that average annual outlays in 1965 and 1966 should not exceed 135 per cent. of the 1962–64 average. The ceiling on foreign lending by banks and other financial institutions was modified so as to permit in 1966 a rise in quarterly stages from 105 to 109 per cent. of the end-1964 level. Moreover, the geographical coverage of the interest equalisation tax was broadened to include the oil-producing countries of the Middle East.

The measures taken in various continental European countries to restrict capital inflows (mainly short-term) and to encourage capital exports have largely remained in force. This applies particularly to Germany. In Switzerland the controls on the inflow of foreign capital have been relaxed as from April 1966 so as to permit the investment of foreign funds in new Federal housing bonds and in new bonds issued by mortgage institutions and by cantonal and local banks. As regards capital exports, the big banks have been authorised to participate with a share of up to 10–15 per cent. in international consortia for certain international loans. In France the freedom to conclude exchange contracts for periods of up to six months forward was extended in October 1965 to cover foreign exchange receipts and payments arising out of capital transactions. At the same time foreign exchange banks were authorised to grant French franc credits to non-residents for a maximum period of six months.

Turning to the industrially less-developed European countries, *Portugal* liberalised in August 1965 its regulations concerning the repatriation of foreign capital and the transfer of earnings. In November 1965 the *Spanish* Government abandoned exchange controls on all types of dividend and interest payments abroad. Moreover, in February 1966 it approved the establishment of a forward market for the peseta.

Within the framework of a broad programme of economic reform, the *Yugoslavian* authorities devalued the dinar in July 1965 from 750 to 1,250 to the dollar. With effect from 1st January 1966 a new monetary unit was introduced in Yugoslavia, the new dinar, which is equivalent to 100 old dinars. As a result, the exchange rate of the dinar against the dollar was changed from Din. 1,250 to Din. 12.50 per dollar. The new exchange rate applies to all foreign receipts and payments.

IV. THE EURO-CURRENCY MARKET.

Two opposing forces have influenced the Euro-currency market since early 1965. On the one hand, the US voluntary restraint programme and the tightening of credit in that country have tended both to reduce the supply of and to increase the demand for Euro-dollars. On the other hand, there has been a substantial flow of funds into the market from European official monetary institutions — mainly the Italian Exchange Office. So far as the size of the market is concerned, the effect of additions to supplies from other quarters has outweighed that of the withdrawals of funds by the United States. In fact the foreign currency liabilities vis-à-vis non-residents of commercial banks in ten reporting countries (Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland and the United Kingdom) increased by \$1.7 milliard between March 1965 and March 1966, and assets by \$3.4 milliard. So far as Euro-dollar interest rates are concerned, however, US developments proved to be the stronger influence, although their effects were tempered by the increase in supply. At the beginning of June 1966 the rate for three-month Euro-dollar deposits stood at 5¾ per cent., compared with 5 per cent. a year earlier.

Changes in the overall positions.

During the first part of 1965 the Euro-currency market went through a period of consolidation, after which it again expanded considerably. The reporting banks' foreign currency liabilities vis-à-vis non-residents contracted slightly during the first half of 1965, from \$17.6 to 17.2 milliard, and then rose to \$19.5 milliard by the end of the year. For 1965 as a whole the increase in liabilities was \$1.9 milliard. The rise in the banks' foreign currency claims on non-residents during 1965 was even more pronounced, amounting to \$2.9 milliard. Here the expansion was already apparent in the second quarter of the year, though it gained momentum later. Thus claims declined from \$18.2 to 17.7 milliard in the first quarter, edged up to \$17.9 milliard in June and expanded to \$21.1 milliard by the end of the year. So far as the net position is concerned, the banks' net foreign currency assets vis-à-vis non-residents fell from \$0.7 to 0.5 milliard in the first quarter but then rose to \$1.6 milliard by the end of the year.

In the first quarter of 1966 the banks' foreign currency liabilities vis-à-vis non-residents declined from \$19.5 to 18.9 milliard, and their claims from \$21.1 to 21.0 milliard. More than the whole of this decline occurred in the banks' dollar positions, where liabilities fell from \$16.3 to 15.1 milliard and claims from \$17.1 to 16.6 milliard. In the other reported currencies the banks' external liabilities went up from \$3.2 to 3.8 milliard and their assets

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		Changes in net positions	
		Liabil-ities	Assets	Liabil-ities	Assets	Liabil-ities	Assets	US dollars	Other curren-cies
		in millions of US dollars							
Belgium . . .	1964 December	420	360	520	320	940	680		
	1965 March	400	440	570	290	970	730	+ 100	— 80
	December	560	470	600	380	1,160	850	— 130	+ 60
	1966 March	560	520	770	490	1,330	1,010	+ 50	— 60
Canada . . .	1964 December	2,590	3,180	20[2]	200[2]	2,610	3,380		
	1965 March	2,370	2,770	30[2]	190[2]	2,400	2,960	— 190	— 20
	December	2,370	2,670	30[2]	110[2]	2,400	2,780	— 100	— 80
	1966 March	2,040	2,440	30[2]	120[2]	2,070	2,560	+ 100	+ 10
France[3] . . .	1964 December	810	860	560	660	1,370	1,520		
	1965 March	730	890	550	590	1,280	1,480	+ 110	— 60
	December	1,070	1,220	530	640	1,600	1,860	— 10	+ 70
	1966 March	770	1,160	750	740	1,520	1,900	+ 240	— 120
Germany . .	1964 December	440	640	80	120	520	760		
	1965 March	230	700	60	120	290	820	+ 270	+ 20
	December	370	620	70	170	440	790	— 220	+ 40
	1966 March	280	620	50	100	330	720	+ 90	— 50
Italy.	1964 December	1,530	870	360	320	1,890	1,190		
	1965 March	1,340	800	450	260	1,790	1,060	+ 120	— 150
	December	1,710	1,570	440	470	2,150	2,040	+ 400	+ 220
	1966 March	1,220	1,280	500	560	1,720	1,840	+ 200	+ 30
Japan. . . .	1964 December	2,380	2,210	350	400	2,730	2,610		
	1965 March	2,500	2,290	370	400	2,870	2,690	— 40	— 20
	December	2,550	2,620	360	380	2,910	3,000	+ 280	— 10
	1966 March	2,570	2,600	340	340	2,910	2,940	— 40	— 20
Netherlands .	1964 December	360	390	150	290	510	680		
	1965 March	360	420	150	300	510	720	+ 30	+ 10
	December	530	420	210	400	740	820	— 170	+ 40
	1966 March	570	360	290	500	860	860	— 100	+ 20
Sweden . . .	1964 December	110	230	50	110	160	340		
	1965 March	130	180	70	110	200	290	— 70	— 20
	December	150	260	70	160	220	420	+ 60	+ 50
	1966 March	140	230	100	150	240	380	— 20	— 40
Switzerland[4].	1964 December	1,590	2,180	330	560	1,920	2,740		
	1965 March	1,450	2,270	340	510	1,790	2,780	+ 230	— 60
	December	1,700	2,660	360	550	2,060	3,210	+ 140	+ 20
	1966 March	1,490	2,520	360	560	1,850	3,080	+ 70	+ 10
United Kingdom . .	1964 December	4,380	3,670	520	660	4,900	4,330		
	1965 March	4,560	3,410	550	720	5,110	4,130	— 440	+ 30
	December	5,260	4,550	540	790	5,800	5,340	+ 440	+ 80
	1966 March	5,440	4,880	620	850	6,060	5,730	+ 150	— 20
Total . .	1964 December	14,610	14,590	2,940	3,640	17,550	18,230		
	1965 March	14,070	14,170	3,140	3,490	17,210	17,660	+ 120	— 350
	December	16,270	17,060	3,210	4,050	19,480	21,110	+ 690	+ 490
	1966 March	15,080	16,610	3,810	4,410	18,890	21,020	+ 740	— 240

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

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		Changes in net positions	
		Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	US dollars	Other currencies
		in millions of US dollars							
Belgium . . .	1964 December	330	260	380	60	710	320		
	1965 March	350	310	300	60	650	370	+ 30	+ 80
	December	460	350	410	100	870	450	— 70	— 70
	1966 March	460	420	460	110	920	530	+ 70	— 40
Canada . . .	1964 December	910	1,210	20[2]	30[2]	930	1,240		
	1965 March	1,010	1,010	30[2]	30[2]	1,040	1,040	— 300	— 10
	December	1,390	900	30[2]	40[2]	1,420	940	— 490	+ 10
	1966 March	1,190	850	30[2]	40[2]	1,220	890	+ 150	—
France[3] . . .	1964 December	730	660	400	340	1,130	1,000		
	1965 March	660	660	330	350	990	1,010	+ 70	+ 80
	December	940	1,010	360	370	1,300	1,380	+ 70	— 10
	1966 March	680	910	430	410	1,110	1,320	+ 160	— 30
Germany . .	1964 December	390	170	40	10	430	180		
	1965 March	190	170	30	20	220	190	+ 200	+ 20
	December	300	240	30	10	330	250	— 40	— 10
	1966 March	240	300	20	10	260	310	+ 120	+ 10
Italy	1964 December	1,250	600	210	150	1,460	750		
	1965 March	1,030	640	250	110	1,280	750	+ 260	— 80
	December	1,420	1,370	250	200	1,670	1,570	+ 340	+ 90
	1966 March	960	1,110	280	270	1,240	1,380	+ 200	+ 40
Japan	1964 December	350	550	100	260	450	810		
	1965 March	380	550	100	230	480	780	— 30	— 30
	December	390	690	100	240	490	930	+ 130	+ 10
	1966 March	430	670	90	210	520	880	— 60	— 20
Netherlands .	1964 December	320	300	100	100	420	400		
	1965 March	300	340	100	110	400	450	+ 60	+ 10
	December	470	340	140	90	610	430	— 170	— 60
	1966 March	480	280	190	140	670	420	— 70	—
Sweden . . .	1964 December	80	140	30	20	110	160		
	1965 March	90	110	40	30	130	140	— 40	—
	December	120	170	50	40	170	210	+ 30	—
	1966 March	120	130	50	30	170	160	— 40	— 10
Switzerland[4].	1964 December	1,440	1,610	180	120	1,620	1,730		
	1965 March	1,290	1,800	150	70	1,440	1,870	+ 340	— 20
	December	1,550	2,160	170	90	1,720	2,250	+ 100	—
	1966 March	1,320	2,070	160	110	1,480	2,180	+ 140	+ 30
United Kingdom . .	1964 December	3,840	2,460	.	.	.	.		
	1965 March	4,060	1,950	.	.	.	.	— 730	.
	December	4,710	2,950	.	.	.	.	+ 350	.
	1966 March	4,770	2,660	.	.	.	.	— 350	.
Total . .	1964 December	9,640	7,960	.	.	.	.		
	1965 March	9,360	7,540	.	.	.	.	— 140	.
	December	11,750	10,180	.	.	.	.	+ 250	.
	1966 March	10,650	9,400	.	.	.	.	+ 320	.

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

from $4.1 to 4.4 milliard. On a net basis their assets in all reported currencies rose during this quarter from $1.6 to 2.1 milliard.

The decline in the banks' foreign currency liabilities and assets during the first half of 1965 was partly seasonal and partly a consequence of the US voluntary restraint programme. The renewed expansion of the market in the second half of the year was due in part to an influx of money from European official monetary institutions. During the third quarter there was a considerable increase in dollar swaps between the Italian Exchange Office and the Italian commercial banks. The further expansion of the market in the fourth quarter was to a large extent seasonal. The fact that the renewed expansion of the market was accompanied by an increase in the reporting banks' net asset position may be ascribed mainly to two factors. Firstly, and also under the influence of the US voluntary restraint programme, there was an increased net flow of funds from the reporting area to the United States. Secondly, the official funds which came into the market showed up primarily on the assets side of the banks' positions.

Total short-term dollar positions of reporting banks vis-à-vis non-residents.

End of month	Including positions vis-à-vis the United States			Excluding positions vis-à-vis the United States		
	Liabilities	Assets	Net position	Liabilities	Assets	Net position
	in millions of dollars					
December 1964	14,610	14,590	— 20	9,640	7,960	— 1,680
March 1965	14,070	14,170	+ 100	9,360	7,540	— 1,820
June 1965	13,900	14,200	+ 300	9,330	7,580	— 1,750
September 1965	14,690	15,650	+ 960	10,230	8,470	— 1,760
December 1965	16,270	17,060	+ 790	11,750	10,180	— 1,570
March 1966	15,080	16,610	+ 1,530	10,650	9,400	— 1,250

The decline in the banks' total positions during the first quarter of 1966 was seasonal. The increase in their non-dollar positions, as well as the rise in their net dollar assets, may, however, be ascribed to the increased cost and decreased availability of dollar credits. This has tended to expand the amount of business done in currencies other than dollars and at the same time to shift the reporting banks' lending away from their own residents towards the United States.

The 1965 increase in the banks' liabilities and assets mainly affected their dollar positions. The pattern of change in these positions during the course of the year was the same as for their overall positions: a pause in the first six months, followed by a renewed expansion later in the year. On both sides of the balance sheet it was their dollar positions vis-à-vis countries other than the United States that accounted for the increase. Indeed, dollar liabilities vis-à-vis the United States declined by $0.5 milliard as a result of the withdrawal of US funds, mainly through Canada. Because of this, the banks' net dollar position moved during 1965 from approximate equilibrium to net assets of \$0.8 milliard, the change being concentrated in the third quarter of the year. The dollar positions outside the United States, however, were more stable, net liabilities declining slightly from \$1.7 to 1.6 milliard.

In the first quarter of 1966 the banks' net position in dollars vis-à-vis non-residents showed an improvement of \$0.7 milliard, over half of it vis-à-vis the United States.

The 1965 increase in the reporting banks' short-term dollar positions occurred at the same time as a substantial rise in "off-shore" dollar financing of other kinds, particularly dollar bond issues in Europe. That the Euro-dollar market and the Euro-bond market should grow together is no coincidence. For one thing, it is extremely likely that the proceeds of dollar bonds issued in Europe will, to the extent that they are not required for immediate spending by the borrowers, in the meantime be placed in the Euro-dollar market. Furthermore, the European banks that underwrite these bond issues need to maintain a pool of dollars in case they have to take up securities that the market cannot promptly absorb. It is probable that this pool of dollars tends to grow over time and that part of it is kept in the Euro-dollar market.

Changes in individual reporting countries.

There was a further sizable increase in UK banks' foreign currency positions during 1965. Liabilities went up from \$4.9 to 5.8 milliard, accounting for about half of the increase in all reporting banks' liabilities, and assets from \$4.3 to 5.3 milliard. Thus the banks' net external foreign currency indebtedness was reduced from \$570 to 460 million.

During the first quarter of 1965 the UK banks' net dollar liabilities rose by \$440 million. Although this movement was partly seasonal, its size must be attributed to domestic monetary tightness and, in particular, to heavy borrowing by UK local authorities. Vis-à-vis western Europe their position deteriorated by \$760 million, whilst net claims on North America rose by \$400 million. During the rest of 1965 there was an improvement in the UK banks' net dollar positions of exactly the same size as the first-quarter deterioration. In the second quarter the domestic monetary situation eased, as the Exchequer went into deficit again and the local authorities stopped borrowing in the Euro-dollar market and began to repay, partly out of revenue and partly out of their increased facilities at the Public Works Loan Board, to which they had very substantial recourse between April and July. In addition, from May 1965 onwards bank lending in the United Kingdom came under quantitative restrictions. As a result of these factors, the UK banks' net dollar positions vis-à-vis non-residents improved by \$250 million in the second quarter and by a further \$140 million in the third quarter, when for much of the time there was a large discount on the forward pound which made switching into dollars attractive.

In the first quarter of 1966 the banks' foreign currency position continued to expand. Liabilities went up from \$5.8 to 6.1 milliard and assets from \$5.3 to 5.7 milliard. Net liabilities were reduced from \$460 to 330 million and stood \$650 million below their level of a year earlier. As a result of increased borrowing by US banks in London, net dollar claims on the United States soared from \$1,050 to 1,550 million while net dollar liabilities to the rest of the world went up from \$1,760 to 2,110 million.

The Japanese banks, whose foreign currency positions are the next largest after those of the United Kingdom, improved their net dollar positions vis-à-vis non-residents by \$240 million during 1965. Liabilities rose by \$170 million and claims by \$410 million. Vis-à-vis the United States, where the greater part of both liabilities and assets are held, the net improvement was \$140 million; it may be attributed to the improvement in the Japanese balance of payments and to the related ease of domestic monetary conditions. Net dollar claims on the rest of the world rose by \$100 million.

The Canadian banks were those most directly affected by the introduction of the US voluntary restraint programme. Thus during the first nine months of 1965 their US dollar liabilities vis-à-vis the United States declined from \$1,680 to 1,090 million. They reacted by adding \$470 million to their liabilities and at the same time drawing down by \$400 million their assets vis-à-vis the rest of the world, whereas they reduced their claims on the United States by only \$40 million. The fact that more money was brought in from the rest of the world than was required to meet the net outflow to the United States is mainly explained by the credit needs of the branches or affiliates of US firms in Canada which found it less easy to obtain finance in the United States. Thus, the Canadian banks' liabilities to residents were drawn down by \$160 million, whilst their claims on them increased by \$210 million.

Between September 1965 and March 1966 the trend of the preceding nine months was reversed. As a result of a \$340 million reduction in their US dollar assets vis-à-vis the United States and a \$220 million increase in their liabilities to residents, the Canadian banks' net positions vis-à-vis the United States and Canadian residents deteriorated by \$100 and 110 million respectively, while at the same time their net position vis-à-vis the rest of the world showed a \$230 million improvement.

Between March 1965 and March 1966 the Swiss banks reduced their net dollar claims on the United States from \$310 to 280 million, but built up their net assets vis-à-vis the rest of the world from \$510 to 750 million. Their positions in the other reported currencies showed little overall change.

The biggest single change in any of the reporting banks' net foreign currency positions vis-à-vis non-residents during the period under review occurred in Italy. In the course of the first nine months of 1965 the Italian banks' net liabilities, which at the end of 1964 had stood at \$700 million, were gradually eliminated and gave way to $30 million of net assets. This improvement was mainly the result of operations of the Italian Exchange Office, which provided the Italian banks with $1,170 million of dollars on a swap basis against lire. These dollars were used by the banks partly to reduce their foreign currency liabilities, but mainly for lending to both non-residents and residents. Thus in this nine-month period the banks reduced their dollar liabilities vis-à-vis countries other than the United States from $1,250 to 940 million and doubled their dollar assets vis-à-vis non-residents from $600 to 1,200 million. Their net lending to residents increased by $260 million, mainly in the form of Swiss francs and Deutsche Mark.

Large foreign borrowing in the context of end-of-year operations and a pause in the Italian Exchange Office's dollar swaps caused a temporary deterioration in the banks' foreign currency position in the last quarter. In the first quarter of 1966 the improvement resumed, but, whereas in the first nine months of 1965 the whole gain had been in the dollar position, between September 1965 and March 1966 the banks' net claims in dollars declined from $110 to 60 million, while their net position in other reported currencies shifted from liabilities of $80 million to assets of $60 million.

Between December 1964 and March 1966 the French banks' foreign currency assets and liabilities increased substantially, the former going up by $380 to 1,900 million and the latter by $150 to 1,520 million. Their net position, therefore, improved by $230 million. Whereas the increase in assets was mainly in dollars, liabilities went up only in the other currencies. As a result net claims in dollars rose from $50 to 390 million whilst the net position in other reported currencies deteriorated by $110 million.

In the Netherlands the main development during 1965 and the first quarter of 1966 was a change in the banks' net dollar position vis-à-vis non-residents, from assets of $30 million to liabilities of $210 million. During the first quarter of 1965 net assets went up slightly to $60 million, but from then on the situation reversed because of tighter conditions in the domestic credit market. In the following twelve months the banks increased their dollar liabilities to non-residents by $210 million while reducing their claims by $60 million. Part of the additional dollars taken in by the banks appears to have been swapped into other foreign currencies, where the net asset position improved from $140 to 210 million.

Apart from Canada, Germany was the only one of the reporting countries where the dollar positions of the banks vis-à-vis non-residents were lower at the end of 1965 than they had been a year earlier. Liabilities declined from $440 to 230 million during the first quarter of the year, in large part because of the repayment of indebtedness contracted over the end of 1964. They rose again during the rest of the year, but, as the banks' end-1965 operations were on a smaller scale than those of a year earlier, their dollar liabilities were no more than $370 million at the end of the year. The smaller scale of the 1965 window-dressing also shows up in the fact that dollar liabilities declined by only $90 million during the first quarter of this year.

Structure and size of the Euro-dollar market.

The activity of the Euro-dollar market may be looked upon as the acquisition of dollars by banks located outside the United States, mostly through the taking of deposits but also to some extent through swapping other currencies into dollars, and the re-lending of these dollars, often after

Dollar positions of reporting European banks vis-à-vis non-residents, outside and inside their own area.

Position vis-à-vis	1964 December	1965 March	1965 June	1965 September	1965 December	1966 March
	in millions of US dollars					
Liabilities						
Other western Europe	800	810	730	910	850	770
Eastern Europe	260	230	170	210	290	220
Canada	880	700	480	530	560	490
Japan	40	40	50	60	50	60
Latin America	610	650	690	680	720	710
Middle East	680	760	800	820	840	860
Other	740	650	730	770	850	860
Total	4,010	3,840	3,650	3,980	4,160	3,970
United States	1,260	1,220	1,270	1,290	1,380	1,450
Total outside own area	5,270	5,060	4,920	5,270	5,540	5,420
Position inside own area	4,370	4,130	4,220	4,500	5,810	5,050
Grand total	9,640	9,190	9,140	9,770	11,350	10,470
Assets						
Other western Europe	380	390	420	480	670	610
Eastern Europe	460	440	500	500	540	580
Canada	430	460	480	670	680	500
Japan	440	460	450	470	510	530
Latin America	290	270	320	360	380	400
Middle East	110	120	100	140	170	150
Other	120	130	180	210	270	310
Total	2,230	2,270	2,450	2,830	3,220	3,080
United States	3,010	3,130	3,040	3,350	3,180	3,690
Total outside own area	5,240	5,400	5,490	6,180	6,400	6,770
Position inside own area	3,960	3,710	3,800	4,140	5,370	4,800
Grand total	9,200	9,110	9,290	10,320	11,770	11,570
Net position						
Other western Europe	— 420	— 420	— 310	— 430	— 180	— 160
Eastern Europe	200	210	330	290	250	360
Canada	— 450	— 240	—	140	120	10
Japan	400	420	400	410	460	470
Latin America	— 320	— 380	— 370	— 320	— 340	— 310
Middle East	— 570	— 640	— 700	— 680	— 670	— 710
Other	— 620	— 520	— 550	— 560	— 580	— 550
Total	— 1,780	— 1,570	— 1,200	— 1,150	— 940	— 890
United States	1,750	1,910	1,770	2,060	1,800	2,240
Total outside own area	— 30	340	570	910	860	1,350
Position inside own area	— 410	— 420	— 420	— 360	— 440	— 250
Grand total	— 440	— 80	150	550	420	1,100

redepositing with other banks, to non-bank borrowers anywhere in the world. The following table is an attempt to estimate, for the eight European reporting countries only (i.e. excluding the figures reported by banks in Canada and Japan), both the scale of this activity at the end of 1964 and 1965 and the principal sources and uses of these funds.

Estimated flow of funds in the Euro-dollar market.

Items	Sources		Uses		Net	
	End-1964	End-1965	End-1964	End-1965	End-1964	End-1965
	in millions of US dollars					
Outside area						
United States	700	800	1,450	1,800	+ 750	+ 1,000
Other	4,000	4,200	2,250	3,200	— 1,750	— 1,000
Total	4,700	5,000	3,700	5,000	— 1,000	—
Inside area						
Official monetary institutions	800	2,250	—	—	— 800	— 2,250
Non-residents other than banks	800	1,000	500	600	— 300	— 400
Non-bank residents, plus swaps from or into the domestic or third currencies[1]	1,200	1,250	3,300	3,900	+ 2,100	+ 2,650
Total	2,800	4,500	3,800	4,500	+ 1,000	—
Total size of the market	7,500[2]	9,500	7,500[2]	9,500	—	—

[1] 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. [2] This estimate cannot be compared with the figure given in last year's Annual Report for the size of the market at the end of March 1965, since on the one hand it excludes Japan, while in other respects it is more comprehensive.

The sources and uses of Euro-dollars have been divided into those which are inside and those which are outside the eight European reporting countries. The "outside" components have, in turn, been split into those located in the United States and those located elsewhere outside the reporting area. So far as the "inside" sources and uses are concerned, three sub-categories are distinguished: (i) dollars received from official monetary institutions; (ii) dollars received from or lent to persons or non-bank institutions located within the reporting area but not in the country of the individual reporting bank; and (iii) dollars which the individual reporting bank has received from or lent to non-bank residents in its own country. This last sub-category also includes dollars arising out of swaps on the sources side and dollars swapped into other currencies on the uses side.

Any attempt to quantify the size and structure of the Euro-dollar market inevitably runs into certain difficulties. Conceptually, the main difficulty is to say how much of the dollar positions vis-à-vis the United States ought to be included in the Euro-dollar market. Even before the market existed, banks outside the United States had dollar liabilities and assets vis-à-vis the United States, the former arising out of the use of credit lines established with banks in the United States and the latter consisting partly of working balances and partly of US money-market instruments. As these items are quite different from Euro-dollars, they are excluded on the basis of rough estimates from the figures in the top line of the table.

Statistically, difficulties arise out of lack of information. They are encountered particularly in drawing up the figures for the lower part of the table. Both the second and third items are approximations, since the information available on positions vis-à-vis non-residents other than banks, on transactions with residents and on swaps into or out of dollars is very incomplete. Subject to these reservations, the figures give some useful indications of the size and structure of the net Euro-dollar liabilities and assets of the commercial banks in the eight European countries.

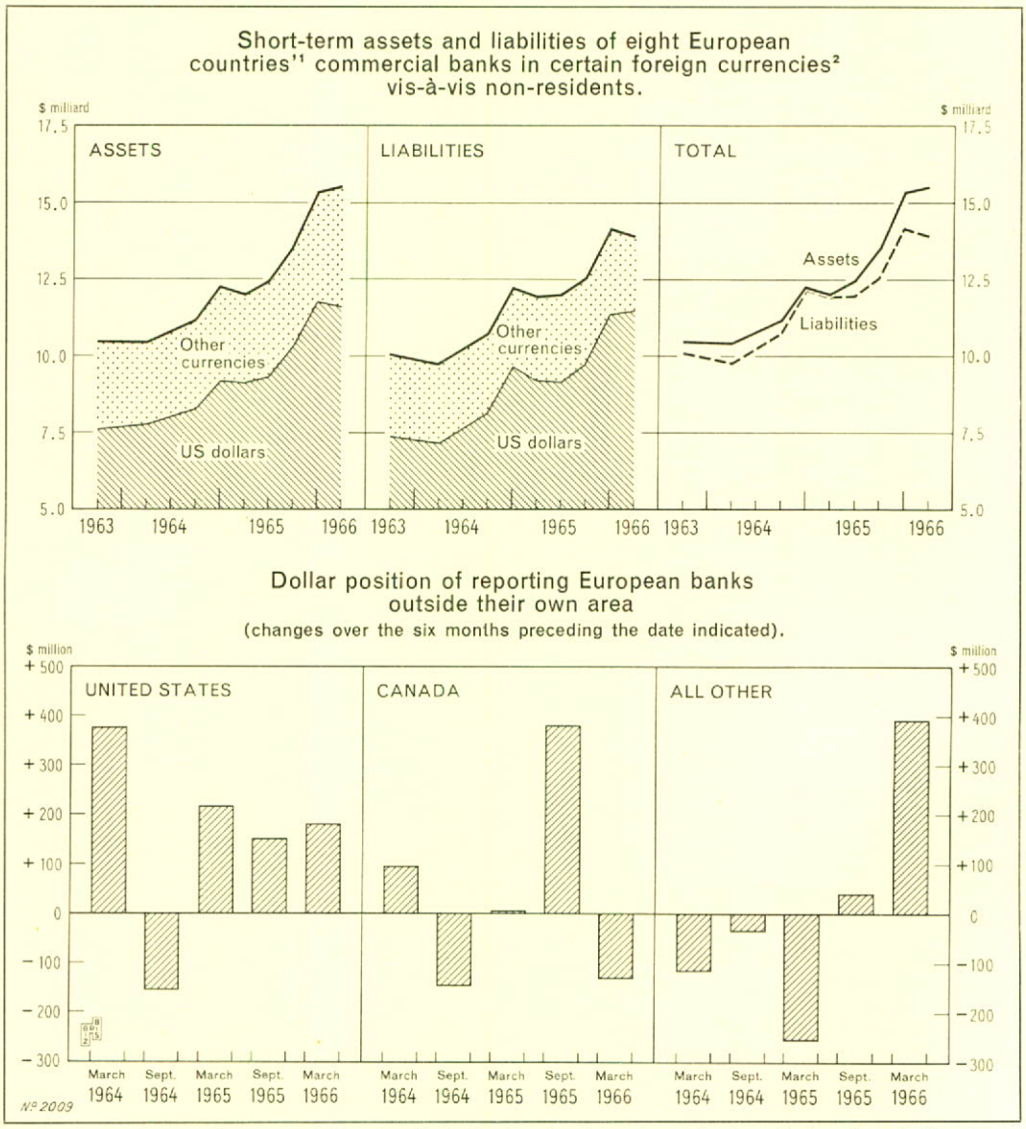
On the liabilities side, the total Euro-dollar funds available to these banks at the end of 1965 may be put at about \$9.5 milliard. Of this amount \$5 milliard came from "outside" sources, with the United States accounting for only \$800 million; the remaining \$4.5 milliard came from inside the reporting area, where the most important item was the \$2.3 milliard obtained from official monetary institutions. The two main official sources were the Italian Exchange Office (\$1.5 milliard at the end of 1965) and the dollar deposits of the BIS outside the United States.

On the assets side, "outside" claims at the end of 1965 may be put at \$5 milliard and "inside" claims at \$4.5 milliard. Outside the reporting area claims on the United States were \$1.8 milliard. This high figure reflects the fact that European branches of US banks, particularly those in London, had remitted substantial amounts of their dollar deposits to their head offices in the United States. Inside the reporting area claims were concentrated to the extent of \$3.9 milliard on residents and on borrowers to whom the banks had lent funds obtained by swapping Euro-dollars into other currencies. While it is not possible to give a break-down of this figure, which has in any case been obtained by difference, it can be said that its largest single component consists of lending by Italian banks to their residents. This amounted to over \$1.8 milliard at the end of 1965, most of the loans being in dollars or Swiss francs.

At the end of 1965 the reporting European banks' Euro-dollar liabilities and assets were approximately in balance both inside and outside the reporting area. There were, however, substantial net liability or asset positions within these two broad areas. Outside the reporting area these banks had net claims of about \$1 milliard on the United States and net liabilities of about the same size vis-à-vis other countries. Inside the reporting area the official monetary institutions were of course only on the supply side, and the counterpart on the uses side is found mainly in the banks' claims towards non-bank residents.

The table also gives an idea of some of the main Euro-dollar developments in 1965. The total net size of the market appears to have gone up by \$2 milliard, from \$7.5 to 9.5 milliard. Most of the increase on the supply side came from a rise of \$1.5 milliard in dollars becoming available to the market from official sources inside the reporting area. In addition, roughly \$200 million of new money came from outside countries other than the United States, \$100 million from the United States and a further \$250 million from the non-bank sector within the European reporting countries. As regards the employment of this $2 milliard increase in Euro-dollar funds, the reporting banks' assets went up by about $350 million vis-à-vis the United States, by $950 million vis-à-vis the rest of the outside world (of which $300 million vis-à-vis "Other western Europe") and by $700 million vis-à-vis their own group of countries. This last figure would include the reporting banks' own use of Euro-dollar funds for end-of-year operations.

As a result the reporting banks' net position improved from about $750 to 1,000 million vis-à-vis the United States and from –$1,750 million to –$1,000 million vis-à-vis other outside countries, while their net position vis-à-vis residents within the group showed a reduction from assets of $1 milliard to approximate balance.



[1] Belgium, France, Germany, Italy, the Netherlands, Sweden, Switzerland and the United Kingdom.
[2] US dollars, sterling, Swiss francs, Deutsche Mark, Dutch florins, French francs and Italian lire.

As regards the position vis-à-vis outside countries other than the United States, the Middle East and Latin America have strengthened their rôle as net suppliers of Euro-dollars. On the other hand, the net supply from "Other western Europe" has been sharply reduced, and Canada, which had been one of the main suppliers of Euro-dollars, has turned into a net user. Net lending to Japan and eastern Europe has continued to go up.

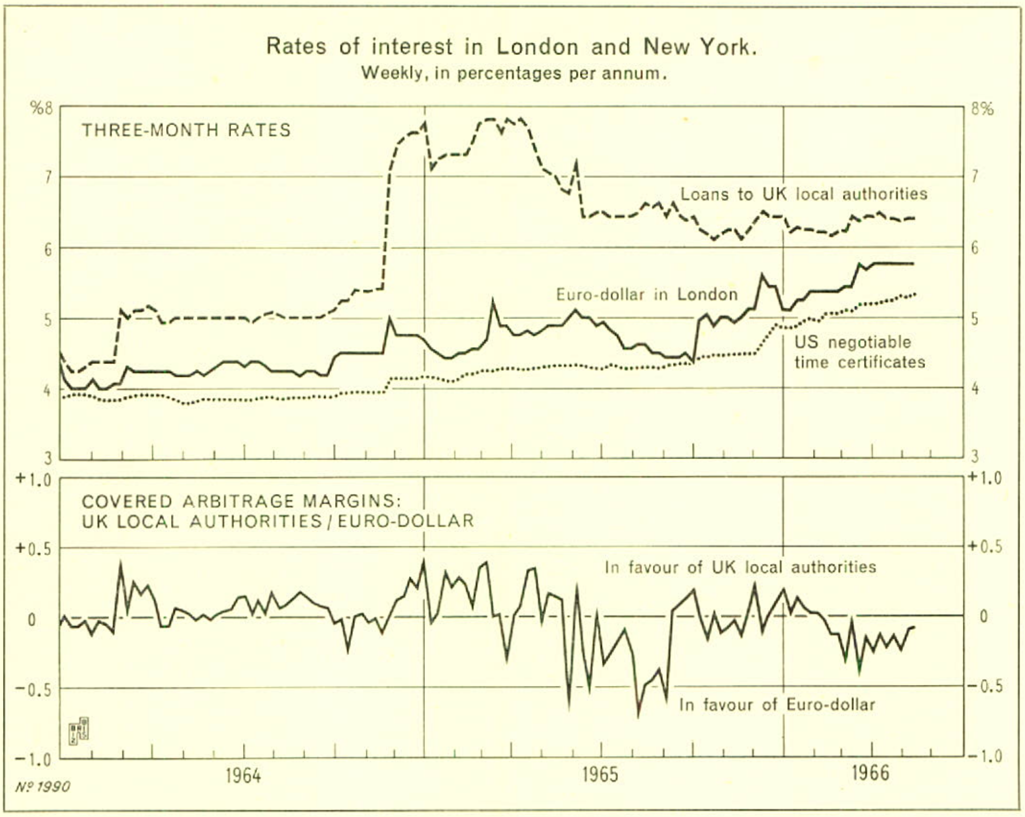
In the first quarter of 1966 the size of the market may have contracted slightly. Supplies from non-residents within the reporting area and from outside countries decreased by about \$250 million, and the amounts derived from official resources were smaller by some \$100 million. On the other hand, part of this decline seems to have been offset by swaps from other currencies into dollars.

On the uses side, the most important change was the further rechannelling of funds from the reporting area to the United States. This movement, whose size seems to have been of the order of \$0.5 milliard, was the result partly of a reversal of end-of-year operations within the reporting area and partly of the further tightening of credit conditions in the United States. Altogether between December 1964 and March 1966, which is roughly the period since the introduction of the US voluntary restraint programme, the net flow of Euro-dollars from the reporting area to the United States and Canada seems to have amounted to about \$1.2 milliard.

Interest rate trends.

During 1965 the Euro-currency market had to adjust itself to some fairly abrupt changes in supply and demand, and on the whole it did so rather smoothly. The part that official intervention (to some extent motivated by other considerations) played in these adjustments has already been mentioned. It was an important one, and undoubtedly smoothed out, though it did not change, the main course of interest rates, relatively moderate movements in which proved sufficient to keep the market on an even keel.

The beginning of the year is seasonally a low point for Euro-dollar interest rates. In January and February the three-month deposit rate, which had fallen back after its rise in late 1964, stood at 4½ per cent. — roughly ½ per cent. above its level of a year earlier. Demand for Euro-dollars was well sustained throughout February, thanks to the borrowing requirements of the UK local authorities and to the fact that the level at which forward rates for sterling were being supported was such that switching out of dollars was attractive. Early in March the impact of the new US measures began to be felt, as one-month US money placed in the market just before they were announced was withdrawn, and the three-month deposit rate for Euro-dollars reached a temporary peak of 5¼ per cent. With higher yields attracting new money into the market, the three-month rate eased to about 4⅞ per cent. later in March. Conditions then remained fairly quiet until late May, when the withdrawal of three-month money that had reached the market in



anticipation of the US controls pushed the three-month rate temporarily above 5 per cent. in early June.

This episode, too, was soon followed by a period of marked ease. By the second half of July the rate had fallen to 4½ per cent. and it remained close to this point until the beginning of October. This development is mainly ascribable to three factors. Firstly, the Italian Exchange Office's dollar/lira swaps, which were particularly large during the third quarter, added substantially to supplies. Secondly, the seasonal improvement in the UK local authorities' cash position, and up to the end of July their substantial borrowing from the UK Public Works Loan Board, tended to reduce the demand for Euro-dollar funds. The three-month local-authority deposit rate declined from 7¾ per cent. in early April to about 6½ per cent. in June. Thirdly, the renewed widening of the forward discount on sterling led to the emergence of a substantial covered interest arbitrage margin in favour of three-month Euro-dollar deposits, which in the course of the second and third quarters sent the UK banks' dollar assets up by $400 million more than their liabilities.

In October the market began to tighten again as banks in certain countries made preparations for the end of the year and the three-month Euro-dollar deposit rate rose from 4.5 to 5 per cent. The market was also influenced at this time by the upward trend of rates paid by US banks on negotiable certificates of deposit, by the abstention of the Italian Exchange Office from further increases in its special swap facilities and, as a result of sterling's recovery, by the disappearance of the covered interest arbitrage margin on three-month Euro-dollars over UK local-authority deposits.

In early December the rise in the US discount rate and in interest ceilings on US bank deposits under Regulation Q strengthened the upward trend of Euro-dollar rates. The $5^5/_8$ per cent. peak reached at this time was partly seasonal, but even after the reversal of end-year window-dressing operations the three-month rate stood at $5^1/_8$ per cent. in early January 1966, about $^5/_8$ per cent. above its level a year before. Moreover, the seasonal ease proved to be of unusually short duration; by the first half of January the rate had resumed its upward trend and by early June 1966 it stood at $5\frac{3}{4}$ per cent.

Although, because of differences in liquidity and in credit risk, Euro-dollar deposits and negotiable certificates of deposit issued by banks in the United States are not strictly comparable, the difference in the yield on these two types of asset is usually a fairly good indicator of the degree of tightness in the Euro-dollar market. Reflecting the vicissitudes of the market, this differential fluctuated sharply in 1965.

Under the first impact of the US voluntary restraint programme the gap in favour of three-month Euro-dollar deposits widened from about $^3/_8$ per cent. at the beginning of 1965 to 1 per cent. in mid-March. It then declined to about $\frac{1}{2}$ per cent. and stayed at this level until June. This relatively high differential may explain why the net dollar position of the reporting European banks vis-à-vis the United States deteriorated in the second quarter.

The third-quarter decline in the Euro-dollar rate reduced the gap in its favour to $\frac{1}{4}$ per cent. in the second half of July, and by September it had narrowed to $^1/_8$ per cent. Correspondingly, the reporting European banks showed a \$290 million improvement in their net dollar position vis-à-vis the United States. This movement was reversed when, as a result of the renewed tightening of the Euro-dollar market, the differential widened to $\frac{1}{2}$ per cent. in October and fluctuated around this level throughout the rest of the year.

As a result of the demand from US banks, the rise in the Euro-dollar rate kept pace throughout most of the first quarter of 1966 with the upward trend of the yield on US negotiable time certificates of deposit, and the differential between the two rates was maintained at $^3/_8$ per cent. In the second half of March, when the Euro-dollar rate went up from somewhat below $5\frac{1}{2}$ to $5\frac{3}{4}$ per cent., the differential widened to more than $\frac{1}{2}$ per cent. From then onwards, while the Euro-dollar rate showed no further increase, the yield on US negotiable time certificates continued on its upward path, and the differential gradually narrowed again, until in early June it was only slightly more than $\frac{1}{4}$ per cent.

V. THE EUROPEAN MONETARY AGREEMENT.

The European Monetary Agreement, which came into force on 27th December 1958, has two principal features: the European Fund and the Multilateral System of Settlements. It is operated, within the framework of the Organisation for Economic Co-operation and Development, by the Council of the OECD and a Board of Management. The Bank for International Settlements, acting as Agent, is entrusted with the execution of all financial operations under the Agreement.

In accordance with the instructions received from the Council at the end of 1964, the Board submitted in the course of 1965 detailed proposals on the conditions under which the Agreement might remain in force after 31st December 1965. These recommendations were subsequently approved by the Council. The changes made to the Agreement and the operations and management of the European Fund up to March 1966 are described below.

Continuation of the Agreement.

The Agreement has been renewed for a further period of three years until 31st December 1968. However, a Contracting Party may withdraw on giving one year's notice. A further comprehensive review of the Agreement is to be carried out by 30th September 1968 to decide on the conditions for its continuation beyond 31st December 1968.

In order to speed up, where necessary, the procedure for the granting of credits, power has been delegated to the Board of Management to grant credits up to $50 million* in each case and for periods not exceeding one year. It is up to the Board to decide in each case whether to follow this special procedure or the normal procedure under which credits are granted by unanimous decision of the Council.

A further amendment to the Agreement enables the Organisation to decide, if desirable, that a member country to which a credit is granted from the Fund should not be called upon to participate in the payment of contributions to the Fund whose sole purpose is to finance drawings on the credit in question.

This limited deferment right differs from the general deferment granted to members by virtue of their special economic position (at present applicable to Denmark, Greece, Iceland, Norway and Turkey) because it only applies to that part of a country's contribution which would otherwise be called up to finance drawings on its own credit. It also automatically ceases to exist as soon as the credit in question has been repaid.

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* 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.

If all undeferred contributions have been called up and the Fund still requires more capital, the contributions with limited deferment shall be called up before those with general deferment.

Under the previous provisions of the Agreement amounts of interim finance made available which were not repaid by the end of the month in which they were drawn had to be brought into the multilateral settlements carried out for that month. Under the new provisions amounts of interim finance outstanding need only be brought into the multilateral settlements at the end of the following month.

Operations under the Agreement.

European Fund. The table below sets out the credits granted from the European Fund which were outstanding during the year April 1965 to March 1966, together with the rates of interest and service charges applied to them.

At the end of March 1965 credits totalling $95 million were outstanding. This amount represented the second tranche of the third credit, the total of the fourth credit and the first tranche of the sixth credit to Turkey.

EMA: Credits granted from the European Fund.

	Amount granted	Period available	Interest on amounts drawn	Service charge on amounts undrawn
	in millions of units of account		in percentages per annum	
Credits repaid since 31st March 1965				
Turkey (3rd credit; 2nd tranche) .	25.0	1st August 1962 to 31st July 1965	3.75	0.25
Turkey (4th credit; 1st and 2nd instalments)	25.0	15th March 1963 to dates below*	3.50	0.25
Credits available at 31st March 1966				
Turkey (4th credit; balance) . . .	10.0	15th March 1963 to dates below*	3.50	0.25
	15.0	30th June 1963 to dates below*		
Turkey (6th credit; 1st to 4th tranches)	20.0	31st March 1965 to dates below*	3.75	0.25
	25.0	30th July 1965 to dates below*		
	5.0	29th October 1965 to dates below*		
	15.0	15th March 1966 to dates below*		
Greece	30.0	8th February 1966 to dates below*	3.875	0.25
Credit granted but not available at 31st March 1966				
Turkey (6th credit; 5th tranche) .	5.0	31st October 1966 to dates below*	3.75	0.25

* The fourth credit to Turkey is repayable as follows: 10 million on 31st October 1965, 15 million on 15th March 1966, 15 million on 31st October 1966 and 10 million on 15th March 1967. The sixth credit to Turkey is repayable as follows: ten instalments of 5 million each on 30th June and 31st December 1968, 31st March, 30th June, 30th September and 31st December 1969, and 31st March, 31st May, 29th July and 28th October 1970; one instalment of 15 million on 14th March 1971; and one instalment of 5 million on 30th October 1971. The credit to Greece is repayable as follows: 5 million on 7th February 1969, 10 million on 7th February 1970 and 15 million on 7th February 1971.

On 30th July 1965 the second tranche of $25 million became available. Turkey drew the full amount of this tranche and used the proceeds to repay the second tranche of the same amount of the third credit which was repayable on that date. On 29th October 1965 Turkey repaid the first instalment of $10 million of the fourth credit, $5 million in cash and $5 million by drawing on the third tranche of the sixth credit, which became available on that date. With effect from 15th March 1966 the Board of Management released the fourth tranche of $15 million of the sixth credit; this amount was also fully drawn and utilised for the refinancing of the second instalment of the same amount of the fourth credit, which was due for repayment on that date.

On 1st February 1966 the Council decided to grant a credit of $30 million to Greece with effect from 8th February 1966. The credit will be available on a revolving basis for three years, the maximum period under the Agreement, and Greece has also been granted the special facility provided for in the Agreement of making repayments over a further period of two years, namely $5 million at the end of the third year, $10 million at the end of the fourth year and $15 million at the end of the fifth year. On 17th February 1966 Greece drew $5 million on the credit and on 9th March 1966 the balance of $25 million.

EMA: Utilisation of credits granted.

At value date for settlements for month	Turkey		Spain		Iceland		Greece		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											
December . . .	0.5	21.0	51.0	24.0	—	—	—	—	51.5	45.0	96.5
1960											
December . . .	15.0	21.5	76.0	24.0	5.0	7.0	—	—	96.0	52.5	148.5
1961											
December . . .	—	50.0	—	—	7.0	5.0	—	—	7.0	55.0	62.0
1962											
December . . .	—	80.0	—	—	5.0	—	—	—	5.0	80.0	85.0
1963											
December . . .	—	95.0	—	—	—	—	—	—	—	95.0	95.0
1964											
April	—	115.0	—	—	—	—	—	—	—	115.0	115.0
November . . .	—	110.0	—	—	—	—	—	—	—	110.0	110.0
December . . .	—	105.0	—	—	—	—	—	—	—	105.0	105.0
1965											
January	—	100.0	—	—	—	—	—	—	—	100.0	100.0
February	—	95.0	—	—	—	—	—	—	—	95.0	95.0
October	—	90.0	—	—	—	—	—	—	—	90.0	90.0
1966											
February	—	90.0	—	—	—	—	25.0	5.0	25.0	95.0	120.0
March	—	90.0	—	—	—	—	—	30.0	—	120.0	120.0

On the various credits granted from the European Fund between June 1959 (when the first drawing was made) and March 1966 there were twenty-five drawings totalling \$314.5 million; of this amount \$194.5 million was repaid. The net amount drawn and outstanding at the end of March 1966 was, therefore, \$120 million, of which \$90 million was owed by Turkey and \$30 million by Greece.

The table on the utilisation of credits granted shows the position at the value date for multilateral settlements (the fifth working day of the following month) for each month of 1964 to 1966 in which changes occurred, and at the value date for December in earlier years.

There has been no call-up of capital in the period under review, so that the amount of contributions paid in has remained unchanged at \$38 million.

Multilateral System of Settlements. No amounts of interim finance have been drawn during the year under review. Buying and selling rates notified by member countries for their currencies remained unchanged and no balances were brought into the Multilateral System of Settlements.

Since the coming into force of the EMA payments to or by the European Fund in respect of the multilateral settlements have totalled \$37.8 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 of member countries on the basis of reports made by the Secretariat or 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 1965 the Council re-appointed M. Hay 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 material on the international gold and foreign exchange markets and the evolution of the external monetary position of OECD countries.

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 transferred from the EPU, stood at \$130.6 million at the end of 1964, of which \$105 million represented outstanding drawings from credits and \$25.6 million the balance of the long-term claims on Norway and Turkey.

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

At value date for settlements for month	Assets				Total of Statement	Liabilities	
	Liquid resources	US Treasury account	Uncalled capital of member countries	Credits and claims out-standing		Capital Fund	Income and expendi-ture account
	in millions of units of account						
Opening	113.0	123.5	328.4	35.0	600.0	600.0	—
1959 December	104.4	123.5	302.9	80.0	610.9	607.5	3.4
1960 December	106.4	123.5	297.9	87.5	615.3	607.5	7.8
1961 December	109.2	123.5	297.9	87.8	618.4	607.5	10.9
1962 December	90.4	123.5	297.9	110.5	622.3	607.5	14.8
1963 December	82.1	123.5	297.9	123.1	626.6	607.5	19.1
1964 December	79.3	123.5	297.9	130.6	631.4	607.5	23.9
1965 January	83.8	123.5	297.9	125.6	630.9	607.5	23.4
February	88.9	123.5	297.9	120.6	631.0	607.5	23.5
March	89.1	123.5	297.9	120.6	631.2	607.5	23.7
April	89.2	123.5	297.9	120.6	631.3	607.5	23.8
May	89.3	123.5	297.9	120.6	631.4	607.5	23.9
June	90.9	123.5	297.9	120.6	633.0	607.5	25.5
July	90.8	123.5	297.9	120.6	632.8	607.5	25.3
August	90.9	123.5	297.9	120.6	633.0	607.5	25.5
September	91.0	123.5	297.9	120.6	633.1	607.5	25.6
October	96.2	123.5	297.9	115.6	633.3	607.5	25.8
November	96.3	123.5	297.9	115.6	633.4	607.5	25.9
December	101.3	123.5	297.9	113.1	635.8	607.5	28.3
1966 January	100.9	123.5	297.9	113.1	635.4	607.5	27.9
February	96.0	123.5	297.9	118.1	635.5	607.5	28.0
March	71.1	123.5	297.9	143.1	635.6	607.5	28.1

The total fell by $5 million in each of the months of January and February 1965, when Turkey repaid the third and the final instalments of the $20 million short-term credit received in April 1964. In October 1965 it declined by a further $5 million as a net result of the repayment by Turkey of the first instalment of $10 million of the fourth credit and its drawing of the third tranche of $5 million of the sixth credit. In December 1965 the fifth amortisation payment of the long-term claims on Norway and Turkey brought the total of credits and claims outstanding down to $113.1 million. After the drawings made by Greece on its new credit, the amount rose to the peak of $143.1 million in March 1966.

These drawings were met entirely out of the Fund's liquid resources, which in March 1966 fell to $71.1 million, the lowest level since November 1964.

The payment of interest on contributions called up followed the same method as in previous years, whereby the cumulative amount of interest paid to each country represents 90 per cent. of its share in the Fund's net income which the country would have received if the Fund had been liquidated at the end of the period in respect of which interest is paid. The two distributions made, for the first and second halves of 1965, brought the cumulative amount of interest so far paid to member countries to $5.3 million.

PART III

ACTIVITIES OF THE BANK.

1. Operations of the Banking Department.

The balance sheet of the Bank as at 31st March 1966, certified by the auditors, is reproduced at the end of the present Report.

The balance-sheet total as at 31st March 1966 amounted to 7,881,659,477 francs;* on 31st March 1965 it had stood at 7,850,380,538 francs.

As explained in Section 2 below, these two figures are not, however, entirely comparable, since the balance sheet as at 31st March 1965 still consisted of two sections. As they stand, they show an increase of 31,278,939 francs over the financial year.

The total of the first part of the monthly statement of account increased steadily, to reach 8,496 million on 31st October 1965, the highest figure recorded during the financial year and also the highest in the Bank's history. It subsequently declined from month to month, until at the end of January it stood at exactly the same level as at the beginning of the financial year, viz. 7,850 million. The total of the monthly statement of account as at 31st March 1966 was not very different from this figure.

Thus, although there were fairly substantial movements during the financial year, the balance-sheet total showed little change.

The following table shows the development of the end-of-year balance-sheet totals over the past five years.

BIS: Annual balance-sheet totals.

Financial years ended 31st March	Total of balance sheet	Movement
	in millions of francs	
1962	4,732[1]	+ 759
1963	4,950[1]	+ 218
1964	5,778[1]	+ 828
1965	7,850[1]	+ 2,072
1966	7,882	+ 32

[1] First section.

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

* Except where otherwise indicated, the term "francs" in this Part signifies *gold* francs. The method of conversion into gold francs (units of 0.29032258... grammes fine gold — Article 5 of the Statutes) of the various currencies included in the balance sheet is the same as that adopted in preceding years; the conversion is based on the exchange rates quoted for the various currencies against dollars and on the US Treasury's selling price for gold at the end of the financial year.

BIS: Memorandum accounts (b).

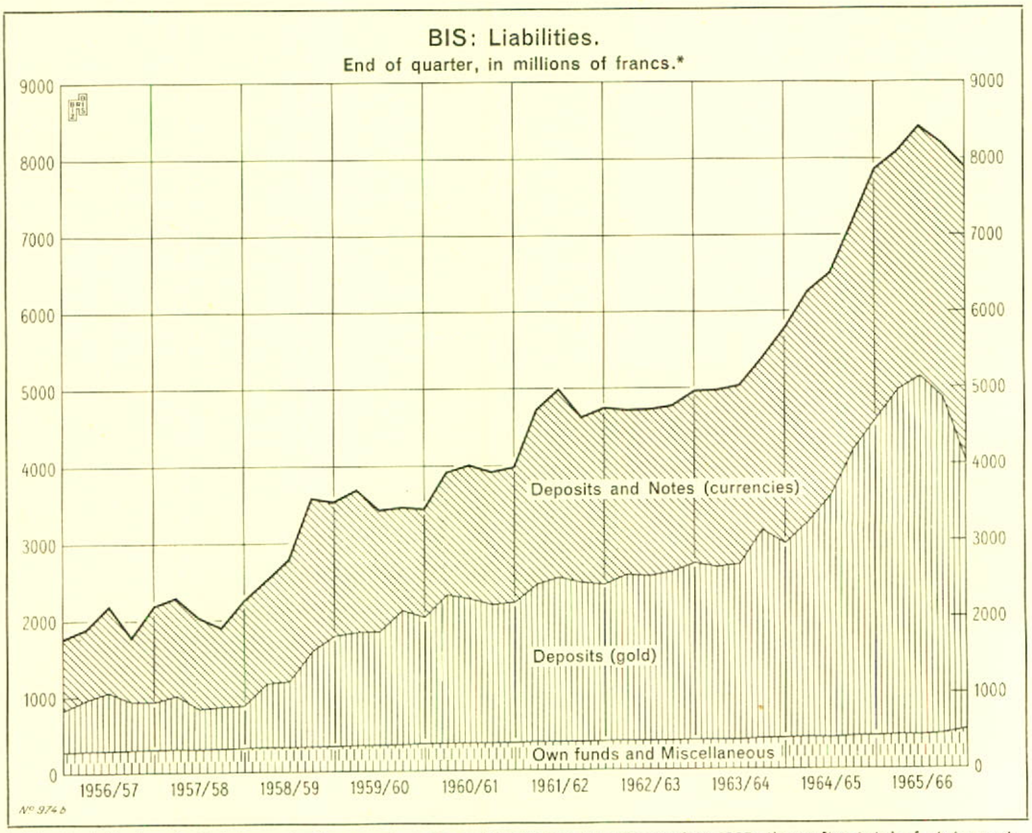
Items	Financial years ended 31st March 1965	1966
	in millions of francs	
Earmarked gold	1,383	1,145
Bank balances	39	32
Bills and other securities	780	715
Total of items not included in the balance sheet	2,202	1,892

with the European Monetary Agreement, as Depositary under the Act of Pledge concluded with the High Authority of 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 1965, the amounts in question are shown at the foot of the assets column under the heading "Memorandum accounts (b)". The figures are given in the above table.

COMPOSITION OF RESOURCES (liabilities).

A. Own funds.

The Bank's Share Capital remained unchanged at 500 million francs, of which 125 million was paid up.



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

Since the Legal Reserve Fund reached its statutory ceiling of 10 per cent. of the paid-up capital during the preceding financial year and the General Reserve Fund has remained unchanged since the financial year 1939–40, the Bank's reserves, at 25.8 million, also showed no change.

As a result of the year's operations (see below, Section 7, "Financial results"), the balance of the Profit and Loss Account, which comprises the net profit for the financial year ended 31st March 1966 and the balance brought forward from the preceding year, amounted to 32.3 million on 31st March 1966, against 31.3 million a year earlier. The amount of the item "Provision for contingencies" rose from 214.5 million on 31st March 1965 to 216.2 million on 31st March 1966; the reasons for the smallness of the increase compared with those in the preceding financial years are explained in detail in Section 2. The item "Miscellaneous" decreased between the same two dates from 36.9 to 33.3 million.

At the end of March 1966 the total of the Bank's own funds ("Miscellaneous" included) was the same as that registered a year earlier, viz. 433 million, corresponding to roughly 6 per cent. of its borrowed funds (7,449 million) and a little less than 5.5 per cent. of the balance-sheet total (7,882 million). If the non-paid-up capital (375 million) were taken into account, the ratio would be approximately 10 per cent. in each case.

The following table shows the figures for the Bank's own funds and its borrowed funds and the percentage ratio between them at the end of each of the last five financial years.

BIS: Composition of resources.

Financial years ended 31st March	Own funds	Borrowed funds	Total	Ratio of own funds to borrowed funds	Ratio of own funds to balance-sheet total
	in millions of francs			in percentages	
1962	379	4,353	4,732*	8.5	8.0
1963	389	4,561	4,950*	8.5	8.0
1964	408	5,370	5,778*	7.5	7.0
1965	433	7,417	7,850*	6.0	5.5
1966	433	7,449	7,882	6.0	5.5

* First section of the balance sheet.

B. Borrowed funds.

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

BIS: Resources, by origin
(not including claims of governments in respect of the Annuity Trust Account).

Origin	Financial years ended 31st March 1965	1966	Movement
	in millions of francs		
Central banks	6,034	6,104	+ 70
Other depositors	919	901	— 18
Notes	464	362	— 102
Total	7,417	7,367	— 50

The increase in the deposits of central banks was very slight, as was the decrease in the deposits of other depositors, viz. around 1 and 2 per cent. respectively. In contrast, the movement in the item "Notes", which represents notes issued by the Bank in currencies and sold to commercial banks, was quite appreciable, a reduction of 22 per cent. having been registered.

Over the financial year deposits in gold declined by 14 per cent., while those in currencies rose by 23 per cent. As far as deposits in gold were concerned, those at sight and at not exceeding three months underwent reductions, whereas those at longer term — between three and twelve months — showed increases. The changes recorded in currency deposits were the other way round.

This divergency reflects to a certain extent the tightening on all markets; in fact, while depositors were willing to deposit gold for longer periods, they chose to increase the liquidity of their resources in currencies by either shortening the term of their deposits on renewal or entrusting to the Bank only funds at generally not more than three months.

At the beginning of the financial year deposits in gold represented 56 per cent. of total resources and deposits in currencies 38 per cent.; on 31st March 1966 the percentages for these two categories, viz. 48 and 47 respectively, were practically the same, while the remaining 5 per cent. consisted of notes.

BIS: Resources, by nature and term
(not including claims of governments in respect of the Annuity Trust Account).

Term	Deposits in gold			Deposits in currencies			Notes		
	Financial years ended 31st March		Move-ment	Financial years ended 31st March		Move-ment	Financial years ended 31st March		Move-ment
	1965	1966		1965	1966		1965	1966	
	in millions of francs								
Sight	3,051	2,484	— 567	67	184	+ 117	—	—	—
Not exceeding 3 months . .	982	591	— 391	2,129	2,816	+ 687	330	346	+ 16
Between 3 and 6 months . .	—	102	+ 102	446	380	— 66	88	16	— 72
Between 6 and 9 months . .	72	272	+ 200	51	17	— 34	46	—	— 46
Between 9 and 12 months . .	28	90	+ 62	57	45	— 12	—	—	—
Over 1 year	—	—	—	70	24	— 46	—	—	—
Total.	4,133	3,539	— 594	2,820	3,466	+ 646	464	362	— 102

As far as gold deposits were concerned, the decline in which was accounted for almost entirely by the decrease in sight deposits, the total varied quite appreciably during the financial year, as did also the distribution according to term. These fluctuations were often very sharp. Thus, from the end of November to the end of December 1965 sight deposits fell from 3,143 to 2,051 million, while time deposits went up from 1,533 to 2,359 million; the movements in January 1966 were in the opposite direction. The reason was that, as in preceding years, operations converting sight deposits into time deposits were carried out on several occasions for short periods on the Bank's initiative. These conversions enabled the Bank to make forward gold purchases, to facilitate rapid intervention on the money market and to play an active part within the framework of central-bank co-operation.

With regard to deposits in currencies, the movements during the financial year were less pronounced: sight deposits showed little change, except at the end of the financial year, when they underwent a relatively very sharp increase which was essentially of a temporary nature; the rise in deposits at not exceeding three months, more than three-quarters of which took place in the last two months, corresponded substantially to the increase in the total of deposits in currencies.

EMPLOYMENT OF RESOURCES (assets).

The following table shows the distribution of the Bank's assets according to their nature.

BIS: Total cash and investments
(not including the claim in respect of the Arrangement dated 29th November 1965 with the Federal Republic of Germany).

Nature	Financial years ended 31st March 1965		1966		Movement	
	in millions of francs					
Cash						
Gold	3,398		3,025		— 373	
Currencies	300	3,698	381	3,406	+ 81	— 292
Investments						
Gold	416		423		+ 7	
Currencies	3,667	4,083	3,924	4,347	+ 257	+ 264
Total						
Gold	3,814		3,448		— 366	
Currencies	3,967	7,781	4,305	7,753	+ 338	— 28

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.

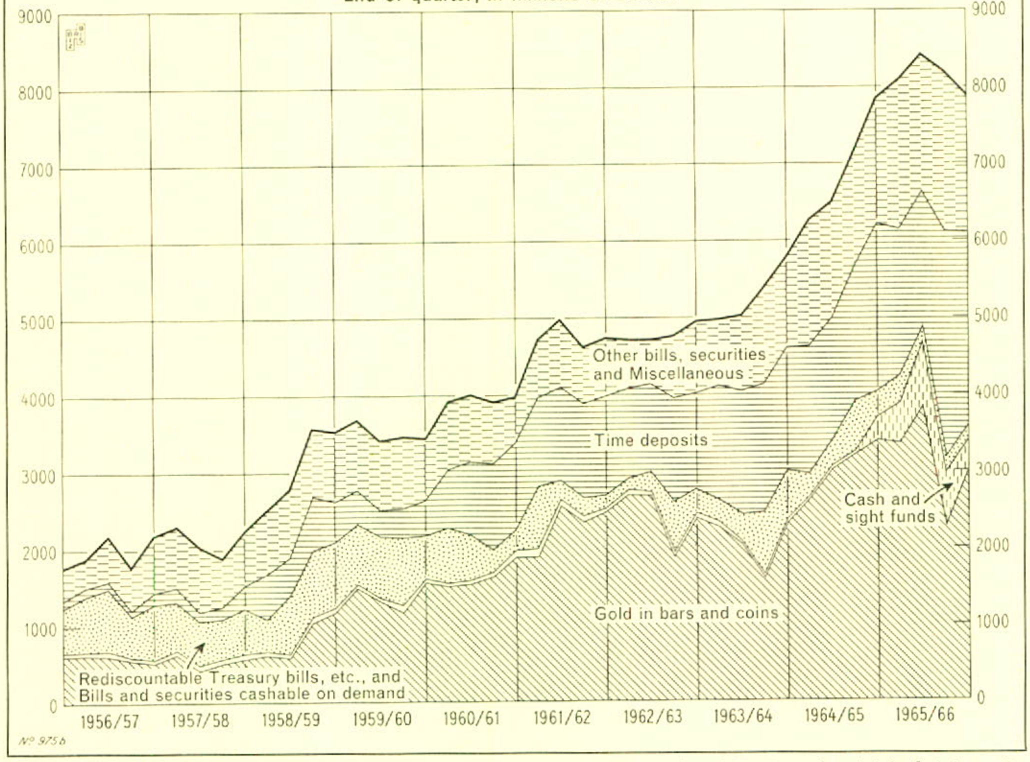
BIS: Gold position.

End of month	Spot position: Gold in bars and coins	Spot position: Investments in gold	Spot position: Deposits in gold	Spot position: Net balance	Forward operations: Net balance	Final net gold position
	in millions of francs					
1965						
March . . .	3,398	416	4,133	— 319	+ 651	332
June	3,355	409 (min.)	4,526	— 762	+1,081	319 (min.)
July.	3,852 (max.)	410	4,542	— 280	+ 604	324
August . . .	3,737	415	4,762 (max.)	— 610	+ 938	328
December. .	2,283 (min.)	419	4,410	—1,708 (min.)	+2,048 (max.)	340
1966						
March. . . .	3,025	423 (max.)	3,539 (min.)	— 91 (max.)	+ 439 (min.)	348 (max.)

While investments in gold remained practically unchanged during the financial year, very sharp fluctuations occurred in the Bank's bullion holdings, which on 31st March 1966 were 373 million francs lower than at the

BIS: Assets.

End of quarter, in millions of francs.*



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

beginning of the financial year. This decline — of 11 per cent. — was the result of a reduction of 594 million in gold deposits, partially offset by a decrease of 212 million in the net balance (gold receivable) of forward operations.

The net balance of forward operations remained consistently positive throughout the past financial year, although, like the Bank's bullion holdings, it showed very sharp fluctuations, particularly over the two end-of-half-year periods, that is, at times when the volume of forward operations in gold was very large. On 31st December 1965, for example, when the Bank's bullion holdings stood at their minimum point of 2,283 million, the net balance amounted to 2,048 million, the highest figure ever recorded; by 31st January 1966 the situation had been reversed as a result of a contraction in the volume of forward operations, the Bank's bullion holdings then amounting to 3,300 million and the net balance to 662 million.

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

A. Sight funds, rediscountable investments and investments cashable on demand.

The movements in the item "Gold in bars and coins" (which consisted mainly of gold in bars) have already been commented upon.

At the beginning of the financial year the figure for the item "Cash on hand and on sight account with banks", at 300 million, was already at a relatively high level as a result of swap operations which had provided the Bank with a substantial volume of sight funds. Still in connection with operations of this kind, the figure for this item continued to register very wide fluctuations; it reached 794 million on 31st May 1965, fell back to 521 million on 31st July 1965, rose again to 840 million on 30th November 1965 (the maximum for the financial year) and had declined on 31st March 1966 to 381 million, at which level it was still 81 million higher than at the beginning of the financial year.

On 31st March 1966 total gold and currency holdings represented 43 per cent. of the total of the Bank's balance sheet, compared with 47 per cent. of the total of the first section of the balance sheet a year earlier.

The figure for the item "Rediscountable Treasury bills", after reaching 290 million (maximum) on 30th April 1965, declined progressively to 67 million (minimum) on 30th November 1965; it stood at the same level at the end of the financial year. The appreciable decline was almost entirely due to the termination of swaps that had been effected within the framework of central-bank operations.

"Bills and securities cashable on demand" rose from 63 to 124 million.

At the beginning of the financial year the total of the Bank's sight funds and rediscountable investments, comprising the asset items so far analysed, was 4,031 million francs and represented 51 per cent. of the first section of the balance sheet; on 31st March 1966 the corresponding figures were 3,598 million and 46 per cent. (of the total of the balance sheet). During this period the percentage of sight deposits on the liabilities side declined from 40 per cent. to 34 per cent., the same figure as on 31st March 1964. There was thus a slight improvement in the Bank's liquidity ratio.

B. Time deposits and investments.

As in recent years, a very substantial part of the currency resources obtained by way of gold swaps against currencies or through gold sales by the Bank was invested in the form of time deposits and advances or in other bills and securities. These items consequently registered fluctuations, which were all the more marked in that such swap operations and gold sales assumed large proportions at various times during the past financial year.

The figure for the item "Time deposits and advances", which stood at 2,191 million at the beginning of the financial year, declined to 1,783 million as at 31st May 1965. After various fluctuations, it increased to 2,127 million as at 30th November 1965 and then rose very steeply to its maximum level of 2,935 million on 31st December 1965. After a sharp decline which brought it down to 2,072 million at the end of January 1966, it regained half the ground lost in the course of February and March and closed the year at the level — still a high one — of 2,507 million, thus standing 316 million higher than a year earlier.

The total of the item "Other bills and securities" at times moved parallel to the preceding item, but the range of fluctuation was always much narrower. From 1,559 million at the beginning of the financial year, it rose progressively to 1,865 million on 30th June 1965 and then gradually declined to 1,536 million on 31st October 1965. After reaching a peak of 2,015 million on 31st December 1965, it stood at the end of the financial year at 1,648 million. This figure included 420 million in respect of investments in gold, against 413 million at the beginning of the financial year.

The following table shows the distribution of the Bank's time investments according to their term and compares their composition at the end of the last two financial years.

BIS: Time deposits and advances and other bills and securities.

Periods	Financial years ended 31st March 1965	1966	Movement
	in millions of francs		
Not exceeding 3 months	2,795	3,062	+ 267
Between 3 and 6 months	639	576	— 63
Between 6 and 9 months	63	228	+ 165
Between 9 and 12 months	111	147	+ 36
Over 1 year	142	142	—
Total	3,750	4,155	+ 405

The increase of 405 million was equally divided between investments at up to six months and those at longer term. As a result, investments at over six months went up from 8 per cent. of the total shown in the above table as at 31st March 1965 to 12 per cent. of the total as at 31st March 1966.

* * *

Apart from an increase in deposits in currencies and a decline in those in a weight of gold, there were no changes of note during the last financial year in the structure of the deposits entrusted to the Bank.

The main feature of the year is rather to be found in the further growth in the volume of swaps concluded with various central banks — either of gold against currencies or of currencies against currencies. These swaps enabled the Bank:

(1) to participate with the minimum of delay and on an appreciable scale in credit operations effected within the framework of co-operation between monetary authorities;

(2) to help to mitigate the disequilibria that might have been caused by large-scale repatriations of funds by the commercial banks, by channelling these funds back to the markets at certain times of the year;

(3) to allow central banks to avoid certain conversions of dollars into gold at the US Federal Treasury.

These operations have shown once more the part that the Bank is able to play in such distinct fields owing, on the one hand, to its position among monetary authorities and, on the other, to its capacity as intermediary between these authorities and the market.

This activity had an influence on the total volume of the Bank's operations, which reached a new record of 86 milliard in 1965–66, compared with 72 milliard in 1964–65, 59 milliard in 1963–64 and 39 milliard in 1962–63.

The net profit for the past financial year remained at the same high level as that for the previous financial year.

2. The assets and liabilities of the Bank appertaining to the execution of the Hague Agreements of 1930 (Young Plan).

The second section of the balance sheet and the notes thereto have been suppressed, since the problems relating to the asset and liability items concerned have been resolved.

This second section of the balance sheet was made up as follows:

BIS: Execution of the Hague Agreements of 1930
(particulars of asset and liability items).

Assets			Liabilities		
		in millions of francs			
Balances at the Deutsche Reichsbank	41.00		Creditor Governments' deposits on the Annuity Trust Account		
			France	83.07	
Balances at the Deutsche Golddiskontbank	70.14		Great Britain	32.46	
			Italy	16.96	
Securities of the German Railway Administration	73.25		Belgium	9.17	
			Yugoslavia	6.67	
Securities of the German Postal Administration	36.63	221.0	Rumania	1.60	
			Japan	1.05	
			Portugal	1.05	
Securities of the German Government		76.2	Greece	0.55	
			Poland	0.03	152.6
			German Government's deposit		76.3
					228.9
			BIS's own funds		68.3
Total		297.2	Total		297.2

The origin and nature of these asset and liability items and the provisional arrangements made in respect thereof were explained in detail in the Bank's seventeenth, twentieth and twenty-third Annual Reports. It will suffice to recall that the investments and deposits were made within the framework of the Hague Agreements of 20th January 1930 (Young Plan) and that the situation was crystallised by the Hoover Moratorium of 1931.

The investments matured during the years 1945 and 1946. At the time of the London Conference on German External Debts, the German Federal Government and the Bank were not able to agree on the amount due and finally decided, by the Arrangement of 9th January 1953, to postpone settlement of the question until 1966. The German Federal Government, for its part, agreed to resume the interest service, which had been interrupted in 1945, as from 1st January 1953 and to pay in that respect an annual amount of 5.6 million Swiss francs up to 31st March 1966.

In point of fact, this provisional arrangement restored the situation created by the Hoover Moratorium of 1931. It was acceptable to the Bank as the governments' deposits could not be withdrawn prior to 1st April 1966 and then only in so far as the corresponding investments of the Bank had been reimbursed.

In 1964 the German Federal Government and the Bank opened new negotiations. Basing itself essentially on the Young Plan, the Bank claimed that it was entitled to reimbursement of its claims at their gold value. The German Federal Government contended that German common law was applicable and that, moreover, even if the Bank's claims enjoyed a special status, they could not be exempted from the reductions agreed upon in the London Agreement on German External Debts of 27th February 1953.

As it proved impossible to reach any agreement on the legal problems, it was considered advisable to seek a compromise solution. After lengthy negotiations, the Bank accepted the 40 per cent. reduction imposed by the London Agreement with regard to gold clauses and a further reduction of 10 per cent. to make the compromise possible. In addition, the German Federal Government waived reimbursement of the deposit accruing to it and the Bank renounced the interest that had not been paid between 1945 and 1952.

The German Federal Government and the Bank confirmed their agreement in an Arrangement signed on 29th November 1965. This Arrangement, after having been ratified by the German Federal Parliament at the beginning of April 1966, entered into force on 14th May 1966. The sum due to the Bank from the German Federal Government was fixed at 156.24 million Deutsche Mark. Thanks to the assistance of the Deutsche Bundesbank, which agreed to advance the funds against surrender of the Bank's claim, this sum was paid in April 1966.

The deposits of the governments that were creditors in respect of the Annuity Trust Account were settled on 13th April 1966, the Bank having paid out to those governments a sum of 108 million Deutsche Mark. This settlement having extinguished, vis-à-vis the Bank, all rights of whatever nature attaching to these deposits, the Annuity Trust Account has been closed.

The Bank's own investments, which amounted to 68.3 million francs, have also been finally settled, the Bank having received in this respect a sum of 48,240,000 Deutsche Mark, equivalent to 36.7 million francs. By utilising the last annuity paid by Germany in respect of current interest and certain profits obtained thanks to the assistance of the Deutsche Bundesbank, the accounting loss has been reduced from 31.6 to 13.3 million francs. This amount has been covered by drawing on the provision for contingencies; in spite of this drawing, it has been possible, as may be seen from the accounts appearing at the end of this Report, to increase slightly this provision, which has risen from 214.5 to 216.2 million francs.

As it was not possible for the payments to be made until April 1966, the balance sheet for the financial year shows the Bank's claim on the Federal Republic of Germany in respect of the Arrangement of 29th November 1965 and the amount due from the Bank to the governments that were creditors in respect of the Annuity Trust Account. As from 30th April 1966 these two items were removed from the Statement of Account.

Taking into account all the circumstances, in particular the monetary and credit measures taken in Germany after 1945 and the concessions made in the London Agreement of 1953, the Arrangement concluded with the Federal Republic of Germany may be considered reasonable. It has the advantage of having put an end to a situation that dated back to 1931.

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

In conformity with the agreements in force, the Bank continued in the year under review to perform the functions of Fiscal Agent of the Trustees for the new bonds of the German External Loan 1924 (Dawes Loan) and of Trustee for the new bonds of the German Government International Loan 1930 (Young Loan) which were issued by the Government of the Federal Republic of Germany in accordance with the London Agreement on German External Debts of 27th February 1953.

The financial year 1965–66 ended for the Dawes Loan on 15th April 1966 and for the Young Loan on 1st June 1966. The interest in respect of the financial year 1965–66 amounted to the equivalent of about 12.1 million francs for the Dawes Loan and of about 36.2 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 1965–66 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.

German External Loan 1924
(Dawes Loan).

Issue	Currency	Nominal value: Bonds issued	Bonds purchased or drawn for redemption in respect of the financial years 1958–59 to 1964–65	1965–66	Balance after redemption
		Conversion bonds			
American . . .	$	44,103,000	11,144,000	1,940,000	31,019,000
Belgian	£	583,100	106,100	17,500	459,500
British	£	8,277,200	1,503,100	249,300	6,524,800
Dutch	£	1,322,500	221,400	40,700	1,060,400
French	£	1,927,400	345,800	57,700	1,523,900
Swedish . . .	S.kr.	14,209,000	2,379,000	403,000	11,427,000
Swiss	£	1,130,500	201,300	34,000	895,200
Swiss	Sw.fr.	8,251,000	1,349,000	232,000	6,670,000
		Funding bonds			
American . . .	$	8,206,000	1,652,000	234,000	6,320,000
Belgian	£	157,700	32,900	4,800	120,000
British	£	2,232,000	458,600	67,100	1,706,300
Dutch	£	291,200	52,800	8,600	229,800
French	£	498,300	103,500	15,200	379,600
Swiss	£	115,000	23,200	3,400	88,400
Swiss	Sw.fr.	415,000	79,000	11,000	325,000

German Government International Loan 1930
(Young Loan).

Issue	Currency	Nominal value*: Bonds issued	Bonds purchased or drawn for redemption in respect of the financial years 1958–59 to 1964–65	1965–66	Balance after redemption
		Conversion bonds			
American . . .	$	55,442,000	4,542,000	784,000	50,116,000
Belgian	B.fr.	202,758,000	16,582,000	2,789,000	183,387,000
British	£	17,702,900	1,434,800	241,500	16,026,600
Dutch	Fl.	52,436,000	4,162,000	713,000	47,561,000
French	Fr.fr.	445,125,000	36,063,000	6,097,000	402,965,000
German	DM	14,469,000	1,165,000	198,000	13,106,000
Swedish . . .	S.kr.	92,763,000	7,555,000	1,269,000	83,939,000
Swiss	Sw.fr.	58,380,000	4,767,000	799,000	52,814,000
		Funding bonds			
American . . .	$	8,999,000	738,000	117,000	8,144,000
Belgian	B.fr.	45,659,000	3,791,000	611,000	41,257,000
British	£	4,223,900	348,200	54,300	3,821,400
Dutch	Fl.	8,479,000	687,000	113,000	7,679,000
French	Fr.fr.	98,078,000	7,908,000	1,252,000	88,918,000
German	DM	413,000	34,000	5,000	374,000
Swedish . . .	S.kr.	6,014,000	497,000	83,000	5,434,000
Swiss	Sw.fr.	1,405,000	115,000	18,000	1,272,000

* Nominal value on 1st May 1966 established in accordance with the provisions of the London Agreement on German External Debts of 27th February 1953 but without taking account of the revaluation of the Deutsche Mark in March 1961.

The position as regards the Dawes and Young Loans is as shown in the preceding tables.

The Bank is also Trustee for the assented bonds of the Austrian Government International Loan 1930 and for the coupons of that loan, which the Federal Republic of Germany has undertaken to pay to the extent of 75 per cent. of the nominal value. In both cases servicing was carried out in conformity with the relevant agreements.

The following table shows the position as regards the assented bonds of the loan and their redemption.

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 1964	1965	
American . . .	$	1,667,000	386,000	73,000	1,208,000
Anglo-Dutch .	£	856,600	193,000	38,200	625,400
Swiss	Sw.fr.	7,102,000	1,354,000	256,000	5,492,000

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

The Bank has continued to perform the functions of Depositary in respect of the loans of the High Authority 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 High Authority on 28th November 1954.

The total amount of these secured loans was originally equivalent to about 817 million francs. Repayments by the High Authority up to 1st April 1966 amounted to the equivalent of about 254 million francs, so that the total amount outstanding was reduced to the equivalent of about 563 million francs. Further particulars of these loans are given in the table on the next page.

The High Authority has used the proceeds of these loans to grant credits in the member countries of the European Coal and Steel Community.

During the financial year 1965–66 the Bank received from the borrowers and distributed among the Paying Agents the equivalent of about 29 million francs in respect of interest and the equivalent of about 40 million francs in respect of redemption.

Secured loans of the High Authority of the European Coal and Steel Community.

Series of Secured Notes of the High Authority	Dates of issue	Countries of issue	Lenders	Original amounts of loans		Amounts unredeemed on 1st April 1966	Rates of interest %	Year of final maturity
1st	1954	United States	US Government	$	100,000,000	72,900,000	3⅞	1979
2nd	1955	Belgium	Caisse Générale d'Epargne et de Retraite, Brussels	B.fr.	200,000,000	154,400,000	3½	1982
3rd	1955	Germany	Rheinische Girozentrale und Provinzialbank, Düsseldorf	DM	25,000,000	17,863,500	3¾	1981
			Landesbank für Westfalen Girozentrale, Münster	DM	25,000,000	17,863,500	3¾	1981
4th	1955	Luxemburg	Caisse d'Epargne de l'Etat, Luxemburg	B.fr. L.fr.	20,000,000 5,000,000	15,440,000 —	3½ —	1982 —
5th	1956	Saar	Landesbank und Girozentrale Saar, Saarbrücken	DM	2,977,450[1]	2,072,305	4¼	1977
6th	1956	Switzerland	Public issue	Sw.fr.	50,000,000	35,000,000	4¼	1974
7th[2]	1957	United States	Public issue	$	25,000,000	17,400,000	5½	1975
10th	1957	Luxemburg	Etablissement d'Assurance contre la Vieillesse et l'Invalidité, Luxemburg	L.fr.	100,000,000	88,366,603	5⅜	1982
11th[2]	1958	United States	Public issue	$	35,000,000	30,400,000	5	1978
13th[2]	1960	United States	Public issue	$	25,000,000	25,000,000	5⅜	1980
15th	1961	Luxemburg	Etablissement d'Assurance contre la Vieillesse et l'Invalidité, Luxemburg	L.fr.	100,000,000	97,277,858	5¼	1986
16th	1961	Netherlands	Public issue	Fl.	50,000,000	50,000,000	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.

The High Authority 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.

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

As has been explained in Chapter V of Part II of the present Report, the Bank continued to act as Agent for the execution of the financial operations of the EMA under the Organisation for Economic Co-operation and Development. The expenses of the Bank in this capacity amounted to 370,808 francs in the twelve months to March 1966; this amount has been duly reimbursed by the Organisation (as shown in the Profit and Loss Account for the financial year ended 31st March 1966).

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

Co-operation between central banks in the field of research and exchanges of information has been strengthened. In addition to the regular meetings of the Board of Directors, the Bank has continued to organise a number of meetings of central-bank experts either to study economic and monetary problems of general interest or to examine specific questions, such as the development of the gold and Euro-currency markets. The Bank's services have assisted in the work of these groups.

During the year the Bank also continued to carry out the functions referred to in the Ministerial Statement of the Group of Ten. In conformity with this statement, which dates back to 1st August 1964, the members of the Group provide the Bank with statistical data relevant to the means used to finance surpluses or deficits on their external account. These data, as an essential basis for multilateral surveillance of international liquidity creation, are circulated to all participants and to Working Party 3 of the OECD. The Governors of the central banks of the Group, when they meet at the Bank, also exchange information as early as possible upon arrangements entered into between members of the Group for new or enlarged credit facilities. The utility of this co-operation has been borne out in the past year.

The Bank has continued to be associated in the work carried out by the Deputies of the Group of Ten and by its Study Groups dealing with the international liquidity problem, the creation of reserve assets and the adjustment process.

The development of co-operation between central banks has also strengthened the relations between the Bank, on the one hand, and the OECD and the IMF, on the other, by extending their collaboration to new fields.

7. Financial results.

The accounts for the thirty-sixth financial year ended 31st March 1966 showed a surplus of 38,578,751 francs. The surplus for 1964–65 was 34,519,144 francs.

From the year's surplus the Board of Directors has decided that it is necessary to transfer 1,000,000 francs to the provision for exceptional costs of administration and 15,000,000 francs to the provision for contingencies; the net profit for the year thus amounts to 22,578,751 francs and, with the addition of the balance of 9,764,036 francs brought forward from the previous year, there is a sum of 32,342,787 francs available.

The Board of Directors recommends that the present General Meeting should distribute, as last year, a dividend of 37.50 francs per share, involving a distribution of 7,500,000 francs. The Board also proposes that, as an exceptional measure, a lump sum should again be applied to the reduction of the amount of the undeclared cumulative dividend. This sum, which has been fixed at 15,000,000 francs, will represent an extraordinary distribution of 75 francs per share. The total distribution will thus amount this year to 112.50 francs, payable on 1st July 1966 in the amount of 160.75 Swiss francs per share. As regards the shares in respect of which the dividend cannot be paid on that date, the conversion to Swiss francs will be effected on the day of payment. The balance carried forward will be 9,842,787 francs.

The amount of the undeclared cumulative dividend will, as a result of this distribution, be reduced from 129.47 to 54.47 francs per share.

The accounts of the Bank have been duly audited by Messrs. Price Waterhouse & Co., Zurich. The Balance Sheet, the Profit and Loss Account and the Report of the Auditors will be found at the end of this Report.

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

The mandate of Mr. Per Åsbrink, who had been elected to the Board under Article 28(3) of the Statutes, being due to expire on 31st March 1966, he was re-elected at the meeting of the Board held on 14th March 1966 for a further period of three years ending on 31st March 1969.

The mandate of M. Henri Deroy as a member of the Board was due to expire on 31st March 1966 and he was re-appointed under Article 28(2) of the Statutes by M. Brunet, Governor of the Bank of France, in March 1966 for a further period of three years expiring on 31st March 1969.

The mandate of Mr. M. J. Babington Smith as a member of the Board was due to expire on 6th May 1966 and he was re-appointed under Article 28(2) of the Statutes by Lord Cromer, Governor of the Bank of England, in April 1966 for a further period of three years expiring on 6th May 1969.

The Bank very much regrets the sudden death on 25th May 1966 of M. Georges Royot, Assistant Manager, who had only recently retired. At the Board meeting held on 14th March 1966 the Chairman, on behalf of the Board, had thanked M. Royot for his valuable and faithful services to the Bank since its foundation.

CONCLUSION.

It is often avowed that economic policy should pursue, and seek to reconcile, four goals simultaneously: full employment, adequate growth, price stability and external balance. But as deeds count for more than words in this matter, the realisation of these objectives over the past year was uneven and their reconciliation haphazard. With few exceptions, the essential difficulty in both western Europe and the United States was excessive demand, caused by boom conditions in general and by public-sector expenditures in particular. While monetary restraint was widely imposed to curb demand pressures, the evolution of government finance usually worked in the opposite direction. As a result, prices were unstable — upwards — and the level of interest rates rose substantially. In these circumstances the pull of market forces was not towards the correction of imbalances in international payments.

The outstanding change from a year ago is that the United States has joined most western European countries in having demand pressures. Although a less extreme case, the increase in demand over the past year has compromised the balanced expansion which the economy enjoyed for several years. The proximate cause of this development was the requirements of the war in Vietnam, which had a psychological as well as direct impact on some other categories of demand, particularly business investment outlays. The pressure was evident not only in prices but also in imports, which have increased above their normal relationship to total output. Some steps have been taken to increase tax revenues, but so far the greater effort to tone down the rate of expansion has been by monetary restraint. Fortunately, increases in wages have, with few exceptions, been reasonably moderate and few important contracts are due for renewal this year.

The degree of policy restraint required by the situation has been a matter of some dispute and very recently a decline in automobile sales has lent support to the side of suspended judgement. But a more basic factor is the course of defence expenditures; and, if these are to continue rising, greater fiscal restraint is necessary. The experience of the past year has shown once again that the process of adjusting fiscal policy in the United States is too cumbersome to allow the flexibility which smooth implementation of the new economics requires. Stand-by powers to raise or lower taxes in easy stages would help enormously in the management of this huge and dynamic economy.

In the United Kingdom the fiscal year ended, as it had begun, with the economy subjected to substantial excess demand. While taxes were raised a year ago, the increase in revenues was outpaced by public-sector expenditure. In addition, the wage-bargaining machinery has been grinding out settlements which contributed to both cost and demand inflation. Consequently prices have risen and the labour market has become tighter. Excess demand has also spilled over into imports; it is striking that, despite the special surcharge, imports were more than 7 per cent. higher in the first four months of this year than in the same period of 1964. An effective ceiling was put on the extension of bank credit to the private sector, but the restraint this might have imposed on internal liquidity was blunted by the extent to which the public-sector deficit was financed by monetary means.

In the budget of May 1966, therefore, the government changed the posture of fiscal policy to one of definite restraint on total demand. A large amount in new taxes was provided for and a substantial cut in the overall budget deficit is foreseen. As the bulk of the new revenue is to come from a system of levies and rebates on employment, the eventual degree of demand restriction is difficult to measure. It should, however, have a significant impact in the coming months. The pressing need remains to secure a major reduction in the size of wage increases.

Among the continental countries of western Europe, apart from France and Italy, the feature of the past year has also been excessive demand. The use of resources has been generally driven to the extreme, resulting in persistent pressure on wages and prices and leading to deterioration in the current external balance. The tendency of output, in these circumstances, was to flatten out. While there has been official concern over the inflationary pressures in the situation, there has not been co-ordinated policy for dealing with them. Monetary policy has been restrictive, severely in some cases, while expenditures in the public sector have risen strongly without an adequate counterbalance from higher taxes.

Because of its impact on smaller neighbouring countries, the situation in Germany has been of key importance. Yet, this champion of price and monetary stability has been rather inconsistent in its pursuit of policy aims. The central bank has been bravely plugging the leaking dyke, only to be drenched by the stream of public spending overflowing the wall. Prices, interest rates and imports have all risen to absorb the inflationary gap between demand and supply. The economy would benefit from a respite, and perhaps, with the tighter budget for this year, one is on the way.

Hence, developments last year highlight the need for better balance in the relative priorities of economic objectives. On the domestic side, price stability has had too low a place relative to expansion of demand. While a situation of this kind could arise from a variety of causes, in fact it arose largely out of too much stimulus from the public-sector finances.

With respect to international payments, also, a reassessment of priorities is in order, since the needs of the adjustment process have had too low a place in the mixture and strength of general policy measures. The external deficits of both the United Kingdom and the United States were reduced substantially last year. However, the improvements were obtained to a great extent by means which rather emphasise the depth of the basic imbalance. The United Kingdom became more committed to direct controls, and the hope that in the United States reliance on such methods would be short-lived has tended to fade. The minimum obligation of both countries is to prevent excessive demand from swelling the volume of imports and to leave some margin in the economy for export expansion. As to the continental countries, the general tendency of relying primarily on monetary restriction to dampen the boom has contributed to the escalation of interest rates and made a basic adjustment more difficult to achieve.

If it takes more than optimistic forecasts to restore equilibrium to international payments, so also will it take more than contingency planning to deal with the substantive difficulties of the international monetary system. With the two reserve centres in external deficit, the reluctance of countries to make commitments on the basic questions leaves an air of unreality in discussions of the problem. One such question involves the global amount of reserves needed to make the fixed exchange rate system viable and the rate at which owned reserves should increase. Another problem concerns the responsibilities of countries for balance-of-payments adjustment and the limits to financing of external deficits through official credit mechanisms.

A vexing issue also is the appropriate rôle that gold should perform in the system and the relationship between gold and other forms of reserves.

Gabriel Ferras
General Manager.

BALANCE SHEET AND PROFIT AND LOSS ACCOUNT

AS AT 31st MARCH 1966

BALANCE SHEET

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

			%
Gold in bars and coins		3,024,558,382	38.4
Cash on hand and on sight account with banks		381,147,346	4.8
Rediscountable Treasury bills		67,838,731	0.9
Bills and securities cashable on demand		124,196,192	1.6
Time deposits and advances			
Not exceeding 3 months	1,825,362,434		23.2
» » » » (gold)	3,405,463		0.0
Between 3 and 6 months	360,014,631		4.6
Between 6 and 9 months	171,113,012		2.2
Between 9 and 12 months	60,388,108		0.8
Over 1 year	86,657,010		1.1
		2,506,940,658	
Other bills and securities			
Gold			
Not exceeding 3 months	276,207,297		3.5
Between 3 and 6 months	95,109,928		1.2
Between 6 and 9 months	22,970,765		0.3
Between 9 and 12 months	25,823,197		0.3
Currencies			
Not exceeding 3 months	957,310,025		12.1
Between 3 and 6 months	120,716,573		1.5
Between 6 and 9 months	33,827,742		0.4
Between 9 and 12 months	60,265,042		0.8
Over 1 year	55,934,218		0.7
		1,648,164,787	
Miscellaneous assets		10,047,544	0.1
Buildings and equipment		1	0.0
Claim in respect of the Arrangement dated 29th November 1965 with the Federal Republic of Germany		118,765,836	1.5
		7,881,659,477	100

MEMORANDUM ACCOUNTS

a. Forward gold operations:	
Net balance: gold receivable (currencies to be delivered)	439,151,937
b. Funds, bills and other securities administered or held by the Bank for account of third parties:	
Earmarked gold	1,144,784,581
Bank balances	32,286,355
Bills and other securities	715,291,607

AS AT 31st MARCH 1966

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	1.6
Reserves			
Legal Reserve Fund ...	12,500,000		
General Reserve Fund ...	13,342,650		
		25,842,650	0.3
Deposits (gold)			
Central banks			
Between 9 and 12 months ...	89,569,609		1.1
Between 6 and 9 months ...	203,431,495		2.6
Between 3 and 6 months ...	84,327,314		1.1
Not exceeding 3 months ...	522,623,119		6.6
Sight ...	2,161,939,548		27.4
Other depositors			
Between 6 and 9 months ...	68,933,832		0.9
Between 3 and 6 months ...	17,262,531		0.2
Not exceeding 3 months ...	68,913,385		0.9
Sight ...	322,269,421		4.1
		3,539,270,254	
Deposits (currencies)			
Central banks			
Over 1 year ...	23,901,465		0.3
Between 9 and 12 months ...	45,071,843		0.6
Between 6 and 9 months ...	16,723,036		0.2
Between 3 and 6 months ...	379,104,496		4.8
Not exceeding 3 months ...	2,412,129,286		30.6
Sight ...	165,546,961		2.1
Other depositors			
Between 3 and 6 months ...	708,993		0.0
Not exceeding 3 months ...	404,447,395		5.1
Sight ...	18,397,808		0.2
		3,466,031,283	
Notes			
Between 3 and 6 months ...	15,960,999		0.2
Not exceeding 3 months ...	345,582,788		4.4
		361,543,787	
Miscellaneous ...		33,332,516	0.4
Profit and Loss Account ...		32,342,787	0.4
Provision for contingencies ...		216,200,000	2.8
Claims of Governments in respect of the Annuity Trust Account ...		82,096,200	1.1
		7,881,659,477	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 1966 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, 4th May 1966. PRICE WATERHOUSE & CO.

PROFIT AND LOSS ACCOUNT

for the financial year ended 31st March 1966

		Gold francs
Net income from the use of the Bank's own funds and the deposits entrusted to it, excluding the final annuity received under the Agreement on German External Debts ...		46,311,387
Commission earned as Trustee, etc. ...		698,390
		47,009,777
Costs of administration:		
Board of Directors — fees and travelling expenses ...	355,216	
Executives and staff — salaries, pension contributions and travelling expenses ...	7,006,473	
Rent, insurance, heating, electricity ...	60,161	
Renewals and repairs of buildings and equipment ...	287,093	
Office supplies, books, publications, news service, printing ...	405,306	
Telephone, telegraph and postage ...	205,248	
Experts' fees (auditors, interpreters, economists, etc.)	66,308	
Cantonal taxation ...	35,281	
Miscellaneous ...	380,748	
	8,801,834	
Less: Amounts recoverable for expenses as Agent of the Organisation for Economic Co-operation and Development (European Monetary Agreement) ...	370,808	8,431,026
		38,578,751
The Board of Directors has decided that it is necessary to transfer		
to the provision for exceptional costs of administration	1,000,000	
to the provision for contingencies ...	15,000,000	16,000,000
NET PROFIT for the financial year ended 31st March 1966 ...		22,578,751
Add: Balance brought forward from the preceding year ...		9,764,036
Total profits available ...		32,342,787
which the Board of Directors recommends to the Annual General Meeting called for 13th June 1966 should be dealt with as follows:		
Dividend of 37.50 gold francs, plus an amount of 75.— gold francs, which increases the distribution to 112.50 gold francs per share and reduces the amount of the undeclared cumulative dividend from 129.47 gold francs to 54.47 gold francs per share ...		22,500,000
Balance to be carried forward ...		9,842,787
		32,342,787

Movement on the provision for contingencies during the financial year ended 31st March 1966

	Gold francs
Balance as at 1st April 1965 ...	214,500,000
less: Loss on German investments under the Hague Agreements of 1930 ...	13,300,000
	201,200,000
add: Transfer from Profit and Loss Account ...	15,000,000
Balance as at 31st March 1966 per Balance Sheet ...	216,200,000