BANK FOR
INTERNATIONAL SETTLEMENTS

FORTY-FIFTH ANNUAL REPORT

1st APRIL 1974 – 31st MARCH 1975

BASLE

9th June 1975

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FORTY-FIFTH ANNUAL REPORT

submitted to the

ANNUAL GENERAL MEETING

of the

BANK FOR INTERNATIONAL SETTLEMENTS

held in

Basle on 9th June 1975

Gentlemen,

I have the honour to submit herewith the forty-fifth Annual Report of the Bank for International Settlements for the financial year which began on 1st April 1974 and ended on 31st March 1975.

After deduction of 5,559,195 gold francs transferred to the Provision for Exceptional Costs of Administration, the net profit for the year amounted to 182,063,281 gold francs, compared with 145,063,281 gold francs for the preceding year and 122,063,281 gold francs for the financial year 1972–73.

The Board of Directors recommends that, in application of Article 51 of the Bank's Statutes, the present General Meeting should allocate the sum of 18,042,187 gold francs in payment of the preferential dividend of 6 per cent. per annum, or 37.50 gold francs per share, and that from the remainder of the net profit it should appropriate 9,021,094 gold francs — a sum falling within the statutory limit of 20 per cent. — in payment of the maximum further dividend of 3 per cent. per annum, or 18.75 gold francs per share.

The Board further recommends that 62,000,000 gold francs be transferred to the General Reserve Fund, and the remainder of 93,000,000 gold francs to the Free Reserve Fund.

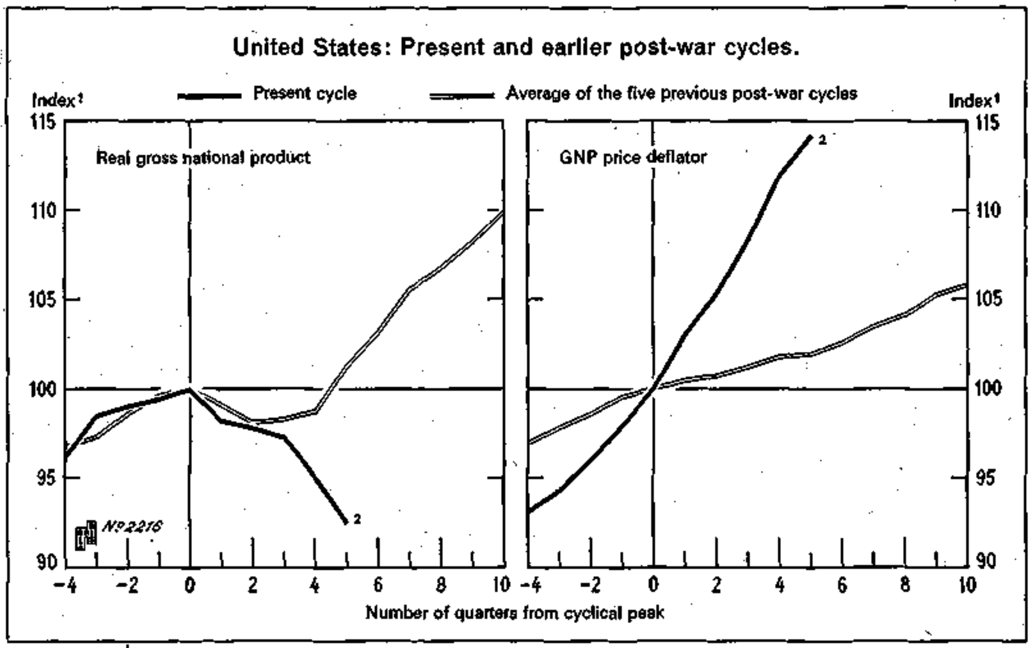
If these proposals are approved, the Bank's total dividend for the financial year 1974–75 will amount to 56.25 gold francs per share. This will be payable to shareholders on 1st July 1975 in the amount of 75.05 Swiss francs per share.

Chapter I of this Report gives a survey of economic developments and policies in 1974–75 against the background of a combination of world-wide inflation and severe recession that distinguishes the present from previous post-war cycles; it deals in particular with monetary policies and the swings in interest rate levels, the effects of the rise in oil prices on international payments balances and the movements in the exchange rates of leading currencies. The second chapter analyses developments in individual countries in respect of production, prices and monetary and fiscal policies. The following two chapters review the events of last year in the fields of foreign trade and payments, gold production, global reserves and foreign exchange markets. The fifth chapter examines developments in the Euro-currency and Euro-bond markets. Chapter VI concerns the Bank's activities during the financial year, the Balance Sheet and the financial results.

I. SURVEY OF ECONOMIC DEVELOPMENTS AND POLICIES, 1974-75.

Production and demand.

Economic developments over the past year are strikingly illustrated by the graph below, which contrasts the present contraction in the US economy and the average of the five previous post-war cycles. Largely under the impact of severe inflation coupled with the disruptive effects of the huge rise in oil prices, the industrial world has slid into its deepest and most pervasive recession since the war. In the forefront of the slump were three large countries, Germany, Japan and the United States, all of which had pressed strong anti-inflationary measures since 1973. In the United Kingdom, where balance-of-payments considerations had also prompted restrictive monetary measures in the autumn of 1973, the downturn started just as early but has been less marked. This unusual conformity of cyclical turning-points triggered a slow-down in world trade and helped transmit the contractionary impulses to most other countries.



[1] Cyclical peak = 100. [2] First quarter 1975.

Around mid-1973, months before the onset of the oil crisis, the rate of expansion had begun to ease in many countries because of limitations imposed by shortages of materials and capacity. Significantly, the US index of capacity utilisation for materials-producing industries rose to a record level and was much higher than that for manufacturing industries generally. Somewhat later, the increasing adoption of restrictive policy measures, aimed against inflation, added force to the slow-down.

The first signs of an actual weakening in production occurred at the end of 1973 in the larger countries. However, it was uncertain to what extent these developments reflected an enduring cyclical pattern or only a temporary reaction to the Arab embargo on oil shipments to the United States and the coal-miners' strike and associated three-day working week in the United Kingdom. Following the termination of the oil embargo and the miners' strike, industrial output showed a modest recovery in the second quarter of 1974 in both countries. While the expansion of factory output began to slacken considerably in many other countries, there was no evidence of serious deterioration, except in Japan. The mid-1974 outlook for most countries was either slow growth, temporary stagnation or, at worst, moderate declines.

In the second half of the year, however, the situation worsened markedly. Industrial output contracted in Austria, Belgium, Canada, France, Germany, Italy and Switzerland, while there was a renewed and sharpened decline in the United States and the United Kingdom. In Japan the drop in output continued. Activity in the automotive and construction industries became especially depressed. The decline in output continued into 1975 and by the late spring of this year most countries were in quite severe recession.

Never in earlier downturns had so many countries simultaneously experienced slack. Unemployment was near or above the levels of previous recessions in Germany, Canada, Denmark, France, the Netherlands and Belgium. The most striking increase was in the United States, where in April this year the unemployment rate reached 8.9 per cent. Although no country fully escaped the adjustment sweeping the industrial world, activity held up reasonably well in Sweden, which had earlier pursued stimulative fiscal policies, and especially in Norway, where activity related to North Sea oil provided a boost.

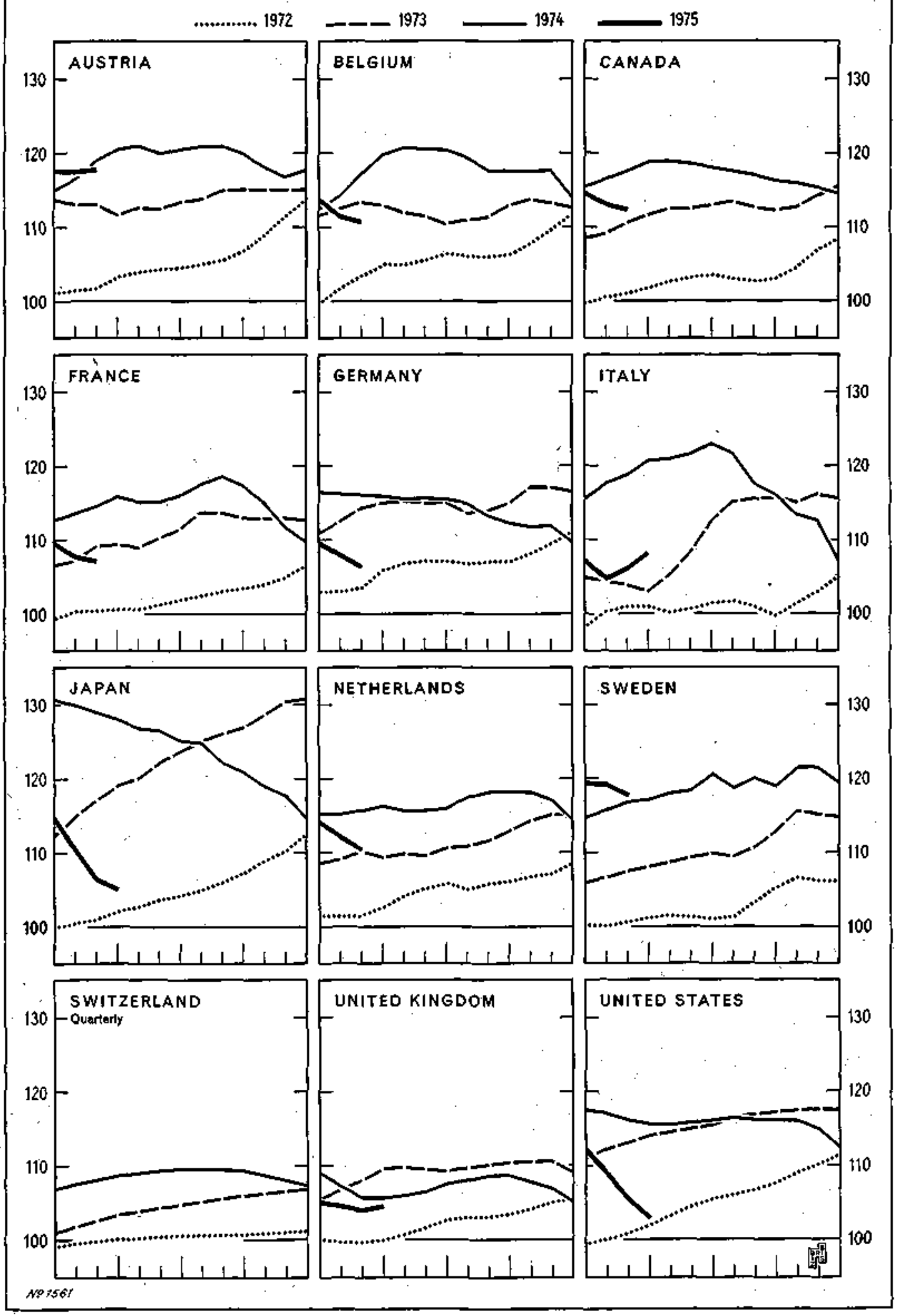
The comparative severity of the recession stemmed from both the reactions of stabilisation policies and private spending decisions to the extraordinarily high inflation and the unprecedented effects of the sudden fourfold jump in the price of oil. In previous downturns there had not been such serious depressants operating simultaneously in the main industrial countries. Besides, recessionary conditions were accentuated by the cautious attitude assumed first on the part of consumers and later on the part of business investors.

The strong inflation over the past two years depressed business activity indirectly via the adoption and maintenance of stringent anti-inflationary measures and directly by eventually cutting back real demand. Most of the larger countries had introduced demand restraint policies during 1973. In the smaller countries, policies were generally less restrictive. The stubborn persistence of severe inflation, allied in some countries with the development of serious external payments deficits, necessitated the maintenance of relatively tight policies even after the slow-down in real expansion had become quite evident. Aggregate demand was further depressed by inflation through added uncertainty, the fiscal drag of some tax systems geared to a relatively non-inflationary environment and the erosion of purchasing power.

The policy dilemma posed by slower growth and persisting inflation was acutely sharpened by the jump in the world price of oil at the turn of 1973/74.

Industrial production.

Uncentred moving averages of monthly indexes: December 1971 = 100.



It was immediately evident that the impact of higher oil prices on domestic demand in the oil-importing countries would be similar in its effect to a large new excise tax. Real domestic demand in those countries was reduced to the extent that transfers of income to oil exporters were not quickly matched by increases in the oil producers' demand for external goods and services. Moreover, the higher relative energy prices altered demand patterns and exacerbated unemployment owing to the limited short-term transferability of specialised labour and capital resources. By reinforcing inflation and causing widespread balance-of-payments deficits, the oil-price rise added to the reluctance of many governments to offset the oil-related contractionary pressures by a shift to stimulative demand-management policies.

In evaluating the contractionary impact of higher oil prices, it should be noted that the relative severity of individual countries' recessions has been only loosely related to the degree of dependence on oil imports. It is true that in Japan, which is heavily dependent on imported oil, the decline in production has been particularly steep. However, the European countries were more dependent than the United States on foreign oil but have had milder downturns. Of course, dependence on imports as such is not an adequate measure of the deflationary effect of higher oil prices. In addition, the extent of highly energy-related activities was important as it indicated the proportion of output directly influenced by the impact of higher relative energy prices. For example, many smaller European countries experienced less slack than most of the larger industrial ones because their economies were much less dependent on domestic motor-car industries. Moreover, other factors were at work, including different policy priorities for tackling problems of payments deficits, inflation and unemployment.

Of the major components of aggregate demand, residential construction has generally suffered the largest decline. To some extent the contraction in house-building was a reaction to very high activity in earlier years. However, tight monetary policies and very high interest rates reduced both the immediate willingness to purchase housing and the availability of mortgage funds to satisfy even the lower level of demand. Furthermore, the higher cost of oil depressed demand for housing that was not serviced by public transport. In the United States, despite official efforts to pump funds into savings institutions that were having difficulties in attracting deposits, residential construction underwent its sharpest post-war decline. After playing a leading rôle in aggregate demand expansion in 1973, construction was weak in Canada and fell sharply in Japan. In the United Kingdom, Germany, Switzerland, the Netherlands and most Scandinavian countries, where the housing sector had begun to show signs of weakness during the previous year, construction activity declined markedly in 1974–75. Residential building in several continental European countries appears not only to be changing in a cyclical context but also to be adapting to a lower normal level of demand following the long-sustained effort to reduce housing shortages.

The slackening of consumption expenditure was a weightier element than usual in the downturn of activity. While the restrictive stance of demand management, price inflation and the housing-related slump in household durable spending were important determinants, there were some quite novel influences emanating from the higher cost of oil. Car sales, in particular, were depressed by increasing fuel costs.

Supply and use of resources.

Countries	Years	Sources of demand						Resources	
		Consumption		Gross fixed domestic capital formation			Exports of goods and services	Imports of goods and services	Gross national product
		Private	Public	Total	Plant and equipment	Dwellings			
		annual average or annual volume changes, in percentages							
Austria	1963–72	4.7	3.4	7.4	.	.	8.9	9.3	5.2
	1973	4.1	3.8	2.8	.	.	8.3	12.4	5.8
	1974	3.7	4.0	1.2	.	.	8.6	8.0	4.4
Belgium.	1963–72	4.2	5.7	4.3	4.7	3.0	9.1	8.6	4.8
	1973	6.6	5.2	5.2	2.3	16.9	15.7	20.4	5.3
	1974	2.8	6.7	7.4	5.1	13.9	7.5	8.5	4.0
Canada	1963–72	5 2	5.8	5.6	5.5	6.3	9.3	9.0	5.4
	1973	8.0	4.1	10.4	9.8	12.7	8.3	12.4	6.8
	1974	4.3	8.9	7.4	9.3	0.8	− 1.1	9.4	3.7
Denmark	1963–72	3.9	6.8	5.8	5.3	6.4	7.6	6.7	4.6
	1973	4.3	4.7	10.9	.	.	9.2	18.3	3.8
	1974	− 3.0	.	.	.	.	.	.	2.0
Finland	1963–72	4.5	5.4	3.9	3.4	5.2	7.5	6.9	4.9
	1973	6.6	4.7	5.8	6.0	5.2	6.4	11.0	6.0
	1974	3.5	3.7	4.1	3.5	6.2	− 0.6	6.5	3.7
France	1963–72	5.5	3.5	7.9	7.8	8.3	11.1	11.3	5.7
	1973	6.0	3.4	8.0	7.0	5.8	12.6	14.1	6.0
	1974	4.3	2.3	4.6	.	.	12.4	9.7	4.1
Germany	1963–72	4.7	3.8	4.7	5.1	3.6	9.4	9.9	4.5
	1973	2.9	4.0	1.1	1.0	1.7	16.2	9.8	5.3
	1974	0.2	4.4	− 7.9	− 6.0	−14.7	13.4	4.9	0.4
Italy	1963–72	5.4	3.8	2.4	2.5	2.2	10.8	9.9	4.6
	1973	5.6	2.7	8.2	9.3	5.6	5.4	10.2	6.3
	1974	2.3	1.8	4.2	4.0	4.7	10.8	2.3	3.4
Japan	1963–72	8.9	6.6	12.8	12.4	14.6	15.2	13.1	10.4
	1973	8.1	7.0	14.3	14.6	13.5	7.3	23.0	10.2
	1974	1.6	3.2	−10.8	−11.8	− 7.2	21.2	12.2	− 1.8
Netherlands. . .	1963–72	5.8	3.2	6.1	5.2	9.4	9.8	9.6	5.4
	1973	2.1	0.7	6.5	7.4	3.9	13.0	12.2	4.6
	1974	3.0	3.0	− 6.5	− 4.0	−13.0	4.5	1.5	1.9
Norway	1963–72	4.2	5.1	5.1	4.6	7.6	7.7	6.9	4.7
	1973	2.7	4.5	15.3	18.3	2.9	8.7	14.4	4.1
	1974	3.2	4.0	6.9	8.7	− 1.3	1.2	5.6	3.6
Spain	1963–72	6.1	5.9	8.6	10.5	1.1	12.5	11.8	6.6
	1973	6.7	6.0	15.6	.	.	12.8	17.2	7.9
	1974	5.0	4.5	5.5	.	.	2.4	7.0	5.0
Sweden.	1963–72	3.2	4.7	4.1	4.3	3.4	7.3	6.9	3.7
	1973	1.9	2.2	0.0	0.0	− 1.5	15.7	6.7	3.1
	1974	4.4	3.7	1.5	5.0	−10.0	3.7	14.7	4.2
Switzerland . . .	1963–72	4.4	3.2	4.8	4.8	4.9	7.3	7.3	4.1
	1973	3.9	4.1	− 0.2	− 1.4	3.2	7.1	5.6	3.5
	1974	2.0	1.8	− 9.3	− 7.5	−14.4	2.4	− 1.0	− 0.8
United Kingdom .	1963–72	2.6	2.2	4.0	4.1	3.9	5.2	5.2	2.7
	1973	4.7	3.7	4.1	4.8	1.2	11.6	11.2	6.0
	1974	− 0.1	2.0	− 2.6	− 1.3	− 8.3	4.1	1.5	0.0
United States . .	1963–72	4.5	3.4	4.9	5.6	3.0	6.3	8.4	4.2
	1973	4.7	1.3	6.4	8.6	− 4.0	19.6	5.6	5.9
	1974	− 2.3	0.7	− 5.7	2.3	−26.6	8.0	1.5	− 2.1

Moreover, as energy demand is only moderately sensitive to price in the short run, consumers spent a larger proportion of their budgets on energy and consequently had less purchasing power available for other expenditures. Real consumption growth slowed down in France, Italy, Switzerland, Canada, Japan and Belgium. It stagnated in Germany and the United Kingdom and dropped significantly in the United States and Denmark. The expansion of consumption expenditure held up reasonably well in Spain and actually increased in Norway and Sweden, where real disposable income was boosted by fiscal measures. A rather disquieting aspect of the overall consumption picture is that a variety of opinion surveys have reported historically high levels of consumer pessimism. Such attitudes are not surprising considering both the uncertainty about jobs and the course of price inflation.

Investment in plant and equipment was still a fairly robust component of demand in most countries in the earlier months of 1974, when only a mild setback in overall economic activity was anticipated. Rising costs were an incentive to maintaining the level of investment spending. As the year advanced, however, investment weakened considerably in the face of declining consumption and housing expenditure and the worsening of the general economic outlook. Business fixed investment expanded at a markedly slower pace in France, Italy and the United States, turned down in the United Kingdom and the Netherlands, and fell appreciably in Germany, Switzerland and Japan. Of course, restrictive stabilisation policies and associated higher interest rates could be expected to depress investment. However, the business sector in some countries such as the United States and the United Kingdom experienced severe financial strains which were due to more than just tight money. With wages generally keeping up with consumer prices and oil producers gaining a growing fraction of the revenue from price rises, business net income suffered. In part, the deterioration of corporate financial positions in many countries reflected a tax squeeze resulting from taxation of profits on the basis of acquisition costs instead of inflated replacement prices of inventories and equipment. In the United Kingdom price controls were an important additional factor in depressing profits.

The high oil price stimulated investment in new energy sources in some areas. Such activity in the North Sea ensured for Norway a relatively strong real growth performance and kept the United Kingdom from registering even weaker results. Overall, the strength stemming from the energy search was more than offset by slackness in other areas of investment as recessionary demand conditions significantly lowered rates of capacity utilisation. In many countries, therefore, as recent surveys of investment intentions confirm, any strong near-term recovery of investment is improbable.

Imports of goods and services in real terms grew considerably more slowly during 1974 in reaction to the general easing of demand. While the volume of industrial countries' oil imports fell, nominal expenditures on oil soared and the resulting payments deficits in some countries prompted stabilisation policies aimed at curbing non-oil imports. Total imports increased very little in the United States, the United Kingdom, Italy and the Netherlands and declined in Switzerland. Their rate of increase fell substantially also in other countries, except Sweden, where there was some acceleration in comparison with 1973.

In most countries the increase in the volume of exports of goods and services was on average much lower in 1974 than in the previous year. The principal exceptions were Japan and Italy, which turned in a considerably stronger performance, and Austria, Germany and France, where export growth continued much as before. After sustaining demand early in the year, the expansion of merchandise exports slackened considerably in the second half of 1974 and for the year as a whole trade among the industrial countries expanded at the slowest pace for many years. On the other hand, exports to non-industrial countries, especially oil exporters, rose appreciably. The short-term absorptive capacity of OPEC countries may have been somewhat underestimated at the time of the initial oil-price rises and the oil producers now stand as a quite buoyant near-term market. However, export gains registered with non-oil-producing developing countries seem to be unsustainable as these countries have recently experienced adverse shifts in terms of trade which have impaired their ability to finance further industrial imports. After a strong performance in the first half of 1974, the growth of merchandise exports halted during the latter part of the year in Germany, France and the United States and slowed considerably in the United Kingdom. In Canada exports had begun to weaken early in 1974 and showed a decline for the year as a whole. After their previous sharp rise, Italian exports went up further during 1974 and remained fairly strong in the early months of 1975. A notable exception to the general pattern was Japan, where the expansion of exports remained extremely strong until the spring of this year. But for many countries exports in the first months of this year continued to be rather weak.

Despite the declining demand conditions described above, government spending policies often contributed little demand stimulus; attention was focused on inflation and balance-of-payments problems. Moreover, the real impact of nominal outlays, especially at the local-government level, was often blunted by unexpectedly rapid inflation. In the United States the volume of public consumption increased at the same low rate as the year before. Moderate slow-downs in public-sector demand occurred in the United Kingdom, France, Norway, Spain, Switzerland, Japan and Italy. In Belgium, Germany and Sweden government consumption expanded somewhat faster than in 1973, while in Canada it rose substantially. In recognition of the inappropriateness of heavy tax burdens in a period of deteriorating demand, a number of governments have made adjustments in tax rates. In some countries, particularly those in northern Europe, fiscal policy has been co-ordinated with incomes policies in a "multi-policy" approach designed to moderate wage/price inflation.

The recession in economic activity over the past six to nine months was much influenced by the course of inventory investment. In most of the larger industrial countries supply shortages had previously kept stocks fairly low while the boom continued, and as the emerging slack was widely interpreted as a temporary adjustment to the energy situation, there was a scramble for stocks in early 1974 — probably helped along by speculative buying. However, the worsening economic outlook over the year led to a drop in voluntary stock-building, although accumulation still occurred as unexpectedly weak sales resulted in mounting involuntary finished-goods inventories. The resulting high level of inventories relative to real sales in various countries was evidence of the extent to which downturns were unanticipated. Sizable liquidation of the excessive stocks became a prerequisite for economic recovery, but in a number of countries deliberate cutbacks of business inventories have been a temporary depressive influence in the fourth quarter of 1974 and the first quarter of this year.

As described in a later section, the deepening recession has induced some shift in demand-management policies. Monetary policy has generally been eased, the most forceful action having been taken in Germany and the United States. Earlier last year some fiscal stimulus was provided in a few smaller countries, notably the Netherlands and Sweden, and in the course of the year government budgets in Canada and the United Kingdom became more expansionary. At the beginning of this year the German authorities shifted fairly strongly to a stimulative fiscal position and a substantial tax reduction was decided upon in the United States in March. For many countries, however, the continuing problems of inflation and external imbalance have prompted caution.

Thus the outlook as mid-1975 approaches is rather mixed. In Germany the prevailing view is that an upturn is likely in the near future and in the United States most observers expect to see a recovery some time in the second half of the year. An upward movement in these two key countries would, of course, improve the atmosphere more generally. It is significant, however, that the absorption of economic slack appears likely to be rather slow. This is not only because real problems of adjustment lie ahead in such key fields as housing, motor vehicles and energy, but also because the authorities are still faced with excessive inflation and feel acutely the threat of its quickening again.

Price and wage inflation.

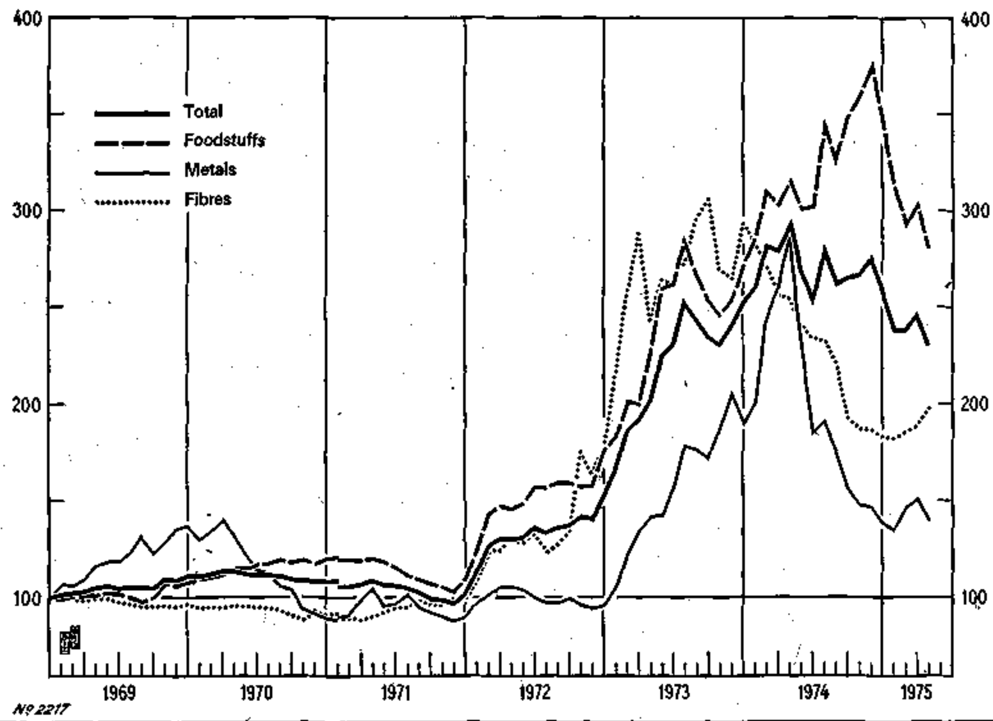
Over much of 1974 price inflation continued to gain momentum in the face of faltering economic activity. From about the spring onwards, when international commodity prices began their sharp decline, wholesale prices started to rise more slowly in most countries — though earlier increases continued to filter through to the consumer level. On the other hand, there was a marked step-up in negotiated wage increases which, combined with the cyclical fall in labour productivity, raised labour costs sharply. By the start of 1975, however, with the jump in oil prices a year old and the recession worsening, the rate of inflation eased off in a number of countries. But in a few, notably the United Kingdom and Italy, the rise in consumer prices was still very high.

The braking of inflation was led by the collapse of the commodity boom — which had been longer, steeper and more generalised than at any time in living memory. World-market prices of industrial raw materials generally reached their peaks by about April 1974. At this time their rise since December 1971, as measured by the "Economist" dollar indicator (which does not include oil), had reached 180 per cent., metals having gone up by 220 per cent. and fibres by over 150 per cent. The subsequent decline, accentuated by inventory adjustments and a shake-out of speculative excesses, was also impressive. The "Economist" industrial raw materials indicator fell by 36 per cent. between April 1974 and April 1975, reflecting, in particular, a plunge in the copper price to two-fifths of its 1974 peak, a halving of the price of rubber and substantial declines for lead, zinc, wool and cotton. Since the dollar depreciated over this period, the fall in terms of most other currencies was even greater. On the other hand, there were lagged increases in transaction prices for such products as iron ore and aluminium — generally in line with the rise in producers' costs.

Spot prices of most foodstuffs stayed at fairly high levels or kept rising until late 1974 but have since declined. Following a fall during the summer, grain prices peaked again in the autumn, before a decline set in under the influence of improved crop expectations and of US action to moderate exports to the USSR. The low level of world stocks kept the outlook uncertain and helped to slow the decline. In the volatile coffee and cocoa markets, prices fell precipitously in the autumn as speculative fever abated. Sugar prices shot up to record peaks in November but thereafter plummeted. Meat prices, which had risen relatively little, declined during much of 1974.

The experience of last year showed again that prices of many raw materials are still *responsive to demand conditions* and can go down as well as up. That market supplies were not cut back much when demand fell was partly because prices still exceeded the low variable costs prevailing in the highly capital-intensive production of many raw commodities. Long planning periods in agriculture, difficulties in financing buffer stocks and the urgent need of some producer countries for foreign exchange

World-market commodity prices: The "Economist" indicator.
Monthly (dollar) indexes: End of 1968 = 100.



were other reasons. The prices of most commodities have remained well above their pre-boom levels, and this may gradually stimulate greater output. However, the substantial rise that also took place in prices of manufactured goods, far exceeding that experienced during the boom of the early 1950s, increased the costs of production of crude materials and has probably raised the longer-run average supply price of many commodities.

Prices at other stages of the productive process responded only slowly to the retreat in raw-material costs, the weakening of overall demand being initially cushioned by a build-up of stocks and cut-backs in output. Wholesale prices surged upwards in early 1974 but by the late spring were generally rising more moderately. They showed a further large increase in the second half of 1974 in Canada and the United States, where the rise in oil prices was phased in gradually and where food prices continued to rise until the autumn. Price indexes by stages of production show the hump in material costs gradually being passed forward in moderated form. Around the turn of 1975, with producers and distributors seeking to liquidate excessive inventories, aggregate wholesale price indexes recorded falls in a large number of countries.

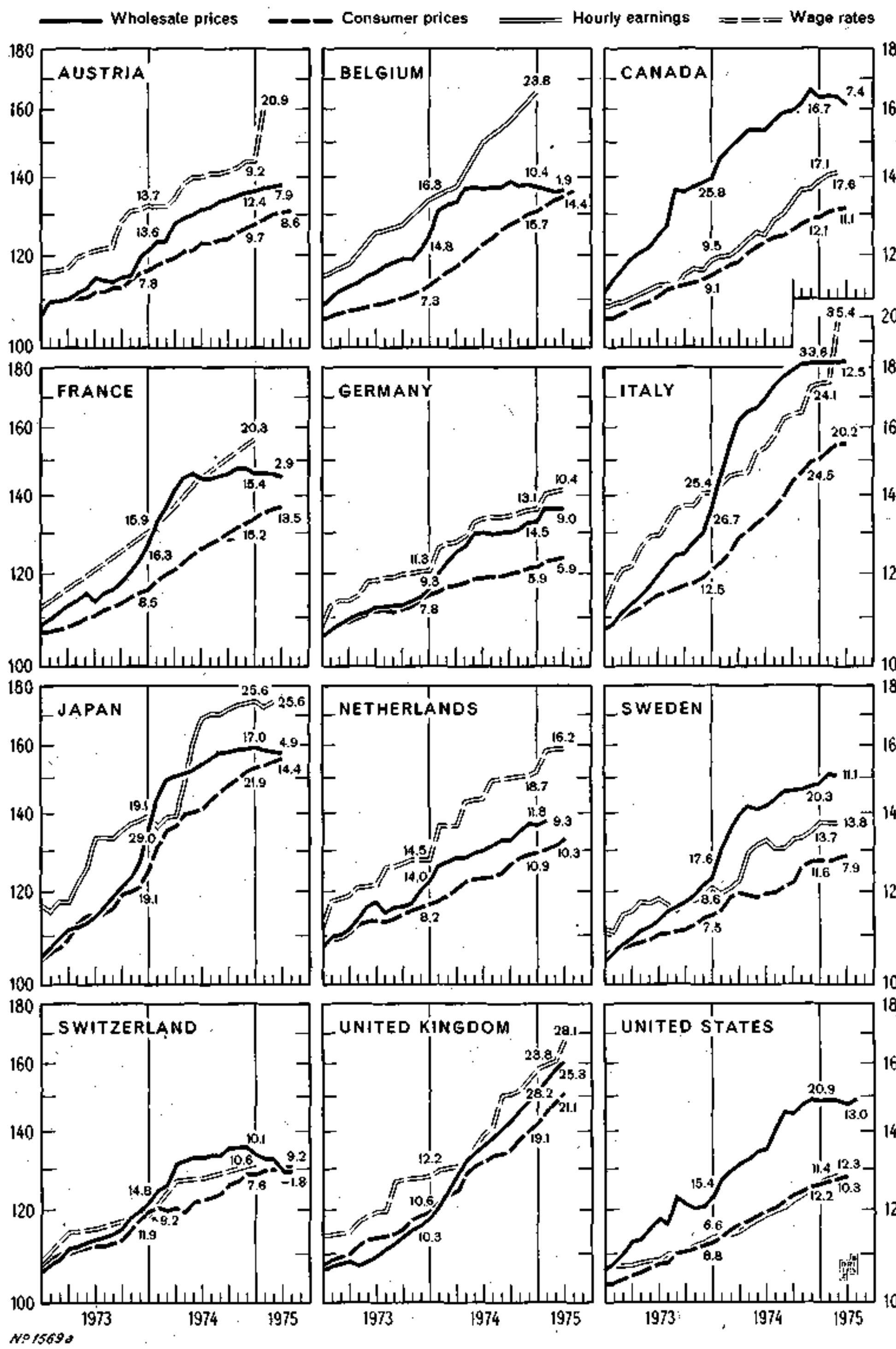
Striking evidence of the virulence of inflation in the industrial countries last year was the steep rise in the prices of finished manufactures. By the autumn of 1974, the year-on-year advance in wholesale or producer prices of manufactured goods was over 20 per cent. in all the major industrial countries except Germany, where the increase was about 11 per cent. In Italy and the United Kingdom the rise was nearer 30 per cent. By late 1974 and early 1975 these prices were increasing more slowly in the United States, Germany and Italy and were actually falling in France and Japan. However, they still appeared to be rising steadily in Canada and the United Kingdom.

Consumer prices continued to rise rapidly throughout most of 1974, though by the turn of the year there were widespread signs of a slow-down. In western European countries and Japan a sharp upsurge early in the year largely reflected the rise in oil prices, which in the United States and Canada was kept under restraint. As the year progressed, prices of manufactured products moved into the vanguard of the advance. Food prices, on the other hand, rose less last year than prices of other goods in all countries except Italy and Japan, where they moved up steeply in the autumn after the removal of controls, and Canada. Rents, often held down by controls, increased very slowly almost everywhere at least until the turn of the year. In Italy and the United Kingdom other services were also a stabilising element, thanks partly to steps to hold down public-utility charges, but in most countries their rise quickened with the spread of wage inflation. Changes in indirect taxes and food subsidies significantly influenced the timing of increases in consumer prices in Italy, Sweden and the United Kingdom, in particular.

A striking feature continued to be the marked divergences between countries' rates of inflation. By the spring of 1975 the twelve-month rates of increase in consumer prices ranged from about 6 per cent. in Germany to around 20 per cent. in Italy, Ireland and the United Kingdom. In between were Austria, Canada, the Netherlands, Sweden, Switzerland and the United States with increases of 8–11 per cent. In the

Prices and wages.

December 1971 = 100 (semi-logarithmic scale).



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

13–15 per cent. range were Belgium, Denmark, France and, following a sharp deceleration, Japan.

Though partly a matter of dependence on imported raw materials and oil, variations in inflation rates also reflected differences in the tightness of policy restraint, the severity of recession and the size of wage bargains. Japan's relative position, which had deteriorated sharply in 1973, has recently improved quite substantially, and Italy has also recorded better results. It is more than coincidence that the fanning-out of the rates of price inflation has been associated with the transition to floating exchange rates. Floating rates have reduced the international transmission of inflation, while at the same time amplifying the impact of inflationary monetary or cost impulses on prices in the country where they originate. In many countries, moreover, consumer prices are significantly influenced by import prices and, in turn, have a marked impact on wage developments and hence on export competitiveness.

Sharp rises in wages have been a major factor in prolonging, and often worsening, the inflationary process. Beginning in the spring of 1974 an acceleration of wage increases occurred in all countries, though with varying severity. By the end of the year twelve-month rates of increase in wage rates and hourly earnings ranged from 10–14 per cent. in the United States, Germany, Sweden and Switzerland to around 25 per cent. in Italy, Japan and the United Kingdom. In most of the other western European countries and Canada increases were in the 15–20 per cent. range.

Though associated with faster rises in living costs, the increase in wages again exceeded that in consumer prices in most countries. Only in the United States was there a fall in real wages. There the rise in wage rates quickened last year following the removal of the control programme but failed, for the second year running, to keep pace with consumer prices.

For a number of reasons wage behaviour appears to have become less responsive to demand restraint policies. The wage claims put forward reflect not only entrenched expectations of regular increases in real wages but sometimes also an attempt to hedge against expected price increases and the erosion of post-tax disposable incomes by inflation. Equally, attempts in some countries to improve the relative position of low-paid workers have provoked wage drift among higher-paid labour.

Apart from the rise in wages, a cyclical slow-down in labour productivity gave a sharp upward push to unit labour costs last year, particularly in Germany, Japan and the United States. In Belgium, France and the Netherlands, where the recession was slower to emerge, productivity growth helped to offset part of the cost impact of the rather large increase in wages. Prices of industrial goods rose rapidly during the year but, especially where controls were operative, were usually outpaced by wages, and profits were squeezed with varying intensity in almost all countries. At the same time, taxation on unrealised stock appreciation gains weakened the self-financing capacity of enterprises, which thus had to borrow more heavily at sharply higher interest rates. As time went on, growing uncertainties regarding price and income expectations, against a background of sharply rising costs, led to a pronounced weakening of investment and economic activity.

At an admittedly heavy cost in terms of output and employment, the weaker labour-market conditions from late 1974 onwards, together with signs of a slow-down in consumer prices, have helped to moderate wage claims. Average earnings were also depressed by the fall in overtime working. By the spring of 1975 wage increases seemed to be past their peaks in most countries, notable exceptions being Canada, Italy and the United Kingdom. In the United Kingdom, as a result of some extremely large public-sector settlements, the year-on-year increase in wage rates reached 32.5 per cent. in March. By contrast, typical contract settlements in Germany in early 1975 were in the 6–7 per cent. range. In Japan increases in the 1975 spring wage round averaged about 15 per cent., against a figure of 32 per cent. a year earlier.

The momentum of inflation put severe strains on efforts to regulate prices and incomes. Statutory wage controls were abandoned in the United States and the United Kingdom but were applied in the Netherlands until the end of the year. The only countries which have set official wage guide-lines this year are Denmark and Spain. However, an increasing number of governments have sought formally to influence wage negotiations by reductions in direct taxes, notable examples being Canada, Germany, the Netherlands and Sweden. More generally, in a number of countries, particularly those in northern Europe, continued efforts have been made to bring the wage bargaining process into the context of a multi-policy approach to economic stabilisation. Integral elements of national bargains have been changes in income-tax rates, social security contributions, food subsidies and taxes or temporary levies on business profits. Approaches of this sort seem most likely to be successful where key negotiations are centralised and there is a broad consensus on national economic goals. In Germany and Japan the authorities' commitment to monetary restraint is considered to have helped to moderate wage claims. In the United Kingdom the Trades Union Congress gave an undertaking that wage settlements should be kept in line with increases in the cost of living. In practice, however, new claims on this basis were superimposed on continuing price-indexed adjustments which were a legacy of the previous control phase. Elsewhere regulatory action was mainly confined to supervision of prices, profit margins and rents. Food subsidies, changes in value added tax and delays in increasing public-sector tariffs were also widely used to help moderate price rises. To the extent that controls were effective in holding down prices, they contributed to a squeeze on profits and often had to be liberalised or abandoned. In Japan, however, the prior-approval requirement for price increases, which was in force between March and September 1974, seems to have helped to hold back increases until monetary restraint could become effective.

At the present time, with all trace of excess demand long past and with competition for thinner markets forcing a close watch on business pricing policy, wage increases are the primary factor in continued inflation.

Monetary policy and interest rates.

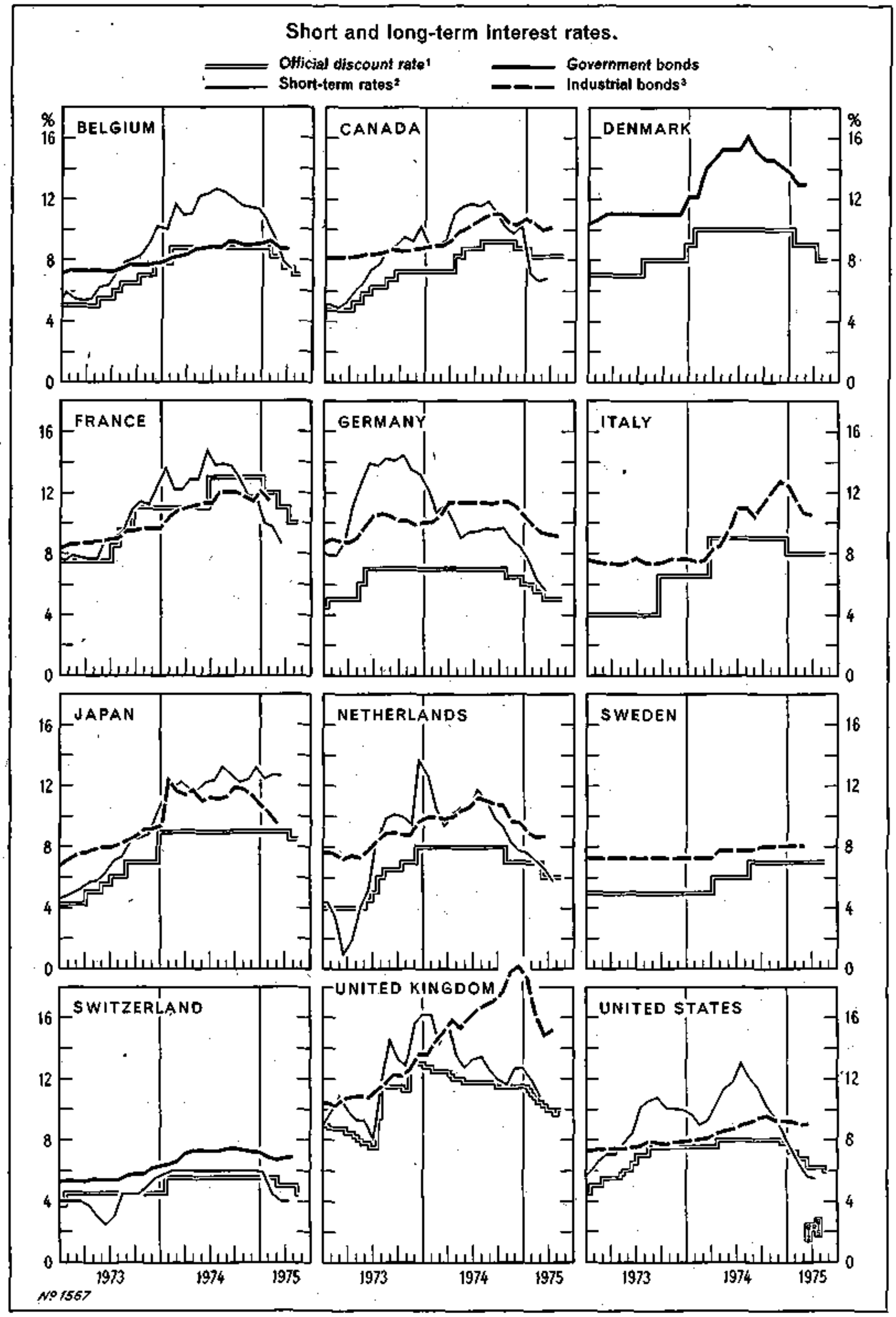
From a policy standpoint, economic developments since the spring of last year have upset the hope that a significant dampening of inflation might be possible without a substantial drop in output and rise in unemployment. They have tended, rather, to bear out the view that the long and rapid inflation would be followed by a severe and protracted adjustment period. Clearly, the excesses of the 1973–74 inflationary boom, together with the wrenching impact of the sharp rise in energy prices, increased the likelihood that a recession would not be of the ordinary variety. Speculative overstocking, excessive capacity in residential construction, major cash-flow and liquidity problems, enfeebled equity and bond markets — all foreshadowed the possibility of a sharper reaction than in previous stabilisation episodes.

Whether in early 1974 national authorities were fully cognisant of the down-side risks in pressing ahead with restraint policies is a moot point. Certainly, however, they saw themselves faced with the acute dilemma of acting to combat inflation, which had been accelerating alarmingly, or moving to offset incipient recession. There was, however, a fair consensus that inflation had to be given the policy priority, and that recessionary tendencies should be dealt with as they emerged, preferably by selective stimulus rather than by general reflation. On the side of external aims, it was further felt that especially vigorous adjustment efforts would be required by countries already experiencing large non-oil deficits. Finally, it was hoped that national policy adaptations would take due account of the desirability of spreading the burden of oil deficits and of maintaining reasonable stability in the foreign exchange markets.

Against this background, interest rates continued to rise on a broad front during the spring and early summer of 1974. During this phase the pace was largely set by the United States, where, after a period of relaxation at the start of the oil crisis, the policy of limiting the growth of the monetary aggregates was resumed, underscored by a rise in the discount rate to a record 8 per cent. Thereafter the monetary aggregates began to grow more slowly again, but by the middle of the summer, when interest rates crested out, the Federal funds rate had topped 13½ per cent., yields on certificates of deposit were at around 12½ per cent. and the banks' prime lending rate had been held down only with difficulty to 12 per cent.

With interest rates moving to unprecedented levels, some questioning arose whether monetary restraint was not being pressed too hard. High interest rates had, of course, produced some notable side-effects, not least by deflecting the flow of funds from the savings institutions and the equity market, as well as by adding an increasing burden on the cost side. Moreover, while it is true that interest rates adjusted for recent rates of price inflation seemed quite low, inflationary expectations were probably subsiding as the economy neared its turning-point, so that "real" interest rates were rising relative to nominal ones. At all events, it was intended that interest rates should play a more prominent rôle than in earlier phases of restraint. As the Regulation Q ceiling on large time deposits had been previously removed, commercial banks were in a position to bid aggressively for funds and they did so. In consequence, "availability" constraints on bank credit expansion via disintermediation in the credit markets did not play an important part. Interest rates were also pushed higher by the borrowing undertaken by Federal agencies in support of non-bank financial institutions which were unable to compete adequately for funds.

At first the sharp rise in US interest rates appears to have caused little or no inconvenience to other countries. On the contrary, the resulting tendency for rates to rise elsewhere was generally accepted and in some cases even reinforced. These



[1] For Canada, Bank rate; for the United Kingdom, minimum lending rate. [2] 3-month interbank rate, except in the following cases: Canada, 90-day finance paper; France, 1-month private bills; Japan, call-money; and the United States, Federal funds. [3] For Italy, industrial credit institutes' bonds; for Japan, Telephone and Telegraph bonds; for the Netherlands, private bonds.

countries too were plagued with inflation, often more intense than that in the United States, and in some of them — France, Italy, Japan and the United Kingdom — an additional cause for monetary restraint was the need to finance and reduce huge external current-account deficits. In the United Kingdom, where the growth of banks' interest-bearing liabilities had been checked by a special deposit requirement, the authorities were actually able to bring short-term rates down, but long-term rates continued to rise. In Germany the Bundesbank was also able to encourage a further decline in short-term rates from their previously high level; but it kept bank liquidity on a tight leash, and long-term interest rates rose to about 11 per cent.

In Belgium and France steps were taken to raise money-market rates and to tighten ceilings on bank credit expansion. Much the same stance had to be taken in Italy, predominantly for balance-of-payments reasons, and both short and long-term rates rose steeply. Japan also relied to a considerable extent on ceilings on bank credit expansion, as to a lesser extent did Switzerland, though purely with the aim of fighting inflation. In Canada domestic interest rates rose with those in the United States in the spring, but from late May the authorities sought to slow the rise. Of the countries with strong external positions, Switzerland and the Netherlands at times took steps to relieve pressures on bank liquidity and the exchange rate.

In the United States short-term interest rates began to ease somewhat in the summer. As it became apparent in the autumn that demand was weakening and monetary growth had slowed down, the Federal Reserve adopted a more accommodating policy in open-market operations and lowered reserve requirements. Around the turn of the year the fall in interest rates quickened, helped by cuts in the official discount rate, and by late February, with the demand for bank credit having fallen sharply, money-market rates were down to around 5½–6 per cent. Bond yields held firm up to October but then declined by ½ percentage point or more by early 1975. The declining tendency of rates stimulated a sharp increase in the volume of bond issues, but equity issues dropped off to negligible proportions.

On the other hand, the stance of US fiscal policy, strengthened by the impact of inflation on tax revenues and the slower growth of expenditure, was basically restrictive over the entire year and into early 1975. In the autumn, moreover, just as the economy was on the verge of a precipitate fall in activity, the Administration recommended the adoption of an income-tax surcharge, tempered by an increase in the investment tax credit. While the fiscal gears were soon to be reversed, with a growing consensus in favour of a stimulatory tax programme, the budget could be expected to provide little active support to the economy until well into 1975.

Other countries were at first quite cautious in adapting their interest rates to the downward trend in the United States and on the Euro-dollar market. Even in Germany, where the decline was sufficient to cause large net capital outflows, monetary attitudes were conditioned by the prospect of a growing public-sector deficit and by the aim of limiting the increase in central-bank money to 8 per cent. in 1975. In the United Kingdom, where inflation was unremitting and a November budget was necessary to help company finances, a short-term rate differential was maintained in favour of sterling.

Though money-market rates began to fall in most other European countries and in Canada, the authorities resisted any appreciable easing until quite late in the year and in one or two countries monetary policy was tightened in some respects. In the Netherlands bank liquidity was restricted and reserve requirements raised with the aim of slowing down the growth of money.

By early 1975, however, most countries were moving some way towards easing monetary restraint. New steps included a liberalisation or removal of bank credit ceilings and a relaxation of reserve requirements in Belgium, France and Switzerland. In Belgium and Germany refinancing facilities available to banks were liberalised. Special credit lines to help certain sectors were provided in some countries, including France, Italy and Japan. In the early spring the Italian authorities abolished the 50 per cent. deposit requirement on imports and removed the ceilings on credit expansion. In the United Kingdom the weakening of credit demand enabled the authorities to suspend the special deposit requirement on the growth of banks' interest-bearing liabilities. More generally, a large number of central banks followed the US Federal Reserve in the round of discount rate cuts in December 1974 and early 1975. Often principally in response to external influences, though increasingly welcome on domestic grounds, money-market rates fell rapidly, and in many countries interest rates on bank lending were also lowered. Only in Japan was there still little relaxation of monetary policy. In most other countries a recent easing of fiscal policy, together with the revenue losses caused by the economic slow-down, will leave large public-sector deficits in 1975.

Following the very high money supply increases in 1972 and 1973, rates of monetary expansion fell back sharply last year in most of the major countries. In the United States the increase in 1974 came to only 4½ per cent. for M_1 and 7½ per cent. for M_2. By about the end of March 1975 the growth of the broad money supply was also considerably less than a year earlier in Germany (1.7 per cent.), in Belgium, Japan and the United Kingdom (9–11 per cent.) and in Italy (17 per cent.). In the United Kingdom the sharp slow-down in M_2 was partly attributable to a reversal of special influences which had exaggerated its rise in 1973. In Italy the import deposit scheme played a significant rôle. In all these countries the increase in M_2 last year was less than the rise in consumer prices — sometimes substantially so. In Canada, France and the Netherlands, on the other hand, the growth of the money supply broadly defined lay in a 16–20 per cent. range and outpaced consumer prices. With higher interest rates on savings and time deposits inducing a shift away from sight deposits, M_1 rose much less than M_2 in 1974 in all countries except Germany, where the public sharply increased their cash balances following the Herstatt crisis. In late 1974, however, the growth of M_1 accelerated in some countries, mainly the United Kingdom, Canada, the Netherlands and Denmark, and may have reflected both easier monetary conditions and precautionary reactions to the deteriorating economic situation.

Bank credit to the private sector continued to expand quite strongly until the summer in most countries and was generally the principal counterpart of money creation. With bank lending rates lagging behind money-market rates, customers often had an incentive in inflationary conditions to borrow for financing stock

The money supply.

Countries		1970 Dec.	1971 Dec.	1972 Dec.	1973 June	1973 Dec.	1974 June	1974 Dec.	1975 March
		percentage changes over twelve months							
United States	M_1	6.1	6.3	8.7	8.7	6.1	5.4	4.7	4.2
	M_2	8.4	11.2	11.1	10.2	8.8	8.6	7.4	7.1
Canada	M_1	5.0	19.9	11.8	15.8	12.9	9.4	3.6	17.1
	M_2	10.3	16.4	14.5	12.1	19.1	19.5	16.3	19.5
Japan	M_1	16.8	29.7	24.7	29.9	16.7	15.7	11.5	11.6[1]
	M_2	16.9	24.3	24.7	24.7	16.8	13.3	11.5	11.6[1]
Belgium	M_1	9.3	11.1	14.0	12.6	8.8	6.7	8.8	7.3[1]
	M_2	9.2	13.1	16.1	15.9	13.5	10.5	9.0	10.5[1]
France	M_1	10.9	11.2	14.3	11.0	9.0	11.2	16.8	10.9[1]
	M_2	15.0	19.7	18.4	14.2	15.0	16.6	17.6	16.6[1]
Germany	M_1	8.6	11.9	14.0	5.8	1.8	5.2	11.7	12.4
	M_2	10.4	14.4	16.7	18.3	13.9	8.3	5.1	1.7
Italy	M_1	27.2	18.8	24.6	22.2	24.1	18.6	10.1	7.0
	M_2	13.6	17.1	22.2	20.7	23.3	21.3	15.3	16.8
Netherlands	M_1	11.8	15.0	17.7	9.4	0.0	1.8	12.2	10.8[1]
	M_2	8.3	9.0	11.9	14.9	21.9	25.9	20.0	16.3[1]
Sweden	M_1	.	9.3	6.9	8.0	13.2	15.5	13.8	16.9
	M_2	.	9.9	12.3	12.5	13.8	13.4	9.4	9.4
Switzerland	M_1	6.9	39.7	4.6	2.3	2.1[2]	− 0.7[2]	0.7[2]	4.3[2]
	M_2	8.7	26.6	2.4	2.4	5.0	10.2	6.6	.
United Kingdom	M_1	9.7	15.3	13.8	12.3	5.8	0.0	10.8	13.2
	M_2	9.5	13.4	25.5	24.0	28.0	21.5	12.5	10.1

Note: M_1 = currency and demand deposits.
M_2 = M_1 plus quasi-money, according to national definitions, which differ from country to country.
[1] February. [2] Based on new series.

accumulation or fixed investment. Even in countries with credit ceilings, special exemptions usually permitted a fairly rapid expansion of total bank lending. Though uncertainties soon worsened the investment climate, involuntary stock accumulation continued for a time and inflation caused a squeeze on corporate profits and liquidity. The weakness of equity and bond markets forced enterprises to turn to the banks to meet essential credit needs. From the autumn onwards, however, bank lending to enterprises slowed down in most countries, Canada and the Netherlands being the only major exceptions.

Bond-market yields rose gradually in early 1974, but for much of the year they were rather low in relation to short-term interest rates. What is more, with Germany a notable exception, yields were usually not as high as current rates of inflation. With the lack of investor interest, new bond issues fell back sharply in most countries. Bond yields generally held up or continued to rise until October, when weaker activity was reflected in a decline in the United States, as well as in Germany and the Netherlands. Until the end of the year, however, bond yields remained more or less steady in Belgium, France, Japan and Switzerland, while in Italy and the United Kingdom they continued to rise. In early 1975, with recession spreading and monetary policies being progressively eased, yields came down in most of these countries, particularly in the United Kingdom. Elsewhere long-term rates fell considerably less than money-market rates, restoring more normal yield-curve relationships. Declining rates were generally associated with a revival in issuing activity. Public-sector debt accounted for a substantial part of the total, though private-sector issuers also took advantage of the situation by lengthening the maturity of their borrowings.

With recent changes in policy mix, comparative monetary conditions have become more balanced. The major tax reduction in the United States and the government's growing financial requirements have brought resistance to the decline of interest rates. In other countries some accent on budgetary stimulus, often of a selective nature, continued, and in most of them the scope for further declines in interest rates seems to be narrowing. In certain countries external constraints continued to play a prominent rôle. But in all of these, as well as in countries with strong external positions, the desire to bring inflation under control, and to keep interest rates at a level sufficient to encourage the flow of savings to long-term markets, argued against too sharp an easing of monetary policy. Indeed, inflows of funds induced some of these countries to bring interest rates down rather more than they desired.

The rise in oil prices and international payments imbalances.

Besides its depressive effect on economic activity and the push it gave to the general rate of inflation in the past year, the rise in oil prices transformed the world balance-of-payments picture. The average price of OPEC countries' crude oil exports went up from about $20 per ton in 1973 to $77 in 1974. Although the price rise and the weakness in economic activity reduced the demand for oil slightly, the value of OPEC oil exports is estimated to have risen from about $32 milliard to $115 milliard between the two years. Even allowing for the substantial increases in both the volume and prices of OPEC's imports, the current-account surplus of these countries amounted to about $70 milliard in 1974, as compared with under $5 milliard the year before. Foreign exchange receipts lagged behind exports of oil, as is usual, so that the OPEC cash surplus for 1974 was about $55 milliard.

The larger share of the OPEC surplus naturally fell upon the industrialised countries. From a 1973 surplus of $2 milliard — itself a low figure because of the upsurge in other commodity prices — the OECD area's current-account balance shifted last year to a deficit of about $33 milliard. This deficit compares with an increase in its oil imports of $60 milliard and a deterioration in its trade balance with OPEC of about $45 milliard. While numerically smaller, the deterioration in the payments position of the non-oil developing countries was, of course, much more onerous; their current-account deficit may be estimated to have risen from about $8 milliard to probably over $25 milliard.

Within the OECD group of countries the tendency in current-account positions last year was towards an aggravation of previous relative imbalances, particularly among the large industrial countries. Besides the fact that the added oil costs differed substantially among the countries, changes in their non-oil trade balances covered a wide range from improvement to deterioration. These differences in trade performance reflected various factors, particularly the relative size of export price

Group of Ten countries: Trade balances in 1973 and 1974, and factors of change.

Countries	Trade balances* 1973	Trade balances* 1974	Changes in trade balances 1973–74	Factors of change: Changes in net oil expenditure	Factors of change: Changes in non-oil trade: total value	Factors of change: Changes in non-oil trade: owing to volume	Factors of change: Changes in non-oil trade: owing to terms of trade
	in milliards of US dollars						
Belgium	0.5	− 1.5	− 2.0	− 1.7	− 0.3	− 0.2	− 0.1
Canada	1.9	0.5	− 1.4	+ 0.4	− 1.8	− 2.1	+ 0.3
France	− 1.4	− 6.9	− 5.5	− 6.4	+ 0.9	+ 1.8	− 0.9
Germany	12.9	19.7	+ 6.8	− 6.3	+13.1	+ 8.4	+ 4.7
Italy	− 5.6	−10.7	− 5.1	− 5.6	+ 0.5	+ 3.2	− 2.7
Japan	− 1.4	− 6.8	− 5.4	−14.2	+ 8.8	+ 5.6	+ 3.2
Netherlands	0.3	− 1.6	− 1.9	− 0.9	− 1.0	+ 1.3	− 2.3
Sweden	1.5	0.1	− 1.4	− 1.4	0.0	− 0.8	+ 0.8
Switzerland	− 2.1	− 2.5	− 0.4	− 0.5	+ 0.1	+ 0.5	− 1.1
United Kingdom	− 8.3	−15.5	− 7.2	− 5.7	− 1.5	+ 1.1	− 2.6
United States	1.3	− 2.3	− 3.6	−16.3	+12.7	+ 7.0	+ 5.7

* Imports c.i.f.

increases, the degree to which domestic ease affected imports, relative movements in exchange rates and, also significant, the sheer effort put into export expansion.

These developments can be seen most clearly in the case of the six largest industrial countries — France, Germany, Italy, Japan, the United Kingdom and the United States. They were the most affected in absolute terms by higher oil prices, with added import costs ranging from about $5½ milliard in the case of Italy and the United Kingdom to over $16 milliard in that of the United States. At one end of the scale, Germany more than absorbed a $6.3 milliard increase in net oil expenditure by an overall rise in its foreign trade surplus from $12.9 to 19.7 milliard. The domestic recession held non-oil imports at the 1973 level while giving an incentive for a further 12 per cent. expansion of export volume, which was helped also by liberal granting of export credits. In addition, Germany experienced a considerable gain in its non-oil terms of trade during 1974 — the outcome of a further appreciation of the Deutsche Mark, coupled with rising prices of manufactured goods exports and falling prices of imported primary commodities. At the other end of the scale, the UK trade deficit widened by $7.2 milliard on an increase in the net oil bill of $5.7 milliard. The significant factors were the deterioration of the non-oil terms of trade owing to the depreciation of sterling — most of which had in fact already occurred in 1973 — and the relatively modest rise, of about 5 per cent., in the volume of exports.

Among the four other largest industrial countries, easily the best outcome on trade account was that of the United States; the overall trade balance deteriorated by less than one-quarter of the value increase in net oil imports. Like Germany, the United States had a big improvement on trade account last year in volume terms.

Imports were slightly below the 1973 level while exports were up by 8½ per cent., no doubt partly owing to the competitive gain from the depreciation of the dollar since 1971. Moreover, despite the renewed downward movement of the exchange rate in 1974, the US non-oil terms of trade improved; to the effect on import values of the ending of the commodity boom was added a strong rise in the prices of US agricultural exports.

Japan, too, offset more than half of its increased net oil expenditure with gains elsewhere on trade account. Total exports rose by over 50 per cent. in dollar value, reflecting both a volume increase as large as that of Germany and a very substantial rise in export prices. In France, where there appears to have been a moderate deterioration in the non-oil terms of trade between 1973 and 1974, almost one-third of the increased net oil expenditure was offset on the volume side of the trade account, exports rising as strongly as in Germany and Japan. In Italy the widening of the trade deficit to over $10 milliard roughly reflected increased oil costs, though a combination of lower imports and higher export volume produced a small improvement in the non-oil balance, despite a worsening of the terms of trade.

Since the middle of 1974 several developments have modified the picture shown by the figures for the year as a whole. On the side of the OPEC countries, crude oil output started to decline and is now some 20 per cent. below the post-embargo peak level of May 1974. Since the mild winter movements of tankers from the Middle East to Europe have been slower than usual, with difficulties being encountered in unloading at destination for lack of unfilled storage capacity. And there have been some instances of minor reductions in selling prices, either directly or through longer credit terms, reduced differentials in respect of varying qualities of oil and similar concessions. On the other hand, imports into OPEC countries have continued to rise. Up to the end of 1974 the OPEC current payments surplus, too, was still rising, from an estimated $15.5 milliard in the second quarter — when the December 1973 price increases began to take effect — to $17.4 milliard in the fourth quarter. Preliminary indications are, however, that the figure for the first

OECD countries: Foreign trade balances, 1974–75.

Countries	1974 1st half	1974 2nd half	1975 1st quarter
	in milliards of US dollars, seasonally adjusted, at annual rates		
France[1]	− 3.6	− 3.1	1.8
Germany	20.4	18.6	19.5
Italy	− 12.5	− 9.1	− 3.4
Japan	− 9.2	− 4.5	0.5
United Kingdom[1]	− 12.5	− 11.6	− 6.5
United States	− 0.1	− 4.5	8.3
Other OECD countries	− 35.3[2]	− 28.0[2]	− 30.0[2]
Total OECD countries	− 52.8[2]	− 42.2[2]	− 9.8[2]

[1] Imports f.o.b. [2] Unadjusted for seasonal variations.

quarter of 1975 was more than one-third lower. Reduced demand for oil is of course related to the recession in the industrialised world as well as to the effects of its higher price.

On the side of the industrialised countries, clear signs of improvement in the current balance of payments are manifest. Their economies, with few exceptions, have gone further into recession, with imports stable or declining; their terms of trade have improved, with the price of oil stable and prices of other commodities declining, while their export prices have continued to rise; their exports to OPEC countries, which advanced 75 per cent. in value in 1974, are continuing to go up; and in addition sales to non-oil developing countries have been well maintained in the face of the deterioration in these countries' terms of trade. Of the five industrial countries with the largest trade deficits for 1974 as a whole, only the United Kingdom and Italy were still showing substantial negative balances in the first quarter of 1975, though much reduced from last year's levels. France, Japan and the United States all had trade surpluses in the first quarter, that of the United States being very large. Also, Germany's surplus, though still large, has been reduced a little.

Obviously, the lessening of payments imbalances in recent months still leaves much to be achieved. The disequilibrium between OPEC and the rest of the world is still very large, as are the individual imbalances of such important countries as Germany and the United Kingdom. Moreover, a good deal of the improvement that has recently occurred can be accounted for by factors that are not likely to be sustained for very long — the relatively depressed level of world economic activity and a payments deficit in the non-oil developing world that is not only wide but still widening.

With regard to the financing of the disequilibrium that emerged last year, it may be said that the problems have in general proved manageable. This has been true both of the oil countries' handling of their surplus funds and of the deficit countries' covering of their financing requirements. On the other hand, financial difficulties that had not been foreseen arose in the summer of 1974, with temporarily rather severe pressures in the international banking field.

As anticipated, a large part of the oil countries' surplus funds was placed at short term in 1974 — $28 milliard in bank deposits, mostly in the Euro-currency market. This was not surprising, given the high level of short-term interest rates that prevailed for most of the year. As monetary conditions eased, the proportion of the total surplus invested in that way came down to about one-third in the final quarter of the year, as against nearly two-thirds during the first six months. The accumulated funds were not shifted about from one financial centre to another — though the mid-year crisis of confidence in the Euro-currency market did bring a temporary increase in the proportion of the current surplus invested in the US market. In addition, oil money appeared to play a part in the strong appreciation of the Swiss franc during late 1974 and early 1975.

The main shifts of emphasis since early 1974 have been in directions generally acknowledged to be desirable: first, as already mentioned, towards rather longer-term investments; and secondly, towards bilateral aid programmes in favour of developing countries, together with lending through the International Monetary Fund and other international agencies. By the final quarter of 1974 the proportion of the surplus used at longer term through these and other non-market channels appears to have been about two-fifths.

For the oil-importing countries financing problems proved less difficult than anticipated. Total gross reserves of these countries actually rose slightly during 1974; the IMF's $3½ milliard 1974 oil facility, which formally expired at the end of February 1975, was not fully utilised; nor was there widespread recourse to trade restrictions or competitive currency depreciations.

In the financing of deficits, Italy was the only major industrial country that had large-scale recourse to official resources in 1974 — borrowing a total of $5.5 milliard from the International Monetary Fund, the other countries of the European Economic Community as a group and, bilaterally, from Germany. The British deficit was to a large extent covered by a rise in oil countries' sterling reserves, supplemented by public-sector loans from the Euro-market; the Japanese deficit by commercial-bank borrowing in the US and Euro-dollar markets; and the French deficit by trade credit, supplemented by accommodating Euro-currency borrowing. However, the French Government made no use of the $1.5 milliard Euro-credit arranged last spring. Total reserves of OECD countries, after falling by $2.3 milliard in the first half of 1974, increased in the second half of the year by $5 milliard.

Outside the industrialised world, too, a surprisingly large proportion of last year's increased payments deficits was met through market channels. Euro-currency credits to non-oil developing countries went up from $5 to 6.6 milliard between 1973 and 1974, though most of this was in the first half of the year; and these countries' short-term borrowings from the US banking system increased from about $1½ milliard in 1973 to about $5½ milliard last year.

In addition, they may be estimated to have received some $2½ milliard in direct grants and loans from individual oil countries. Their recourse to international lending agencies also increased. After having as a group made small net repayments to the IMF in 1973, fifty-one non-oil developing countries drew a total of $1½ milliard from the Fund in 1974. That figure was only a small proportion of their total financing needs; but more than three-quarters of it was drawn during the latter half of the year, despite which their combined reserves declined by $1 milliard.

Looking to the future, a number of major steps have been taken this year to enlarge official financing facilities. In January the International Monetary Fund's new Interim Committee agreed on an increase of about one-third, to SDR 39 milliard, in total Fund quotas, as well as on the continuation for 1975 of the Fund's oil facility, with a figure of SDR 5 milliard being fixed as the total of new resources to be sought — on top of the unused portion of the 1974 oil facility. Details of the country distribution of the overall quota increase have not yet been settled. As regards the 1975 oil facility, resources totalling SDR 3½ milliard are reported to have been obtained so far. A new feature of the facility is the inclusion of provisions to subsidise the interest paid on drawings by those developing countries most seriously affected by the increase in oil prices.

In February the Council of Ministers of the European Communities adopted a plan for the EEC to raise capital in non-member countries, and particularly in the oil-producing countries, for the purpose of providing medium-term loans to member countries. Initially the total of such loans (principal and interest) is not to exceed $3 milliard.

Parallel with these developments, the OECD countries decided to establish a Financial Support Fund. Its object is to grant loans to member countries "in exceptional circumstances", i.e. to act as a sort of safety net. The agreement establishing the Fund was signed by nearly all OECD members in April and now awaits ratification by their legislatures. Each participant in the Fund will have a quota that serves to determine both its financial obligations and its borrowing rights, as well as its relative weight for voting purposes. If all OECD members participate, total quotas will amount to $25 milliard.

Partly related to last year's financing problems were the pressures that developed in the international banking field. Exceptional demands for balance-of-payments finance were being made on the Euro-currency market, and this, together with restrictive monetary policies, produced a very sharp rise in interest rates and concern about a possible liquidity squeeze. Anxieties were aroused by the announcement in April of heavy losses by the Franklin National Bank of New York, and the failure of the Herstatt Bank in Cologne gave a real shock to confidence in the Euro-currency market.

The pressure on Euro-market banks during the summer led to an actual decline in their deposits, but in the early autumn the situation began to right itself. This was helped partly by some easing of monetary conditions and partly by measures taken by the banks and the authorities. The banks improved their internal controls over foreign currency transactions and adopted more cautious lending policies; the authorities in a number of countries tightened up their banking supervision procedures; and the central banks of the Group of Ten countries announced that they would act as lenders of last resort in the event of liquidity difficulties in the Euro-market. In particular, it was agreed that responsibility for banks' foreign branches would rest with the central bank where the head office is located. Furthermore, the proprietors of the many consortium banks operating in London have explicitly acknowledged moral responsibility for these institutions. The central banks subsequently set up an international committee on bank supervision, so as to exchange information on the best practical procedures and to keep abreast of current developments which might require action by them.

Exchange rate developments and the monetary system.

Viewed against the payments upheavals of the past year, trade-weighted exchange rate movements of leading currencies have been relatively moderate. Since late January 1974, for example, shortly after the full rise in oil prices and the removal of controls on US capital outflows, changes in exchange rates have on the whole been no larger than they were during the earlier phases of floating — with the single exception of the meteoric rise of the Swiss franc since last summer. The reason, of course, is that floating has, in varying degrees, continued to be controlled. Currencies

Group of Ten currencies: Estimates of effective exchange rate changes.

Currencies	25th January-10th May 1974	10th May-6th Sept. 1974	6th Sept. 1974-28th February 1975	28th February-16th May 1975	25th January 1974-16th May 1975	5th May 1971-16th May 1975
	percentage changes					
Swiss franc	+ 7.1	+ 0.1	+ 14.7	− 2.7	+ 19.6	+ 42.7
Deutsche Mark	+ 7.4	− 5.8	+ 6.2	− 1.8	+ 5.5	+ 26.3
Dutch guilder	+ 4.2	− 0.7	+ 3.6	− 0.9	+ 6.3	+ 15.9
Japanese yen	+ 3.1	− 5.9	+ 1.1	− 0.4	− 2.3	+ 11.4
Belgian franc	+ 3.8	− 0.5	+ 3.6	− 1.1	+ 5.7	+ 8.6
French franc	− 3.3	+ 6.8	+ 3.9	+ 5.3	+ 13.0	+ 6.2
Swedish krona	+ 4.3	− 0.6	+ 4.5	+ 0.7	+ 9.1	+ 5.1
Canadian dollar	− 1.1	− 0.2	− 4.1	− 2.1	− 7.4	− 7.9
US dollar	− 9.3	+ 6.0	− 8.6	+ 2.7	− 9.8	− 18.9
Italian lira	− 2.9	− 1.1	− 6.9	+ 1.7	− 9.2	− 24.1
Sterling	+ 1.2	− 0.7	− 4.6	− 4.0	− 7.9	− 24.5

Notes: 1. *The effective change in the exchange rate of the currency of an individual country is defined as equivalent* to that unilateral change which it is estimated would affect the country's trade balance to the same extent as the actual multilateral changes in exchange rates that have taken place.
2. Except in the final column, changes are measured in post-Smithsonian central and middle rates of exchange for all currencies except the Canadian dollar, for which the rate of Can. $1 = US $1 is used.
3. Where two-tier markets operate, the commercial rate of exchange has been used.

Source: Bank of England.

in basically weak positions have been supported in the exchange market, while in the countries with stronger currencies the authorities have also intervened in the market, though on a lesser scale, to moderate the upward movement of their exchange rates.

Of all major currencies the Japanese yen has shown the smallest cumulative change since early 1974, with a trade-weighted depreciation of 2.3 per cent. During the first eight months of 1974 Japan's balance-of-payments deficit totalled $7.9 milliard. The deficit was, however, more than covered by net inflows of foreign exchange managed through the banking system, totalling $8.5 milliard. Consequently, for part of this period — from late January to early May, when the dollar was weakening — the yen actually appreciated by about 3 per cent.; subsequently, however, as the authorities acted to forestall overborrowing by the banks in the Euro-currency market, it declined by about 6 per cent. by early September. Since then the effective exchange rate has risen very little, although the balance of payments showed a marked improvement from September 1974 onwards.

Sterling, too, received massive support during the period under review. Despite a $9 milliard current payments deficit in 1974, by mid-April 1975 the effective exchange rate was only 4.3 per cent. lower than it had been in late January 1974. This decline had taken place largely in the final quarter of 1974, the authorities intervening on a fairly large scale between November 1974 and January 1975. In late April 1975 sterling began to depreciate again quite rapidly and by the third week of May the cumulative decline of the effective exchange rate since late January 1974 had reached 7.9 per cent. Apart from these two periods of decline, official intervention was relatively moderate, sterling being sustained by high domestic interest rates and the build-up of oil countries' sterling balances.

Perhaps the most striking case in which the movement of the exchange rate was modified by official action of various sorts was that of the French franc. Despite a 1974 current payments deficit of over $6 milliard, the franc has been appreciating on a trade-weighted basis for most of the time since May 1974. Capital inflows — the result partly of high interest rates and partly of officially-initiated foreign borrowing — have exceeded the current deficit, so that the reserves have been rising fairly steadily too. By early May 1975, when the government announced its interest in rejoining the "snake", the franc was 7.5 per cent. above its trade-weighted level at the time of leaving the "snake". Its relationship with the "snake" currencies then quickly moved within the prescribed margins.

In Italy, on the other hand, nearly $8 milliard of compensatory foreign borrowing in 1974, most of which was used for market intervention, went together with a relatively large further depreciation of the lira. Except during the summer months, when to the normal seasonal improvement in the balance of payments were added the effects of a sharp tightening of monetary policy, the lira was moving lower for most of the year. By the end of February 1975 it was nearly 19 per cent. below the level of a year earlier. Since then, however, an acceleration of the improvement in the underlying balance of payments that began in late 1974 has been accompanied by a 1.7 per cent. improvement in the trade-weighted exchange rate, as well as by significant official purchases of dollars in the market.

For the other currencies shown in the table — all of which, except the US and Canadian dollars, have on balance appreciated since early 1974 — official intervention was on a much smaller scale.

Since late January 1974 the US dollar has been through three main phases, a 9.3 per cent. trade-weighted depreciation up to early May 1974, a 6 per cent. recovery during the summer and an 8.6 per cent. further decline between early September 1974 and the end of February this year. By then, it had fallen on the trade-weighted basis almost to its early-July 1973 low point. In addition to the extra cost of oil imports — not fully offset by the increase in OPEC countries' imports from, and investments in, the United States — the downward movements of the dollar were influenced by a number of other factors. In the first part of 1974 there was a large expansion of US banks' foreign lending, itself the combined result of the removal of controls and of other countries' financing needs; and from later in the year onwards there was some increase in oil countries' investment in non-dollar currencies as well as a sharp decline in US interest rates. During the summer of 1974, on the other hand, the dollar was supported by very high interest rates and, less directly, by the effects of the banking disturbances in Europe.

Federal Reserve intervention to support the dollar during February-July 1974 totalled $0.5 milliard, most of it through drawings, subsequently repaid, on the swap network. Between mid-October 1974 and late March 1975 the US authorities supported the dollar in the market to the extent of $1.1 milliard. After the turn of the year pressure on the dollar became much stronger and the relatively large support given in February and March helped to reverse the trend of the dollar again. Between the end of February and mid-May the dollar appreciated 2.7 per cent. on the trade-weighted basis and progress was made in repaying swap debts.

Of the currencies which have appreciated on balance since early 1974, the Swiss franc stands out with a rise of 20 per cent. on the trade-weighted basis. The size of this appreciation is related to the strong upward movement of the franc since mid-1974 against the Deutsche Mark and the other "snake" currencies, against which it had earlier moved within a fairly narrow range. The "take-off" began as a movement out of the Deutsche Mark, following the Herstatt failure, with the franc rising by about 8 per cent. against the Deutsche Mark from late June to mid-October. At that point came the removal of the interest ban on non-resident franc deposits in Switzerland, followed by inflows of money into Switzerland from oil countries and other sources, causing the franc to rise by a further 6 per cent. against the Deutsche Mark on top of the general appreciation of continental currencies against the dollar. The authorities reimposed a negative interest charge on non-resident franc deposits in November and followed this in January and February 1975 with their first large-scale market intervention for two years. Nevertheless, by end-February the franc had appreciated by 23 per cent. on the trade-weighted basis in little more than a year. Between then and mid-May it eased about 2½ per cent. Consideration is now being given to joining the European "snake", as a way of giving some firm base for export industries.

The further appreciation of the Deutsche Mark since early 1974 was of course based on Germany's international trading performance. Considering the size of the trade surplus last year, however, the rise of the Deutsche Mark may be considered relatively moderate. Had capital outflows not caused Germany's reserves to cease growing towards the middle of 1974 and actually to decline somewhat during the second half of the year, upward pressure on the Deutsche Mark would surely have been stronger.

Looking at the period since early 1974 as a whole, the main exchange rate movements have been the rise of the Deutsche Mark (together with other "snake" currencies) and the Swiss franc, together with the decline of the US dollar, the lira and sterling. Broadly, these were continuations of earlier trends. Thus, if the situation now is compared with what it was just before the May 1971 currency crisis, seven leading currencies have experienced double-figure movements in their trade-weighted exchange rates: the Swiss franc, the Deutsche Mark, the guilder and the yen have appreciated by 43, 26, 16 and 11 per cent. respectively, while the lira and sterling have depreciated by about 24 per cent. each and the US dollar by 19 per cent.

Of the four countries whose currencies have appreciated, only Switzerland is showing signs of having lost ground competitively, though the rapid rise of the franc since mid-1974 is too recent for its full effects to have worked through. The appreciation of the Deutsche Mark has gone hand in hand with an expanding German trade surplus, though export orders have been declining recently. On the other side of the medal from Germany is the United Kingdom. Measured roughly by the increase in industrial wholesale prices adjusted for the movement of the trade-weighted exchange rate, the United Kingdom has had the benefit since early 1971 of an improvement in its competitive position second only, among industrial countries, to the United States. Nonetheless, it has experienced over the past four years a severe deterioration in its non-oil foreign trade balance. Italy's non-oil trade balance, too, deteriorated during this period; but the change was far less than in the United Kingdom and, in addition, Italy's competitive position, as measured by price movements, did not improve. The United States, on the other hand, has since early 1971 experienced the greatest improvement in its competitive position of any major industrial country, the depreciation of the dollar having been accompanied by a relatively better price performance. That US exporters have been able to take advantage of this is shown by the recent evolution of the non-oil trade balance.

As the behaviour of exchange markets left no practical alternative to a continuation of floating rates, the attempt to reform the monetary system was effectively shelved last year. The conception of a reformed par value system which the Committee of Twenty had been discussing was in any case debatable; and the Committee differed widely about how such a system could be made to work. Hence, in place of concrete proposals for reform, the Committee's final report to the IMF Governors indicated the general lines along which it thought the system could evolve in the future and recommended a number of "immediate steps".

Apart from the setting-up of the Fund oil facility, the Committee's suggestions aimed mainly at adapting IMF rules to the existence of floating rates. Its principal proposal, adopted by the Fund with effect from 1st July 1974, was for a change in the method of valuation of SDRs. Up to then, the dollar exchange rate had had a dominant influence on the value of the SDR against other currencies — which meant that, with the market depreciation of the dollar, the value of other countries' holdings of SDRs was likewise depreciating. Under the new method, to remain in force for an "interim period", the SDR is defined as being equal to a weighted basket of the currencies of the sixteen member countries with a share in world exports exceeding 1 per cent. during 1968–72. The weight of the US dollar is 33 per cent., followed by the Deutsche Mark with 12½ per cent., sterling with 9 per cent., and the French franc and Japanese yen with 7½ per cent. each. By using market exchange rates, the Fund can determine the exchange value of the SDR against each member's currency.

The Committee also recommended a code of good behaviour for floating currencies. The code's main guide-lines are that short-term disruptive movements of rates be smoothed out; that a measure of resistance be offered to slightly longer-run rate movements caused by temporary factors; and that substantial deviations from a medium-term norm for the exchange rate be resisted if such a norm can be estimated. These guide-lines were adopted by the IMF Executive Directors in June 1974 and may hopefully provide a framework for more exchange rate stability. The Committee also suggested that the Fund exercise surveillance over the adjustment process and over the development of global liquidity so as to facilitate progress towards a more stable system.

Essentially, however, the Committee left the evolution of monetary reform to the new Interim Committee of the Board of Governors which, at its suggestion, was established in October 1974 at the Fund's annual meeting. As well as continuing work on monetary reform, the Interim Committee's task is to advise on current problems, including the adjustment process and the handling of sudden disturbances which might threaten the system. At its first substantive meeting, in January 1975, the Interim Committee agreed on the Fund's 1975 oil facility and on the main lines of the next general increase in Fund quotas.

In addition, the Committee has asked the Executive Board to prepare a number of draft amendments to the Fund's Articles. The exchange rate obligations of member countries are supposed to provide for stable but adjustable par values, but with floating of currencies allowed in particular situations under the surveillance of the Fund. Also, the obligation of making payments to the Fund in gold is to be eliminated and the official price of gold abolished. Apparently monetary authorities will not be bound by rules on the gold transactions they may wish to enter into, either with the market or among themselves; however, the Interim Committee favoured an understanding that the total monetary gold stock should not rise as a result of future transactions with the market. Complementary to the idea of reducing the rôle of gold in the monetary system is that of increasing the place of the SDR. Proposals for an amendment to promote this objective centre on the abolition of the restrictions originally attached to the use of SDRs. Finally, the Interim Committee has called for an amendment under which it would be replaced by a permanent Council with decision-making powers.

On the much discussed topic of a link between SDR allocations and development finance, an amendment to the Fund's Articles has not yet been suggested owing to lack of agreement on the matter. Instead, the whole question of the transfer of real resources from developed to developing countries is now mainly being dealt with by a new Joint Ministerial Committee of the International Monetary Fund and the World Bank, usually referred to as the Development Committee. This was set up at the same time as the Interim Committee, also on the recommendation of the Committee of Twenty.

Basically, therefore, the Interim Committee finds itself in the same position as its predecessor: in the face of delays in the adjustment process, market forces made the Bretton Woods system unsustainable, while both monetary conditions and political difficulties make the creation of a new par value system seem a quite distant objective. Indeed, there is some question as to whether it can still be called an objective.

II. DEVELOPMENTS AND POLICIES IN INDIVIDUAL COUNTRIES.

The United States. In early 1974 monetary policy had been eased somewhat to cushion the shock of the oil embargo. By mid-March, however, it was seen that recessionary tendencies were still confined to the automobile sector, short-term credit demand was strong and non-farm payrolls had recovered to the previous November's peak. Moreover, the price system had yet to absorb the twin shocks of the oil-price explosion and the termination of remaining price controls at the end of April. In these circumstances monetary policy was shifted to a much tighter course, and the discount rate was raised in late April to a record 8 per cent. In addition, fiscal policy became increasingly restrictive as rising nominal incomes helped to swell tax revenues and efforts to curb expenditure were continued.

By mid-year inflation was at a new high rate, and there was still little evidence of a serious downturn. Over the first six months wholesale industrial prices surged upwards at an annual rate of more than 30 per cent. while consumer prices rose by over 12 per cent. With regard to real output, almost all of the first-quarter decline in real gross national product was related to the automotive and energy sectors. Moreover, the change in second-quarter real product would have been positive, instead of negative, had it not been for the partial take-over of Aramco by Saudi Arabia; the resultant decline in US oil company profits had been recorded as a decline in net exports. Up to June unemployment did not exceed the January rate of 5.2 per cent., and employment went on rising at a moderate pace. Industrial production rose slowly as car sales and output recovered in the second quarter and stocks returned to normal. After weakening earlier in the year, manufacturing orders appeared to be holding up in volume terms, and the backlog of unfilled orders continued to grow. On the other hand, housing starts remained severely depressed at an annual rate of about 1.5 million units, against a peak of around 2.4 million in early 1973. Another sign of future weakness was the Commerce Department's large upward revision in mid-July of the estimated stock of inventories. Up to August the Federal Reserve authorities continued to maintain a restrictive policy stance. In response, the Federal funds rate rose sharply to over 13 per cent. in July, while the banks' prime lending rate went up to 12 per cent. Monetary expansion moderated substantially, with the annual growth rate of M_1 over the second and third quarters slowing to 4 per cent.

Activity began to slacken perceptibly in the third quarter. Industrial production stagnated, housing starts plunged to the lowest level for over four years and the unemployment rate rose in September to 5.8 per cent. A small rise in consumption was offset by a decline in most categories of gross investment, so that real output contracted somewhat. A spurt in car purchases in anticipation of steep price increases on 1975 models, together with some stockpiling prompted by an expected November coal strike, helped to sustain activity. Despite the noticeable weakening of demand, however, there was little evidence of diminishing inflation other than the continuing decline in raw-material spot prices under way since mid-March.

In these circumstances the Federal Reserve authorities eased their policy slightly in early September by removing the 3 per cent. marginal reserve requirement on large-denomination certificates of deposit maturing in four months or more. Shortly afterwards the longer-run targets for monetary growth were raised modestly. Meanwhile, after a widely publicised series of policy meetings, the Administration reaffirmed in early October that stopping inflation still had top policy priority. To this end, and to mitigate the sectoral impact of monetary and fiscal restraint, tax increases and expenditure measures were proposed which would have left the overall Federal deficit essentially unchanged.

From November the mild fall-off in activity gave way to the steepest descent witnessed since the Great Depression. Between last September and April of this year industrial production plunged by 12.9 per cent. while unemployment soared to 8.9 per cent., the highest rate since before the war. From the third quarter of 1974 to the first quarter of 1975 real output dropped at an 11 per cent. annual rate. The fourth-quarter fall reflected declines in all major components of private demand across a broad range of industries. In the first quarter final demand held steady but the overall output deterioration remained strong as large liquidation of stocks occurred. With demand very weak, and with the energy and post-controls price adjustments largely completed, inflation has slowed down remarkably. In the period January-April 1975 the increase in industrial wholesale prices dropped off to an annual rate of 6.5 per cent.

Against this background, and with the demand for bank credit beginning to ease, the Federal Reserve authorities continued to relax monetary restraint. In November reserve requirements were lowered in respect of long-term time deposits, while those against short maturities were raised so as to encourage banks to bid for deposits with longer maturities. Requirements against net demand deposits were lowered slightly, and marginal reserve requirements on short-term certificates of deposit introduced in 1973 were removed altogether.

In early December the Federal Reserve Board approved the first reduction in the discount rate in three years. The rate was cut by ¼ percentage point to 7¾ per cent., and four further reductions brought it down to 6 per cent. in May. The reserve requirements against net demand deposits were again lowered in January, while those against the banks' borrowings abroad were reduced in April. With reserves also being supplied through open-market operations, the rates on Federal funds, Treasury bills and loans to prime bank customers fell sharply. By late May the prime rate was moving to 7 per cent., while rates on Federal funds and three-month Treasury bills stood at about 5.1 per cent. However, with the calendar of new bond issues at record levels, long-term rates have declined rather modestly. At first the narrowly-defined money supply responded only sluggishly to monetary ease, though the growth of M_2 was stronger. In the past few months, however, M_1 growth has been resumed, with the official target range being fixed for the time being at 5–7½ per cent. per annum.

The economy was subject to various financial difficulties as a consequence of rapid inflation combined with a deepening recession. Corporate tax liabilities

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

Items	1969	1970	1971	1972	1973	1974 1st half	1974 2nd half	1975 1st quarter
	adjusted annual rates, in milliards of dollars							
Demand for funds								
US Government securities	− 3.6	12.8	25.5	17.3	9.7	5.1	18.9	69.4
Corporate and foreign bonds	13.0	20.6	19.7	13.2	10.2	20.2	23.5	37.2
State and local-government securities	9.9	11.2	17.6	14.4	13.7	18.3	16.5	16.3
Mortgages	27.7	25.7	46.9	67.3	73.2	63.3	48.4	44.7
Consumer credit	10.4	6.0	11.2	19.2	22.9	12.7	6.6	− 3.3
Bank loans	15.3	6.4	9.3	21.8	38.6	32.6	21.6	− 9.2
Other	15.3	9.8	5.7	5.7	11.8	29.7	34.2	1.2
Total[2]	88.0	92.5	135.9	158.9	180.1	181.9	169.7	156.3
Met directly by								
Federal Government	2.9	2.8	3.2	2.6	3.0	2.5	12.5	15.7
Federal Reserve	4.2	5.0	8.9	0.3	9.2	6.1	6.3	8.9
Commercial banks	18.2	35.1	50.6	70.5	86.6	87.5	41.3	15.2
Savings institutions	14.5	16.9	41.4	49.3	35.1	35.2	19.8	51.8
Other financial institutions	22.6	23.0	18.6	33.5	37.1	33.0	47.6	35.5
Private non-financial sector	25.9	− 0.6	−13.2	− 5.7	8.4	7.0	29.5	10.4
Foreign sector	− 0.3	10.3	26.4	8.4	0.7	10.6	12.7	18.8
Total[2]	88.0	92.5	135.9	158.9	180.1	181.9	169.7	156.3
Corresponding changes in financial assets								
Money (M_1)	7.7	10.5	12.7	16.7	12.6	13.2	− 0.5	7.8
Time and savings deposits	− 2.3	56.1	81.0	85.2	76.3	88.9	55.2	89.0
Credit-market claims	82.6	25.9	42.2	57.0	91.2	79.8	115.0	59.5
Total[2]	88.0	92.5	135.9	158.9	180.1	181.9	169.7	156.3
[1] Does not include equity issues by non-financial business, which amounted to	3.8	5.7	11.5	10.5	7.3	5.4	2.3	2.3
Total net flows, including equities	91.8	98.2	147.4	169.4	187.4	187.3	172.0	158.6
Total, as percentage of GNP	*9.9*	*10.1*	*14.0*	*14.6*	*14.5*	*13.7*	*12.1*	*11.2*

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

continued to be calculated on the basis of "historical" costs of inventories and fixed capital, rather than on inflated replacement prices. The resulting squeeze on after-tax cash flows came on the heels of a longer-term trend towards higher debt/equity ratios and lower cash-flow coverage of fixed commitments. These changes towards lower safety margins had been prompted, in part, by over-confidence that the business cycle had been tamed. Faced in 1974 with depressed equity markets and record long-term interest rates, businesses drew heavily on bank credit for their rising cash needs. The banks' vigorous competition for deposits, particularly after the full suspension in May 1973 of interest rate ceilings on large time deposits, contributed to uncomfortably low ratios of capital to assets. Against this background the collapse of the Franklin National and Herstatt banks seriously weakened the ability of smaller regional banks to raise short-term funds and shunted funds more in the direction of the larger banks.

Critical problems also arose in other key sectors, particularly the public-utility and construction industries. Regulatory agencies often failed to allow utilities the immediate revenue relief required to offset rising raw-energy and other costs. High interest rates drew deposits out of savings institutions, which could not offer competitive deposit rates because their portfolios consisted largely of lower interest rate loans made in earlier years. Construction financing received a further blow from the severe setbacks experienced by the real estate investment trusts, whose optimism had spilled over to the institutions financing them. Consequently, despite various types of government financial aid, residential construction became "crowded out" in financial markets.

By the first quarter of 1975 this broad picture had changed in several respects. The demand for bank loans and consumer credit dropped off in absolute terms and mortgage lending continued to slow down despite a sharply increased flow of funds to the savings institutions. The corporate sector, besides cutting back on investment, sought to meet its financial requirements by borrowing more at long term. Another feature was a steep increase in the issue of government securities, the bulk of which was taken up by commercial banks and foreign investors.

After the turn of the year general support arose for a major reduction in taxes, and by March the tax programme was a reality. It provided for a $22.8 milliard reduction in personal and business taxes spread over 1975 and 1976. The measures included rebates on 1974 personal income tax payments, a reduction in 1975 tax liabilities with special emphasis on lower-income families, and a 5 per cent. tax credit of up to $2,000 towards the purchase of a new home. Business taxes were reduced by a two-year increase in the investment tax credit and a reduction in the profits tax rate applied at the lower end of the scale. On the other hand, tax revenues were bolstered by a phasing-out of oil-depletion allowances and by changes in the tax treatment of multinational firms. By May the projected 1976 budget deficit was in the neighbourhood of $70 milliard, or about 5 per cent. of gross national product. While Congressional response to the problems of recession was fairly quick and strong, a policy to deal with the many uncertainties in the energy sector has not congealed.

Germany. By the spring of 1974, under the influence of restraint policies applied since late 1972, domestic demand in the Federal Republic had been easing for over a year. Industrial investment and residential construction were still declining in real terms and only public consumption expenditure was increasing. Net exports of goods and services, on the other hand, had risen sharply over six quarters, thus helping to maintain real gross national product. Unemployment was not excessive, though it had moved up from 1 to 2 per cent. of the labour force since early 1973, with a further 1 per cent. on short time. The worrying aspect continued to be inflation: the twelve-month increase of industrial producer prices was nearly 14 per cent. and retail prices were up 7 per cent.

Policy had been relaxed only on a selective basis. On the fiscal side, tax incentives to fixed investment had been restored and government expenditure programmes initiated to assist certain industries, particularly textiles and building. On the monetary side, the authorities moved to offset the outflow of funds resulting from the oil crisis, first by means of temporary central-bank credit and then by lowering reserve requirements. In addition, controls on capital inflows were substantially eased. Further assistance to the money market was given in March-April, but in subsequent weeks, with the Bundesbank purchasing substantial amounts of dollars in exchange-support operations, liquidity-absorbing measures were taken to prevent monetary growth from speeding up. The banks were offered short-term Treasury bills, and in late May their rediscount quotas — calculated since March on a more liberal basis — were subjected to a 75 per cent. utilisation ceiling. On average, central-bank reserve money grew in the first half of 1974 at an annual rate of 6½ per cent., fractionally slower than in the second half of 1973. And while short-term interest rates declined by up to 5 percentage points between October 1973 and May 1974, bond yields moved up — that on public-authority bonds from 9.7 to 10.6 per cent. — in the face of weak investor demand.

At the end of June, however, the closure of the Herstatt bank shook confidence and led to strong pressure on the Deutsche Mark. To calm the situation, the Bundesbank restored the banks' rediscount quotas in full and offered unlimited lombard credit at the standard rate of 9 per cent. Additional refinancing facilities were made available to private and regional banks, as well as to the Reconstruction Loan Corporation in respect of its lending to small firms. Moreover, the Bundesbank participated in the establishment of a liquidity consortium bank to give support to basically sound banks in temporary difficulties. Later, to reduce the possibility of similar occurrences in future, regulations concerning banks' foreign exchange transactions, trading in commodity futures and capital ratios were tightened.

Large-scale capital outflows continued into the autumn, as bond yields abroad had moved above those in Germany. Accordingly, in September and early October bank reserve requirements were lowered by a total of about DM 8.5 milliard. Some remaining controls on capital inflows, notably the cash deposit requirement on foreign borrowing by companies, were also suspended.

Meanwhile, the gradual trend towards budgetary relaxation continued, partly as an automatic consequence of recession. At the end of June the one-year surcharge of 10 per cent. on income and corporation tax expired. With unemployment and spare capacity creeping up, tax receipts generally tended to lag while social security payments rose at a faster pace. Moreover, public consumption expenditure in the second half of 1974 was 4 per cent. higher in real terms than a year before. The public sector's cash deficit thus widened from a mere DM 2.4 milliard in 1973 to DM 23 milliard in 1974, a change equivalent to 2 per cent. of gross national product.

A further sharp downturn in economic activity occurred in the closing months of 1974, causing the authorities to adopt stronger expansionary policies. The main factor was the tapering-off of the export boom. In volume terms, exports of goods and services had ceased to expand after the first quarter; and in the autumn both orders and deliveries began to decline. At the same time, the weakness of private domestic demand persisted. Real consumer spending was still unchanged from the level reached in the first half of 1973, partly because personal saving increased from 13.5 per cent. to about 15 per cent. of disposable income, and fixed investment settled

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

Items	Years	Private households	Housing	Enterprises	Public sector	Foreign countries[1]	Credit institutions[2]	Other financial institutions[3]
		in milliards of Deutsche Mark						
Net saving plus capital transfers	1972	67.80	5.10	25.45	24.60		7.00	0.60
	1973	69.20	1.25	27.40	41.50		6.60	1.00
	1974	77.60	10.35	13.35	23.25		8.50	1.30
Net investment (—)	1972	.	−40.10	−59.35	−26.05		− 1.75	− 1.05
	1973	.	−43.35	−62.95	−26.85		− 1.70	− 1.60
	1974	.	−36.45	−38.85	−32.20		− 1.95	− 1.45
Financial surplus or deficit	1972	67.80	−35.00	−33.90	− 1.45	− 2.25[4]	5.25	− 0.45
	1973	69.20	−42.10	−35.55	14.65	−10.50[4]	4.90	− 0.60
	1974	77.60	−26.10	−25.50	− 8.95	−23.45[4]	6.55	− 0.15
Corresponding changes in financial assets or liabilities[5]								
Money, time and savings deposits	1972	46.50	0.30	24.75	6.20	2.05	−83.65	3.90
	1973	37.65	0.15	15.25	13.40	4.20	−72.95	2.25
	1974	46.80	− 0.25	6.70	2.55	4.10	−65.10	5.15
Claims on non-bank financial institutions	1972	18.55		2.15	0.10	0.10	0.10	−21.05
	1973	21.25		2.85	0.15	0.10	0.10	−24.45
	1974	19.25		2.80	0.20	0.10	0.40	−22.80
Money-market paper	1972	—		− 0.55	− 0.20	0.15	0.60	—
	1973	0.45		1.30	4.95	− 1.05	− 5.75	0.15
	1974	0.25		0.05	− 5.55	− 0.10	5.40	− 0.05
Bonds and shares: Purchases	1972	10.90		1.45	0.45	12.15	8.15	4.35
	1973	13.65		2.90	− 0.10	6.95	4.35	4.00
	1974	11.25		3.60	− 0.15	− 1.30	15.20	5.05
Sales	1972		− 0.20	− 6.15	− 4.60	1.65	−27.95	− 0.20
	1973		− 0.05	− 4.15	− 2.10	− 1.75	−23.55	− 0.15
	1974		− 0.05	− 4.90	− 3.55	− 3.35	−21.30	− 0.40
Bank credit	1972	− 7.40	−24.30	−49.05	− 9.75	− 1.10	92.25	− 0.60
	1973	− 2.95	−26.60	−28.15	−13.95	− 6.10	77.40	0.35
	1974	0.70	−15.00	−30.00	−13.60	−16.00	74.15	− 0.15
Other loans	1972	− 0.60	− 9.05	− 2.70	− 0.70	—	− 0.05	13.15
	1973	− 0.70	−13.60	− 2.20	− 0.65	—	− 0.10	17.25
	1974	− 0.45	− 8.90	− 2.50	− 1.00	− 0.05	− 0.20	13.05
Other claims and liabilities	1972	− 0.15	− 1.75	− 3.80	7.05	− 1.40		
	1973	− 0.15	− 2.00	−23.35	12.95	12.55		
	1974	− 0.20	− 1.90	− 1.25	12.15	− 8.85		
Gold and foreign exchange	1972					−15.80	15.80	
	1973					−25.40	25.40	
	1974					2.00	− 2.00	

[1] A negative figure signifies an increase in Germany's claims (or a decrease in Germany's liabilities) vis-à-vis foreign countries. [2] Including the central bank. [3] Building and loan associations and insurance sector. [4] Net foreign investment (i.e. balance of goods and services). [5] A minus sign represents a decrease in assets or an increase in liabilities.

down some 12½ per cent. below its 1973 peak. The biggest decline here was in construction — especially house-building, since public construction benefited from increased government outlays. Plant and equipment orders generally were depressed by the squeeze on profits in manufacturing, where the combination of falling output and rising pay caused unit wage costs to increase by 15 per cent. between the first and fourth quarters of 1974. The outcome was that real gross product declined in the fourth quarter at an annual rate of 6 per cent. In March 1975 industrial production was 8 per cent. down over the year. At the same time, seasonally adjusted unemployment had risen to 900,000 (3.9 per cent. of the dependent labour force), with an equal number on short time.

As the deepening recession could have little immediate impact on the size of wage settlements, it was with some hesitation that the authorities moved to restimulate demand. In late October the central-bank discount rate was cut from 7 to 6½ per cent. and the lombard rate from 9 to 8½ per cent., the first changes in these rates since June 1973. Concurrently, DM 2.5 milliard was added to the banks' rediscount quotas. In response to this signal of a shift in policy, yields on the capital market, which had levelled off since mid-year despite a revival of new-issue activity, began to fall steeply. For 1974 as a whole, net sales of fixed-interest securities totalled DM 25.8 milliard, slightly more than in the previous year. Public-sector issues including communal bonds accounted for well over half this amount, compared with one-third in 1973, and financed two-thirds of the fiscal deficit. After mid-year, with private-sector credit demand shrinking, both banks and non-bank residents made substantial bond acquisitions.

Early in December, with a view to lessening inflationary expectations, the Bundesbank published for the first time a target growth rate for the supply of central-bank money in the year ahead. The figure was 8 per cent., a significantly faster rate than that prevailing for most of 1974 but slow enough to make the probability of an upturn in output dependent on moderation in wage behaviour. At the same time, the government introduced a fiscal programme to stimulate demand. It comprised an investment premium of 7½ per cent. for private capital outlays initiated between 1st December 1974 and 30th June 1975 and an increase of over DM 1.7 milliard in government spending, including payments to employers engaging previously unemployed labour and to unemployed persons moving to new areas to take up jobs. These measures were expected eventually to raise the public-sector deficit by about DM 10 milliard. In addition, it was estimated that a reform of income tax and children's allowances effective from 1st January 1975 would lower revenue by some DM 14 milliard, bringing the total projected deficit of the public sector (including the social security funds) for 1975 to over DM 50 milliard, more than double the 1974 figure.

The authorities' persevering efforts to curb the inflationary spiral were rewarded in the early months of 1975, when major pay settlements established a pattern of 6½–7 per cent. increases in the new wage round, little more than half the rate of the previous year. At the same time, the rise in wholesale prices almost ceased, and first signs appeared of a revival in housing demand. Passenger-car sales and domestic orders for investment goods showed some increase.

To further the prospects for expansion, the banks' rediscount quotas were increased by another DM 2.5 milliard for February–March, after which bank liquidity was augmented by the withdrawal of government deposits at the Bundesbank. Reinforcing the downward trend of interest rates, the Bundesbank's discount and lombard rates were lowered in stages to 4½ and 5½ per cent. respectively by late May. Long rates also continued to decline, the yield on public-authority bonds falling to about 8½ per cent. With effect from 1st June, minimum reserve requirements against domestic liabilities were cut by 5 per cent.

Japan. In 1974 Japan suffered its most severe post-war recession as stabilisation policies focused on taming a strong outburst of inflation. Real gross national product fell by nearly 2 per cent., compared with a longer-term average increase of over 10 per cent., while prices soared on all fronts. These developments, together with the appearance of a huge external current-account deficit, were attributable in large part to Japan's heavy dependence on imports of oil and raw materials. The policy of demand restraint, initiated in early 1973, but later considerably reinforced and maintained into the early months of 1975, was marked by success first in the external balance and more recently in a pronounced diminution of wage/price pressures.

Industrial output declined steadily throughout 1974 and by December was nearly 15 per cent. below the year-earlier level. All major demand components showed weakness except exports, which advanced by 21 per cent. Following a strong rise in 1973, personal consumption edged up only slightly. In response to soaring construction costs and tight financial conditions, private housing investment dropped by over 7 per cent. Private plant and equipment outlays fell by over 11 per cent. Real government outlays fell off owing to both price inflation and retrenchment measures, including postponement of public investment projects. With the recession going beyond all expectations, the inventory/delivery ratio increased sharply, the margin of idle resources grew steadily and by the end of the year the ratio of job vacancies to job seekers was below unity for the first time since 1966.

In early 1974 the rise in wholesale prices, already quite serious in the previous year, accelerated to one of the highest rates in the industrial world. To buttress demand restraint policies, a temporary price control programme was undertaken. Standard prices for several basic necessities were fixed in January, and in March and April increases in the prices of a large number of products were made subject to prior approval. The requirement was removed in September, but it had helped to hold back price increases until the rise in import prices had moderated and the more stringent demand-management policies could become effective. By March of this year, the year-to-year rise in wholesale prices was down to 4.9 per cent., and that of consumer prices had fallen back to 14.2 per cent. Over the year the emphasis shifted from import price inflation to domestic cost-push pressures. After already large increases in 1973, nominal wages jumped up by nearly 27 per cent., reflecting mainly the unusually big settlements negotiated during the spring round.

Fiscal and monetary policy remained restrictive, with little sign of an easier stance until the early spring of this year. The brunt of fiscal restraint was borne by public investment, which declined by 13 per cent. in real terms. However, the supplementary budget late in the year had to provide for higher-than-planned increases in salaries of public employees and social security payments. For 1974 as a whole the overall public-sector deficit far exceeded that of the previous year.

In its "window guidance" policy the Bank of Japan laid down stricter lending criteria for the financial institutions in 1974, and reserve requirements were kept at the higher levels set in the previous year. And the official discount rate, which had been raised to a record post-war high of 9 per cent. in December 1973, was kept at that level until April 1975.

By December the annual growth rate of M_2 had decreased to 11.5 per cent. against 16.8 per cent. in 1973 and almost 25 per cent. in 1972. The expansion of total bank credit slowed to 10.8 per cent. from the 1973 rate of 16.6 per cent. Call-money rates rose over the year and by December were near 13½ per cent., almost 3 percentage points above the year-earlier level. Interest rates on bank loans and discounts rose significantly, while yields on long-term industrial bonds had moved up to 9.7 per cent. by December.

In contrast to the year 1973, when the deceleration of bank lending had been accompanied by a strong expansion in lending by other financial institutions, as well as in trade credit and in security issues other than by the central government, continued credit restraint last year was reflected in a slow-down in credit-granting

Japan: Changes in financial assets and liabilities.

Items	Years	Corporate sector	Personal sector	Central govern-ment	Public enter-prises and local author-ities	Banking system	Other financial institu-tions	Rest of the world[1]
		in milliards of yen						
Financial surplus or deficit (—)	1972	− 6,185	10,585	720	−3,080			−2,040
	1973	− 6,875	9,920	1,510	−4,585			30
	1974	− 10,090	13,880	990	−6,065			1,285
Corresponding changes in financial assets and liabilities								
Money and time deposits	1972	7,440	13,905	−2,630	275	− 12,830	−6,160	
	1973	4,440	15,665	−3,050	360	− 8,845	−8,570	
	1974	3,190	14,470	−3,605	540	− 7,825	−6,770	
Insurance and trust claims	1972	665	3,160	− 610	5	10	−3,230	
	1973	455	3,440	− 790	10	95	−3,210	
	1974	20	4,135	− 935	95	150	−3,465	
Securities (net)	1972	− 625	1,240	− 1,040	−1,525	330	2,210	210
	1973	− 780	1,660	70	−1,960	1,050	400	− 190
	1974	− 1,040	1,730	− 1,690	−2,755	3,560	405	− 235
Loans	1972	− 16,180	−5,375	3,010	−1,745	12,335	7,955	
	1973	− 15,160	−8,670	5,090	−2,810	9,525	12,025	
	1974	− 13,130	−6,485	6,035	−3,375	7,450	9,505	
Official reserves	1972							− 915
	1973							1,645
	1974							− 350
Other foreign claims (net)	1972	10	50	190	5	800	85	−1,335
	1973	990	20	255	5	− 20	80	−1,425
	1974	− 485	-	70	5	− 1,310	− 25	1,870
Miscellaneous transactions[2]	1972	2,505	−2,395	1,800	− 95	− 645	− 860	
	1973	3,180	−2,195	− 65	− 190	− 1,805	− 725	
	1974	1,355	30	1,115	− 575	− 2,025	350	

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

in all these forms. With their net foreign position deteriorating sharply, the commercial banks had considerably less recourse to financing from the Bank of Japan in the form of loan and bill transactions. At the same time, the Bank of Japan substantially increased its purchases of government securities so as to help meet the additional needs of the financial system for central-bank money.

By early 1975 price inflation, though advancing more slowly, was still unacceptably high. Hence, despite a rise in unemployment, policy could be relaxed only marginally, particularly as the new spring round of wage negotiations loomed ahead. In February and March the government did announce a number of selective stimuli, including an increase in public works, additional unemployment benefits and subsidies on payments to part-time employees, financial assistance for small enterprises and housing, the authorisation of more local-government bond issues and an easing of controls on capital outlays for plant and equipment and building construction. The budget for the fiscal year 1975 provides for higher expenditure on social security and government investment.

In mid-April the discount rate was lowered by ½ percentage point to 8½ per cent. and market interest rates began to decline. The prospects for improved price stability and policies more conducive to recovery were enhanced by the outcome of the spring wage settlements, in which the authorities succeeded in keeping the increases down to around 15 per cent., about half the size of a year earlier.

United Kingdom. For the past year the UK authorities have struggled, not very successfully, with a situation deteriorating on several fronts at once. A major current payments deficit due to increasing pressure of home demand and import prices in 1973 was raised to massive proportions by the rise in oil prices. With wages and prices escalating and economic activity weakening, relatively more emphasis than in other countries was given to sustaining real growth and limiting unemployment. The impact of taxation and price control, however, together with highly adverse capital-market conditions, exacerbated the growing financial squeeze on companies. To relieve this, the authorities were obliged in late 1974 to enlarge still further a budget deficit already swollen by subsidy commitments and public-sector pay rises.

Following the dislocations of the three-day week in January-March 1974, output recovered but did not rise above its late-1973 level. Consumer spending was hesitant, partly because of the oil crisis, but also because of high import prices, especially for food, and higher taxation after the March budget. Private investment, particularly house-building, was on a downward trend, though public consumption and investment rose modestly. In volume terms the year-on-year growth in exports of goods and services was a great deal more than the rise in imports, but this favourable development was outweighed by a huge adverse shift in the terms of trade.

By late spring the growth of output seemed to be faltering. On the assumption that the external deficit had largely to be accepted and financed, the government introduced in July a mildly expansionary budget providing for a cut in value added tax from 10 to 8 per cent. and various extra subsidies, aimed partly at slowing down the wage/price spiral.

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

Items	Years	Public sector	Overseas sector[1]	Persons	Industrial and commercial companies	Banks	Other financial institutions
		in millions of £ sterling					
Saving plus net capital transfers	1972	3,080		4,095	5,211	460	
	1973	2,925		5,408	7,307	793	
	1974	2,214		6,795	7,828	1,446	
Gross domestic capital formation (−)	1972	− 4,762		− 2,800	− 4,717	− 623	
	1973	− 5,753		− 3,225	− 7,845	− 971	
	1974	− 7,344		− 2,919	− 11,435	− 1,175	
Financial surplus or deficit (−)	1972	− 1,682	− 82[2]	1,295	494	− 163	
	1973	− 2,828	1,176[2]	2,183	− 538	− 178	
	1974	− 5,130	3,903[2]	3,876	− 3,607	271	
Corresponding changes in financial assets and liabilities[3]							
Bank lending[4].	1972	− 589	− 7,489	− 1,927	− 2,988	14,025	− 1,032
	1973	− 1,782	− 12,393	− 1,027	− 4,504	20,543	− 837
	1974	− 541	− 8,078	− 24	− 4,411	13,173	− 119
Notes and coin and bank deposits	1972	− 498	7,462	2,013	2,288	− 12,183	918
	1973	− 444	13,915	3,510	2,605	− 20,584	998
	1974	− 857	9,283	3,343	48	− 12,699	882
Total currency flow[4]	1972	− 1,265	1,265				
	1973	210	− 210				
	1974	− 59	59				
Overseas loans and investments[5]	1972	495	− 575		4	45	31
	1973	335	− 795		432	− 57	85
	1974	40	− 744		462	180	42
Marketable government debt	1972	981	327	5	− 20	− 1,713	420
	1973	− 1,238	− 229	784	− 5	7	681
	1974	− 2,219	1,021	562	41	214	381
Non-marketable government debt	1972	− 362	—	467	− 76	− 21	− 8
	1973	62	—	54	− 67	− 41	− 8
	1974	112	—	− 69	− 26	− 12	− 5
Local-authority debt	1972	− 423	149	− 82	125	31	200
	1973	− 1,232	318	356	164	21	373
	1974	− 2,131	− 78	799	141	− 175	1,444
Claims on other financial institutions[6]	1972		− 81	4,920	52		− 4,891
	1973		72	5,118	9		− 5,199
	1974		266	4,995	− 101		− 5,160
Shares and securities[7] . . .	1972	14	− 464	− 1,111	59	115	1,387
	1973	6	322	− 1,781	863	295	295
	1974	25	1,027	− 1,173	595	1	− 475
Other domestic loans[8] . . .	1972	219		− 3,031	− 53	347	2,518
	1973	1,206		− 3,155	− 1,010	283	2,676
	1974	538		− 2,329	101	154	1,536
Unidentified	1972	− 254	− 676	41	1,103	− 352	
	1973	49	176	− 1,676	975	291	
	1974	− 38	1,147	− 2,228	− 477	909	

[1] A negative figure indicates an increase in UK claims (or a decrease in UK liabilities) vis-à-vis the overseas sector. [2] Balance of goods and services, plus (in 1973) capital transfer payments under the Sterling Agreements. [3] A minus sign represents a decrease in assets or an increase in liabilities. [4] Foreign currency borrowing by the central government from UK banks is included as an item financing "total currency flow" in the UK balance-of-payments accounts, but in this table is included in bank lending. [5] Including adjustments correcting the banks' external transactions for changes in foreign currency assets and liabilities arising from movements in exchange rates. [6] Net inflow to life assurance and pension funds and deposits with other financial institutions. [7] Including transactions in unit trust units. [8] Mainly loans for house purchase.

Source: Bank of England.

By this time, however, a major acceleration of the spiral had already been set in motion from the wages side. Apart from the miners' wage settlement of nearly 30 per cent., the third stage of the statutory incomes policy — introduced in November 1973 — allowed for initial wage increases of up to 10 per cent. and for subsequent "threshold" payments once the retail price index had risen 7 per cent. above the level of October 1973. Having been devised before the leap in oil prices, the scheme assumed a far too optimistic outlook for prices, and threshold payments from May onwards added a further 12½ per cent. to wage rates up to the end of the year.

Moreover, the statutory limitations on pay were lifted after July — but not those on prices, which had, in fact, been tightened. The Labour Government's "social contract" relied on voluntary restraint by the trade unions in return for increased union legal privileges and industrial influence, together with various redistributive fiscal measures. Unions were urged to limit their pay claims to compensation for rises in the cost of living. However, low-paid workers were to be partially exempt, other exceptions were permitted, a few unions rejected the appeal anyhow and most others chose to interpret it, incorrectly, by ignoring much of the amounts paid under the threshold provision. Consequently, by March 1975 the twelve-month rise in wage rates was almost one-third.

After mid-year the upsurge of wages, in conjunction with continuing price restraint, had a dominating influence on other developments. There was a large increase in real personal disposable income, augmented by the budget measures in July. However, personal saving mounted sharply, so that real personal consumption did not rise above its year-earlier level until the fourth quarter of 1974. Current government expenditure increased — a direct reflection of higher public-sector wages — while gross fixed investment showed a moderate fall. In manufacturing it maintained the level reached in the first quarter, mainly because of outlays connected with North Sea oil development; but other private investment, especially house-building, declined, and so did public investment (except for house-building, where special measures were taken to assist the construction industry). Towards the end of the year, as world demand weakened, exports declined somewhat more than imports. Having risen in the third quarter, real gross domestic product fell in the fourth — largely because of lower stock-building and exports — leaving output in the second half of 1974 nearly 1½ per cent. higher than a year earlier, whereas in other major countries it had fallen.

Nonetheless, as this increase was less than the economy's potential, capacity utilisation declined and unemployment and short-time working gradually rose. Activity weakened further during the winter months, with industrial production in the first quarter of 1975 falling back to its lowest level since the three-day week a year earlier. Unemployment accelerated, reaching 794,000 seasonally adjusted (3.4 per cent. of all employees) in April. The trade balance improved significantly, as exports recovered while imports, especially of raw materials and fuel, continued to fall.

On the financial side, the unusually large surplus of the personal sector, together with the current external deficit, was matched by huge deficits of the company and public sectors. For companies, the operation of the price code combined with soaring wages brought a squeeze on profits at a time when cash flow had already suffered severely from the impact of higher raw-material costs. Historic-cost pricing, insisted upon for tax and accounting purposes, meant that, with raw-material costs going up, a rising proportion of cash receipts had to be used to replace stocks. Another source of pressure was the inclusion in taxable profits of the difference between the value of stocks held at the end and at the beginning of an accounting period.

At the same time, firms were precluded from raising long-term funds by the collapse of the capital market. Both bond and equity prices declined almost uninterruptedly throughout 1974, until in mid-December long-term government bonds were yielding 17.5 per cent., company debentures 19.5 per cent. and equity dividends 13 per cent. The equities index then lay more than 70 per cent. below its 1972 high. Bank credit had to fill the gap, and manufacturing industry increased its borrowing from this source in the twelve months to November by 40 per cent. As a result, debt/equity ratios rose sharply and the "cover" ratio of cash flows to fixed-interest commitments declined severely.

Easing the financial pressure on companies was the main objective of the November budget. Corporate tax liabilities on stock appreciation exceeding 10 per cent. of other trading profits were deferred, and the price code was modified to allow 80 per cent. of increases in wage costs to be passed on, instead of 50 per cent. as hitherto. These two measures together were calculated to add £1,500 million to company cash flows in 1975. Also, the initial depreciation allowance on industrial buildings was raised from 40 to 50 per cent.; and up to £1,000 million of medium-term funds for business was to be provided by banks and other financial institutions through the government-sponsored body "Finance for Industry". The government also indicated its readiness to give direct financial help to ailing firms and has done so in several cases.

Much of the relief to companies was at the expense of the public sector's own financial position. In addition, price restraint by the nationalised industries enormously enlarged their subsidy requirements and wage costs of central and local government rose much faster than expected. The result was a mushrooming of the public sector's financial deficit and, to an even greater extent, of its total borrowing requirement which includes funds for on-lending to the private and overseas sectors. Whereas

United Kingdom: Domestic credit expansion.

Items	1969	1970	1971	1972	1973	1974
	in millions of £ sterling					
Public-sector borrowing requirement[1]	−475	− 5	1,380	2,060	4,225	6,365
Net sales of public-sector debt to non-bank private sector (−)	−345	− 110	−2,105	−1,025	−2,035	−3,440
Bank lending to private sector[2]	525	1,135	1,575	5,710	6,240	4,415
Bank lending in sterling overseas	150	25	295	135	190	290
Domestic credit expansion	−145	1,045	1,145	6,880	8,620	7,630

[1] The difference between the public sector's financial deficit (see table on page 42) and its net borrowing requirement is accounted for by loans of various kinds, refinancing of export credits and until 1971 transactions in import deposits. [2] Excluding lending in foreign currencies for investment overseas.

the original budget estimates for 1974–75 put the borrowing requirement at £2,700 million, the outturn was no less than £7,600 million, about 10 per cent. of gross domestic product.

The public-sector deficit, together with industry's recourse to bank loans, meant that the growth of total domestic credit in 1974 was again very large — £7,630 million. However, this was below the 1973 total because of the smaller increase in bank loans, particularly to non-industrial borrowers. Early in the year banks were effectively discouraged from lending by the supplementary special deposits scheme and by qualitative guide-lines, but credit demand later subsided. Moreover, the public sector obtained much of its finance from large sales of debt to UK non-bank residents. The money stock, which grew more slowly than domestic credit because of the external deficit, increased much less than the gross domestic product at current prices. At the end of February 1975 the authorities suspended the supplementary deposits scheme.

The first quarter of 1975 saw a sharp upturn in financial markets, partly influenced by the decline in interest rates overseas and by the help to company finances in the November budget. It was helped also by the government's abrogation of the freeze on commercial rents, an important step in view of financial institutions' involvement in the property sector. Short-term rates retreated by some 2 percentage points, the Bank of England's minimum lending rate being lowered from 11½ per cent. at the start of the year to under 10 per cent. in April. Long-term yields fell even more and the equity index more than doubled, reducing the dividend yield to 6.3 per cent. and stimulating a revival of share issues by companies.

In his April budget the Chancellor pointed the finger at excessive wage increases and emphasised that the priority must now be to adapt consumption to the cut in real income implied by the higher cost of oil. In order to counteract wage gains and to limit the government's massive borrowing requirement, various direct and indirect taxes were increased and the phase-out of subsidies to nationalised industries, begun in November, was continued. However, the momentum of public expenditure was such that the projected borrowing requirement for 1975–76 still increased to £9,100 million. Even with this budget deficit, a stagnation of economic activity was anticipated and unemployment was expected to exceed 1 million in the course of the year.

Canada. Thanks to Canada's self-sufficiency in energy and some policy easing from the fiscal side, the downturn in economic activity came later and was milder than in the United States. Real output continued to rise in the first quarter and then remained at a high level in the spring and summer before turning down later in the year. Housing starts dropped by nearly 20 per cent. and personal consumption rose at only about one-half of the 1973 rate as sales of motor-cars slowed down and then fell off sharply in the fourth quarter. Net foreign demand declined as the result of a mild drop in real exports alongside a continued strong advance in imports. On the other hand, business investment remained fairly robust, as the steel, chemical and pulp and paper industries sought to correct earlier capacity inadequacies, and government expenditure on goods and services also rose strongly. Unemployment did not increase much until December, when lay-offs in the motor-car industry added nearly a full percentage point to the unemployment rate.

The consumer price index advanced by 12 per cent. during 1974, with the food component rising by 17 per cent. while the energy component, under the influence of domestic petroleum price restraints and consumer subsidies, rose by only 9.5 per cent. Wage increases more than kept pace and were running at over 17 per cent. by the final quarter.

In the first half of 1974 a number of fiscal measures, designed to mitigate the impact of inflation, helped to sustain consumer demand. The indexation of the personal income tax system announced in 1973 came into force. Public-sector pensions were also indexed and family allowances were substantially increased. In July the manufacturers' sales tax on clothing and shoes was abolished. Finally, certain food prices were subsidised. In response to the economic slow-down, the Federal Government's November budget provided for a 5 per cent. reduction in personal income taxes, indirect tax cuts on building materials and construction and transport equipment, an extension of the two-year write-off period for industrial plant and equipment and measures to encourage saving and home-buying. The implied increase in net Federal Government outlays was equivalent to about 1¼ per cent. of gross national product.

Up to August monetary policy was restrictive, with greater emphasis than in past years being placed on the cost of credit rather than on availability constraints. Bank rate was raised progressively to reach a level of 9¼ per cent. by late July. Before long, however, concern about aggregate demand led the authorities to ease monetary policy somewhat. Bank of Canada operations to reduce short-term interest rates were facilitated by the downturn in US and international rates in late August. Bank rate was brought down by ½ percentage point in November and again in January 1975. In addition, the chartered banks' secondary liquid-asset requirement was reduced in three steps from 8 per cent. to 5½ per cent., primarily in order to offset the restrictive impact of the highly successful Canada Savings Bond campaign last year.

The commercial banks' major assets in Canadian dollars grew by 19 per cent. for the second consecutive year. The rapid pace of bank loans to business eased slightly in the later months of the year owing to the fact that the prime lending rate was slow to respond to the decline in short-term market interest rates. The banks' personal and mortgage credits again recorded large increases, of 20 and 33 per cent. respectively, but tapered off in the second half as markets for consumer durables softened. The banks' holdings of liquid assets went up by 14 per cent., compared with only 3 per cent. in the previous year. The broadly-defined money stock rose by 16 per cent., or somewhat less than in 1973. In the third quarter M_1 declined in absolute terms, but it expanded again in late 1974 and early 1975.

Total funds raised by domestic borrowers increased by 45 per cent. in 1974. The government re-emerged as a strong net borrower, though with most of the proceeds going to swell its cash balances, and non-financial business also substantially increased its recourse to the credit markets. Greater borrowing by provinces and

Canada: Total funds raised by major sectors.

Sectors	1970	1971	1972	1973	1974
	in milliards of Canadian dollars				
Non-financial business . . .	3.2	5.3	4.8	6.8	10.1
Consumers	0.7	1.4	2.2	2.8	3.0
Mortgage borrowers	1.6	2.5	4.1	6.3	6.1
Provinces and municipalities	2.2	2.9	3.6	3.3	4.2
Total.	7.7	12.1	14.7	19.2	23.4
Government of Canada . . .	2.0	3.0	1.6	— 0.1	4.2
Grand total	9.7	15.1	16.3	19.1	27.6
As percentage of GNP . . .	*11.3*	*16.4*	*15.7*	*16.1*	*20.0*

municipalities involved record sales of net new bond issues to non-residents, including a few direct placements with investors in oil-exporting countries.

Interest rates followed those in the United States rather closely. Short-term rates rose sharply in the spring and continued at high levels until August, when the Bank of Canada shifted to a more accommodative cash reserve policy. A marked decline in short-term rates then ensued. Chartered-bank lending rates for large borrowers rose by 2 percentage points between January and July, and remained at a high level until well into October before slowly declining. Long-term interest rates were relatively stable early in the year but then rose strongly until late August. In December industrial bond rates were still 2 percentage points higher than a year earlier.

In the spring of 1975 the signs of economic slack became more widespread, but price inflation seemed also to be slowing down a little. Industrial production had dropped 2½ per cent. in the first quarter, and by March the unemployment rate had risen to 7.2 per cent. A stimulative Federal Government budget was expected in late May.

France. By early 1974 France had experienced five years of rapid growth, full employment and broad external balance. With expansionary forces still strong, restrictive monetary and fiscal policies were maintained in order to moderate inflation and help reduce the large current-account deficit caused by higher oil prices.

The measures taken to control bank credit expansion, a mainstay of monetary policy, were adjusted so as to bring the authorised increase down to 12 per cent. for the year as a whole. In June supplementary reserve requirements for banks whose lending exceeded the rate announced by the authorities were made more severe, though exemptions in respect of credits for exports and energy-saving investments gave the banks substantial leeway. In the spring and early summer the authorities encouraged a rise in money-market rates broadly in line with that on one-month Euro-dollars, supplementing this movement in June by raising the official discount rate from 11 to 13 per cent. In addition, the burden of ordinary reserve requirements was shifted somewhat from time to sight deposits and, as banks' indebtedness to the Bank of France had risen excessively, the 33 per cent. reserve requirement against the growth in bank assets was suspended, the lending guide-line being considered an adequate restraint on credit-granting.

A new package of fiscal restraint measures was introduced in July, partly to counteract the rise in budget outlays caused by the speeding-up of inflation. These measures included expenditure economies, a temporary reduction in depreciation allowances for investment and non-recurrent tax surcharges on corporations and high personal incomes. In addition, Fr.fr. 3.5 milliard of the increase in tax revenue due to inflation was frozen at the Bank of France. Other important actions were energy-saving measures to curb imports and tighter price restraints, including negotiated cuts in traders' margins. In September, when renewing price restraint contracts, the authorities revoked permission to pass on increases in raw-material costs and instead laid down maximum price increases for groups of products.

After holding up well until mid-year, industrial production declined from the autumn onwards, largely because of a turn in the stock cycle and a weakening of consumption. However, as exports went on rising and house-building slowed down only moderately, the growth of real gross national product, at 4 per cent. for the year as a whole, exceeded that in most other countries. Productivity advances absorbed part of the rise in wages, but consumer prices still went up by some 15 per cent. during the year.

In view of the mild slow-down, policy relaxation was cautious and selective. In August short-term export credits were exempted from the credit guide-lines and made subject to a separate twelve-month indicative growth limit, set at 22 per cent. for October–December. In addition, a Fr.fr. 4 milliard facility outside the indicative credit limits was created for providing investment credits to firms undertaking to expand their exports, while special mechanisms were created to help small businesses to weather prolonged credit restraint, notably by permitting a rescheduling of tax payments where necessary. Reserve requirements against banks' savings deposit liabilities were reduced from 6 to 4 per cent. in August. With the authorities' money-market interventions moderating their decline, money-market rates fell much more slowly than Euro-dollar rates and in December the day-to-day rate was only some 2 percentage points below its July peak.

The growth of public expenditure slowed down sharply under the influence of policy restraint. Moreover, rising tax revenues squeezed private liquidity until late in the year when a postal strike and administrative changes considerably delayed collections. As a result, whereas in 1973 the government had a budget surplus of over Fr.fr. 7 milliard and improved its position with the banking system by more than that, last year the surplus was only Fr.fr. 4 milliard. In the first half of 1974 the Treasury redeemed market paper, but its deteriorating position later prompted it to have substantial recourse to funds from the banking system. The government's 1975 budget, presented in September, envisaged continued restraint in spending and provided for a new type of surtax on large enterprises whose value added (mainly profits and wages) exceeded a specified norm. In addition, the government took a firm line in public-sector wage negotiations, and in December it imposed a freeze on traders' margins.

France: Uses and sources of credit.

Items	1971	1972	1973	1974
	in milliards of French francs			
Uses				
Official international reserves	17.8	6.5	− 7.4	− 2.4
Public sector[1]	7.9	10.8	11.4	11.8
Enterprises	65.4	80.2	83.4	103.2
Housing	27.3	38.5	42.3	34.2
Individuals	4.8	7.8	0.8	− 0.2
Other uses	0.9	11.7	23.8	40.7
Total	124.1	155.5	154.3	187.3
Primary sources				
Banking system	74.7	91.1	89.4	90.6
Specialised financial institutions and Treasury	30.2	43.9	43.7	77.0
Insurance companies	3.4	2.6	3.2	3.6
Capital market	15.8	17.9	18.0	16.1
Total	124.1	155.5	154.3	187.3
Corresponding changes in financial assets				
Money	27.9	39.3	29.6	30.5
Liquid saving	57.7	60.0	68.0	81.2
Securities[2]	15.6	12.9	13.3	12.3
Government claims[3]	1.8	12.1	9.6	21.6
Other claims	21.1	31.2	33.8	41.7
Total	124.1	155.5	154.3	187.3
Total, as percentage of GNP	*13.8*	*15.5*	*13.5*	*14.1*

[1] Excluding the Treasury. [2] Taken up by enterprises and individuals. [3] Equals cash surplus.
Source: Bank of France.

From the summer onwards, following a protracted bank strike, banks gradually brought the expansion of non-exempt credits within the prescribed norm. Taking exempted credits and foreign currency lending into account, total bank lending to enterprises and individuals expanded by 17 per cent. in 1974, compared with 18 per cent. in 1973. At the same time, enterprises substantially increased their direct recourse to credit from abroad. Adjusted for the effects of the postal strike, money and quasi-money rose by some 16 per cent.

Capital-market yields remained at their mid-year highs until the end of the year. Total issues dropped to Fr.fr. 25 milliard from Fr.fr. 38 milliard in 1973, when there had been an exceptional Treasury issue for Fr.fr. 6.5 milliard. Borrowing by the enterprise sector fell very little.

In early 1975, with demand weakening over a wider range of industries and unemployment higher, monetary policy was eased cautiously. The scheme aimed at controlling bank credit expansion was extended in a more flexible form, some additional credit categories were exempted and a higher limit was fixed for short-term export credits. In January the banks' reserve requirements on sight deposits were lowered and those on savings deposits were removed. The decline in money-market rates quickened and the Bank of France's discount rate was lowered to 10 per cent. in three stages between January and April.

New fiscal measures were introduced to give a selective stimulus to investment, the aim being to encourage growth without prejudicing the improved external account or aggravating inflation. Thus, in January public works and government lending programmes were accelerated and steps were taken to revive social house-building. In March normal depreciation allowances were restored, the terms governing the granting of certain equipment credits were liberalised and an additional Fr.fr. 3 milliard facility for financing increases in export capacity was introduced. Further measures in April, estimated to amount to Fr.fr. 15.5 milliard, included increased investment by public-sector enterprises, a tax offset for enterprises equal to 10 per cent. of the value of equipment ordered before the end of 1975 and additional subsidised investment credit facilities for small companies and exporters, with Fr.fr. 5 milliard of the financing to come from a government-guaranteed loan issued by specialised medium and long-term credit institutions.

Italy. In early 1974 Italy was still in a phase of vigorous expansion which had begun a year earlier, with output in some sectors pressing against capacity. In addition, following steep rises in the cost of imports, exacerbated by the earlier depreciation of the lira, price and wage inflation had reached grave proportions. There was a parallel deepening of the current-account deficit, posing large-scale financing problems, and in general the critical situation gave a dark hue to the outlook.

Under these conditions restraint policies were tightened significantly from the turn of the year. In particular, most categories of bank lending to March 1975 were made subject to a 15 per cent. ceiling, the receipts from the import deposit scheme and the lira counterpart of officially-prompted borrowing abroad were frozen, the bond issues of the special credit institutions decreased notwithstanding the banks' investment requirements and interest rates were permitted to rise sharply. In August 1974 fiscal policy was also made more restrictive. The measures included increases in indirect taxes, a tax on high incomes (not payable until 1975) and higher charges for public services. But the cash deficit of the Treasury, together with independent administrations, continued to increase, reaching Lit. 8,650 milliard for the year, compared with Lit. 7,500 milliard in 1973 and Lit. 5,600 milliard in 1972.

The strong advance in output up until the spring had been based mainly on an upswing in fixed investment and consumer durables while stock replenishment supported output growth through the summer. Thereafter, the decline in world demand, together with domestic restraint policies and the weakening of inflationary expectations, took their toll. With housing still quite low and the stock cycle turning, adjusted industrial production fell by 4 per cent. in the third quarter of 1974 and by a further 9 per cent. in the fourth quarter. Recorded unemployment rose fairly moderately, however, because the spread of part-time working and increased recourse to the Wage Equalisation Fund forestalled lay-offs, while employment in services continued to grow.

Consumer prices accelerated anew following the August increases in indirect taxation and the expiry somewhat earlier of the one-year freezes on the prices of industrial and staple products. By the end of the year their rise was slowing down but was still running at 24.5 per cent., while contract wage rates in industry were increasing at the same rate.

Treasury operations contributed over Lit. 7,600 milliard to monetary base creation last year, but the external deficit offset more than half of this. With the banks' recourse to the central bank being kept under restraint, the monetary base went up by Lit. 4,000 milliard in 1974, compared with nearly Lit. 5,100 milliard in 1973.

Bank prime lending rates increased over most of the year and reached a peak of 18.5 per cent. in November, against 10 per cent. a year earlier. The authorities sought to insulate to some extent the cost of long-term financing by prolonging the banks' bond investment obligation; yields on new bond issues of the special industrial credit institutions went up only from 7½ per cent. in January to a 12½ per cent. peak in November. But with non-bank investors withdrawing from the market, total net issues on the domestic capital market fell to Lit. 4,245 milliard in 1974, compared with Lit. 12,440 milliard in 1973. On balance, taking account of a sharp decline in lending by the special credit institutions and in direct issues of bonds and shares, total domestic credit granted to the private sector came to Lit. 12,300 milliard, a rise of only 12.2 per cent.

It became increasingly clear that total domestic credit expansion, public and private, in the year ending March 1975 would fall well within the target limit of Lit. 22,400 milliard set in consultation with the International Monetary Fund. In the light of the weakness of the domestic economy and the strong external improvement, monetary policy was eased progressively. In late December the Bank of Italy's discount and lombard rates were lowered from 9 to 8 per cent. In January the banks' reserve requirements were basically restructured with the introduction of a 15 per cent. cash requirement against the growth of deposit liabilities and a revised bond investment coefficient obliging the banks to commit about one-third of the growth of their resources in this way. New selective credit facilities for agriculture, exports and building were introduced and the credit ceiling, already eased in December in respect of credits for exports and to large firms, was removed in March. The termination of the import deposit requirement announced at the same time implied a substantial easing in private-sector liquidity in the following months. With the decline in money-market interest rates quickening, the banks agreed in January to cut maximum deposit rates by 2 percentage points and began in March to lower lending rates, encouraged by the official offer of priority in refinancing to banks which did so. In March the government announced a three-year programme of additional expenditure designed to relieve crisis conditions in the housing industry. By this time industrial production was sharply down, but with the trade balance improved and signs of lessening inflation, the Italian economy appeared to be weathering its acute crisis. In late May the discount rate was cut from 8 to 7 per cent.

Belgium. Belgium was another of the countries in which output continued to expand until well into the summer of last year. Exports were still rising, while in addition, spurred on by inflationary sentiment, equipment investment, stock-building, consumer durables expenditure and housing all advanced strongly. Moreover, rises in import prices had given a sharp boost to the inflationary spiral, since most wages, rents and pensions were automatically, and frequently, adjusted through indexing arrangements.

Monetary and fiscal policies were tightened further in the spring and summer. The guide-line for bank credit expansion, made into a formal ceiling in March, was lowered from an annual rate of 17 to 14 per cent. in June and previously exempt export and government-guaranteed investment credits were made subject to it. However, the banks were asked to give priority to these credits within the ceiling and to exercise severe restraint in the granting of hire-purchase credits. Reserve requirements were eased for technical reasons but other measures fostered a steep rise in interest rates. In particular, the cost to banks of refinancing facilities was increased, partly by severely restricting their access to credit at the discount rate. Lending for housing was spaced out and in the late summer stringent restrictions were placed on the granting of mortgage and hire-purchase credits. Moreover, a delay of one year was imposed on large new building projects.

The government cut back its investment programmes — by up to 27.5 per cent. in the case of non-priority projects — and suspended the calling of tenders for public buildings for three months in the summer. But current public expenditure went on rising rapidly, so that the budget deficit, at B.fr. 97 milliard, was slightly larger than in 1973. As the year progressed, the Treasury was able to reduce its recourse to the central bank. The 1975 budget, presented in August, provided for increases in indirect taxes and in taxes on corporations and high incomes, which were calculated to yield B.fr. 20 milliard during the year.

The slow-down in activity from the summer onwards was largely due to a weakening in exports and personal consumption, together with a turn in the stock cycle. Housing and industrial investment continued at a high level and a good rise in productivity was recorded. This was far exceeded, however, by the 24 per cent. rise in average earnings during the year. Consumer prices rose by 15.7 per cent. The system of price supervision, involving fixed maxima for basic products and advance notification requirements, was maintained. As from mid-October the required notification period for increases was raised to six months and wage rises in excess of productivity gains ceased to qualify as justification for price adjustments.

Money-market interest rates began to decline in the summer, but the turning-point for other key rates did not come until the autumn. In October, with the outlook increasingly uncertain, the credit-granting norms were liberalised, particularly in respect of export credits, and thereafter banks' required reserve holdings were not increased further. Money-market intervention rates were brought down and in November the banks' refinancing facilities were increased.

After expanding rapidly early in the year, bank lending to the private sector subsequently decelerated so that the overall increase came to only 12 per cent., against 18 per cent. in 1973. Reflecting, in addition, a slow-down in credit to the public sector, the broadly-defined money supply went up by 9 per cent., compared with 13.5 per cent. the year before. Interest rate and tax considerations prompted a large increase in the private sector's holdings of Belgian franc deposits abroad, and there was a broadly parallel rise in enterprises' foreign borrowing. Interest rate considerations also induced a shift in flows of new funds from savings deposits to cash bonds and securities. However, with financial institutions substantially reducing their purchases, total net issues of fixed-interest securities, both government and private, declined in 1974.

A more pronounced easing of policy occurred around the turn of the year as unemployment began to rise much faster than in previous recessions. In December the government announced an increase in public-sector employment, more labour-training facilities and the offer of a premium payment to small enterprises taking on more employees. It also increased export and investment-credit facilities and stated that in 1975 it would make no further cuts in its own investment spending. In early February the credit ceilings were liberalised for construction and certain investment loans, the terms of rediscounting were eased and reserve requirements were cut. Later that month mortgage credit regulations were eased. With short-term interest rates continuing to decline, the National Bank's discount rate was brought down from 8¾ to 6½ per cent. between January and May. Finally, at the end of April the credit ceilings, the banks' government-bond investment obligation and their reserve requirements were allowed to lapse. The banks' existing blocked reserve holdings were to be released in stages between May and July. In early May, moreover, the government announced fiscal concessions to companies in respect of fixed investment, stocks and social security contributions, but continued the struggle against inflation by the introduction of a two-month price freeze.

Netherlands. After eighteen months of moderate growth in output, there was a significant margin of economic slack in the early months of last year. Unemployment exceeded 3 per cent., amounting to almost twice the number of job vacancies, while a major current-account surplus had emerged. The slackness of domestic demand was attributable partly to restrictive fiscal and debt-management policies but partly also to a weakness of business investment caused by the downward pressure of cost inflation on real profit rates. To contain the recession and forestall additional pay claims, the authorities decided to shift policy towards stimulus in such a way as to compensate employees for loss of income as a result of the higher cost of oil. The income burden, which was essentially a temporary matter for the economy pending higher export prices for Dutch natural gas, would thus fall on the company and government sectors.

The main rôle was played by budgetary and wages policy. Initial moves in February to step up government expenditure and postpone a special levy on business investment in the western region were followed in March by a more comprehensive programme costing Fl. 2¼ milliard in a full year. Fiscal incentives to investment were improved and income taxes reduced, especially on low incomes. Moreover, Fl. 600 million was added to planned government expenditure to cover increased costs, a departure from the established practice of compensating for such cost increases by cutting back public outlays in volume terms. Shortly afterwards the supplementary wage increase (additional to cost-of-living adjustments) paid from April onwards under the terms of the government's emergency legislation was raised. Strict price controls remained in force, though with some alleviation after 1st July, when retail prices for foodstuffs other than meat were exempted and the proportion of wage increases that could be passed on was raised to 50 per cent. for industry (compared with one-third previously) and 85 per cent. for services.

Under the impact of these measures, real consumer spending advanced further and, with exports also moving ahead, overall economic activity appeared to be holding up fairly well. The authorities allowed some tightening of credit in July-August, with the banks' free reserves falling off from 1½ to about ½ per cent. of their short-term liabilities. Activity was not sustained, however, as export volumes contracted after mid-year and consumption fell sharply in the fourth quarter. Fixed investment also remained weak throughout the year, residential construction declined by 13 per cent., and for the third year in succession public capital outlays contracted. Business investment was affected not only by the intensified profit squeeze resulting from recession but also by the government's policy of allowing real disposable wages to increase by about 2½ per cent. in 1974. In the circumstances, labour's share of the value added in all industries and services was pushed up from 79½ per cent. to a new high of 82 per cent.

Industrial production edged further upwards to reach a peak in August, but the order inflow had already begun to dwindle and towards the end of the year output declined sharply. By early 1975 it was 9 per cent. below its August high. In April unemployment on a seasonally adjusted basis reached 4.9 per cent. of the labour force, the highest rate since the early 1950s.

As total demand weakened, the authorities gradually stepped up the stimulus from the fiscal side. The 1975 budget proposals, presented in September, included

Netherlands: Changes in financial assets and liabilities.

Items	Years	Govern-ment	Local authorities	Banking	Institu-tional investors[1]	Personal and business sector	Rest of the world[2]
		in millions of guilders					
Financial surplus or deficit (—) (cash basis)	1972	205	− 2,585	4,435	11,210	− 8,690	− 4,575
	1973	580	− 2,770	3,030	13,265	− 8,630	− 5,475
	1974	− 945	− 3,900	3,110	14,160	− 8,425	− 4,000
Corresponding changes in financial assets and liabilities[3]							
Primary and secondary liquidity	1972	—	380	—	− 620	5,245	
	1973	—	40	—	1,565	8,890	
	1974	—	185	—	1,235	10,100	− 3,225
							− 2,370
Bank credit	1972	2,110	1,290	− 2,785	− 250	− 2,145	− 3,310
	1973	2,250	− 825	− 2,975	185	− 6,560	
	1974	1,335	− 225	− 2,590	− 250	− 6,480	
Net recourse to capital market	1972	− 2,215	− 4,270	7,220	12,080	−11,440	− 1,375
	1973	− 1,805	− 2,005	6,005	11,515	−10,595	− 3,115
	1974	− 2,435	− 3,860	5,700	13,175	−11,245	− 1,335
Direct external capital transactions	1972	310	15	—	—	− 350	25
	1973	135	20	—	—	− 165	10
	1974	155	—	—	—	− 800	645

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

another Fl. 600 million for additional public expenditure and projected the overall deficit at Fl. 4.6 milliard, compared with the deficit of Fl. 2.8 milliard originally proposed for 1974. Further spending programmes announced in November, together with new income-tax reductions and improved investment incentives, raised the prospective deficit by another Fl. 3.5 milliard; an additional Fl. 560 million was allocated in February 1975, partly by way of financial assistance to companies. In April, finally, the government agreed on a proposal by Parliament that an additional Fl. 1 milliard should be provided to alleviate unemployment in the building sector. In view of the time required to activate these programmes, the government's borrowing requirement in 1975 is expected to be about Fl. 6 milliard, or 3.1 per cent. of net national income.

Credit and debt-management policies were kept fairly restrictive over most of the year. To offset part of the monetary impact of the external surplus, the government followed its previous practice of borrowing in excess of its needs, taking up a total of Fl. 2.4 milliard from the capital market, or Fl. 1.3 milliard more than in the cash budget deficit. Long-term interest rates rose during the first half of the year and remained high until the early autumn. In late October the Nederlandsche Bank lowered its discount rate from 8 to 7 per cent., concurrently with a similar move in Germany. Thereafter both short and long-term yields moved down, roughly in line with those abroad, until the end of the year. The stock of money and quasi-money rose by 20 per cent. in 1974, considerably faster than nominal gross national product, but this partly reflected a shift from longer-term deposits not included in M_2.

In November the banks were informed that monetary policy during 1975 would aim at preventing bank credit financed from monetary resources from expanding at a faster pace than nominal gross national product. During the early months of 1975 interest rates declined more slowly in the Netherlands than elsewhere, as the authorities sought to moderate the demands of business for short-term finance. In early March, however, the continuing decline in interest rates abroad led the Nederlandsche Bank to make a further cut in its discount rate to 6 per cent.

Generally speaking, the stimulus given to demand was not expected to produce a rapid upturn in activity. Moreover, with money wages largely determined by indexation, the increase in unemployment has hitherto had little impact on the rate of inflation. In 1974 wage costs per employee rose by 15 per cent., of which only 3.5 percentage points represented initial awards. The rest reflected mostly the operation of escalator clauses, since the cost of living rose by 9.5 per cent. In the first quarter of 1975 initial awards were only around 2 per cent., but indexation remained in force and consumer prices were still showing an increase of around 10 per cent. over a year earlier. In April the proportion of wage increases in industry that may be passed on in prices was raised from one-half to two-thirds.

Switzerland. By early 1974 the Swiss economy had begun to react to the broad range of anti-inflationary measures introduced around the turn of 1972–73. While the key move had been the floating of the Swiss franc, other measures included building restrictions, credit ceilings and various steps to absorb excess liquidity. For 1974 as a whole real private consumption rose more slowly and investment dropped off sharply. Construction was particularly affected, partly because of policy restraints, but partly also because of a structural weakening in demand, both private and public, after many years of intense activity. On the other hand, exports remained buoyant until the autumn, but thereafter came under the shadow of weakening world demand and declining competitiveness. The general cooling-off strengthened after mid-year and led to a decline in industrial production and — later in the year — also to a shrinkage of imports. Price and wage increases were slow to respond but decelerated somewhat in the autumn; for consumer prices the twelve-month rate of change was about 11 per cent. in September and 9 per cent. in April 1975.

The broad policy aim in the first half of 1974 was to hold back monetary expansion until the huge earlier increases in liquidity from abroad had been further absorbed. In conformity with this objective, the discount rate was raised from 4½ to 5½ per cent. in January. But at the same time, partly in the light of exchange-market conditions, the National Bank was able to initiate a gradual reduction of minimum reserves and a more generous granting of central-bank credit. Moreover, penalty deposits against the banks' lending in excess of the growth ceiling were called up only in part and in April the ceiling on bank credit expansion was raised from 6 to 7 per cent. Financial markets remained tight and interest rates increased considerably, partly under the influence of an even steeper rise in Euro-franc market rates. An increasing number of bond issues were poorly received and in May the authorities began to intervene on the bond market and to reduce domestic issues and capital exports.

After the summer the National Bank began for the first time to foster a monetary expansion designed to accommodate domestic needs. Credit ceilings were cautiously relaxed, central-bank credit was provided more readily and temporary tensions were eased by offering currency swaps. Minimum reserve requirements were cut again in October and those against domestic liabilities suspended altogether in November. In addition, the National Bank financed part of the government's payments abroad to help towards covering the larger budget deficit. Reflecting also a weakening of overall demand, financial tensions eased in the autumn and interest rates responded accordingly.

The banks' total lending to residents increased by 7.4 per cent. in 1974, compared with 8.2 per cent. in the preceding year. The supply of money and quasi-money rose by 6.6 per cent., against 5.0 per cent. in 1973. On the capital market net domestic placements of publicly-offered securities totalled Sw.fr. 4.5 milliard, or 4.8 per cent. more than in 1973. Net foreign issues, on the other hand, dropped from Sw.fr. 2.2 milliard to Sw.fr. 450 million in 1974 and placements of medium-term foreign notes declined from Sw.fr. 3.4 milliard to Sw.fr. 2.8 milliard. Bank lending abroad subject to authorisation amounted to Sw.fr. 1.9 milliard, compared with Sw.fr. 3.2 milliard in 1973.

In retrospect, the floating of the Swiss franc was a crucial step in enabling the authorities to regain control over domestic monetary expansion. On the other hand, developments since last autumn have revealed some of the limitations of floating for a small industrial country with a very large financial sector. Around that time domestic demand weakness had led to a substantial contraction in the trade deficit, and a sudden *acceleration of capital inflows* also occurred. While these inflows were partly initiated by non-residents, and were to some extent resisted by exchange measures, it is probable that the tightness of domestic monetary conditions relative to those abroad also led to imports of funds by residents. In any case, the resultant sharp appreciation of the Swiss franc posed a growing threat to exports and employment and prompted a limited return to exchange intervention from January onwards. Somewhat earlier, authorisations for lending abroad were increased, and in early March the discount rate was reduced from 5½ to 5 per cent.

Furthermore, minimum reserve requirements on foreign liabilities were reduced in April and the authorities announced their intention of allowing the monetary base to grow by 6 per cent. this year. With rising unemployment concentrated in the construction and export industries, building restrictions were lifted and steps taken to promote exports. Then, at the beginning of May, the ceilings on bank lending were suspended altogether and regulations on hire-purchase credits eased. At the same time, the National Bank cautioned that monetary expansion should not go too far and that priority should be given to credits stimulating employment and exports. Subsequently, the official discount rate was lowered to 4½ per cent., the ceilings on foreign lending and the placement of non-resident notes were suspended and reserve requirements against foreign liabilities were further reduced.

Austria. The rapid growth rate recorded in recent years carried over well into the spring of 1974, after which activity slowed down in response to a flattening of private consumption and a drop in fixed investment. Early in the year exports accelerated sharply and thereafter stabilised at a high level. For a time the easing of demand pressures was welcomed, but by the end of the year industrial production and building activity had fallen substantially and receipts from tourism had proved disappointing. Full employment was maintained, though with the number of foreign workers somewhat reduced. However, the increase in prices, which had moderated by the autumn of 1973, speeded up by mid-1974 to a twelve-month growth rate of over 10 per cent., remaining at that level from then onwards.

Previous anti-inflationary policies were maintained with little change throughout 1974. Fiscal restraint, first introduced towards the end of 1972, was continued, with the 1974 budget being framed so as to avoid an additional stimulus. Moreover, in parallel with similar steps at the local-authority level, certain expenditure appropriations were temporarily blocked and tax revenues partly sterilised. The National Bank adhered to its restrictive course and prolonged in modified form the growth ceiling on bank lending and similar arrangements with other financial institutions.

With the external flank covered by the float of the schilling and controls on capital flows, minimum reserves and open-market operations were used for shaping the supply of liquidity according to domestic requirements. Thus, minimum reserves were reduced in the spring and open-market purchases extended in several stages. In addition, the banks' funds blocked under exchange control agreements were released in two tranches. The increase in the discount rate from 5½ to 6½ per cent. in May was designed to forestall an outflow of funds to foreign markets offering more attractive rates.

Bank credits to the domestic economy increased by 14.4 per cent., as against 10.9 per cent. in 1973. However, the banks' security purchases (including short-term government paper) declined from Sch. 10.4 milliard to Sch. 3.4 milliard, so that in each of the last two years the banks' total lending expanded by between 13 and 14 per cent. As a result of a shift to borrowing abroad — mainly by the government — net official foreign exchange acquisitions had a stronger expansionary effect than in 1973. However, since non-monetary bank liabilities rose much faster than before, the money supply broadly defined went up by only 6.5 per cent., compared with 5.4 per cent. in 1973. The bond market was characterised by considerable strain. The continuing shift by investors to other forms of savings — partly as a consequence of tax reliefs — made it necessary to adjust nominal rates from around 7 per cent. to 8½ per cent. at mid-year. It is noteworthy that this increase was also applied to bonds outstanding. Net issues declined by almost Sch. 0.6 milliard to Sch. 11.8 milliard in 1974.

Early in 1975 industrial capacity utilisation fell perceptibly, output dropped below the comparable levels of 1974 and unemployment began to rise. Household saving increased, the propensity to invest weakened further and exports began to drop off.

In the early spring, therefore, the government shifted its policy emphasis somewhat. In order to stimulate investment and foreign trade it was decided to inject Sch. 12.7 milliard into the economy, mainly by de-blocking government funds but also by implementing part of the anti-cyclical contingency budget. Moreover, export financing was made easier. On the other hand, apart from a reduction in the discount rate from 6½ to 6 per cent. in April, no new monetary measures were taken, as the margin available for credit-granting was considerable.

Denmark. In view of its heavy dependence on oil imports and its long-standing weakness on external current account, Denmark was faced with a severe adjustment problem last year. In consequence, the authorities had to tolerate substantial slack and maintain a fairly stringent monetary policy until late in the year.

Economic activity increased further in early 1974 but dropped off abruptly after the middle of the year, with unemployment rising quite sharply. The downturn in residential construction was particularly marked, with building starts running at about half the high rates recorded in the past two years. Increases in indirect taxes, higher oil prices and employment uncertainties contributed to a decline of about 3 per cent. in real private consumption. Business investment was maintained early in the year but fell back later on. Public-sector outlays rose only slightly in real terms as an increase in consumption expenditure was largely offset by a further fall in public investment due to an embargo on starting public building and civil engineering projects until the autumn. Slack domestic demand was thus a contributory factor in the good performance of manufactured exports, which recorded a rise of 10 per cent. in volume terms. By late 1974 the current account was much improved and in early 1975 price inflation eased off considerably from its earlier peak rate of nearly 17 per cent.

In the first half of 1974 Parliament approved various anti-inflationary measures, including cuts in government expenditure, a compulsory savings plan for income-tax payers, subsidies to industry designed to moderate the impact of cost-of-living wage adjustments on prices and, finally, increases in sales taxes on various consumer goods. In the late summer and autumn, however, a number of selective measures were taken to help stimulate activity in the building sector. Moreover, in September, largely for reasons of tax reform, Parliament voted a D.kr. 7 milliard reduction in personal income taxes, to become effective in January 1975. For the fiscal year ending March 1975 the government's cash budget is estimated to show a deficit of D.kr. 3.1 milliard, as against a surplus of D.kr. 3.8 milliard in the previous year.

Monetary policy was restrictive up to mid-1974, but market conditions eased somewhat thereafter. The ceiling on credit lines was left unchanged for the first seven months of 1974, but actual bank lending continued to increase. In late August recessionary tendencies combined with easing external pressures prompted an upward adjustment in the bank lending ceiling by 3 per cent., followed in November by another 2 per cent. increase. In the autumn the government began to remove various temporary restrictions on mortgage credit. Bank lending grew at a slower pace later in the year, largely owing to a fall in building loans, and the new credit limits were not quickly utilised. Bank liquidity improved as the government's cash position shifted from surplus to deficit, which entailed withdrawals of funds from the central bank. The drop in international interest rates, the better external situation and growing unemployment prompted reductions in the discount rate to 9 per cent. in mid-January and 8 per cent. in early April.

Total lending by the commercial and major savings banks rose during 1974 by 7.0 per cent., compared with an increase of 15.8 per cent. in 1973. The growth of the money supply broadly defined slowed to about 9 per cent., the smallest rise since 1971. Net capital imports increased, with business borrowing abroad amounting to about D.kr. 4.5 milliard. The 1975–76 budget as approved by Parliament provided for a cash deficit of around D.kr. 9.4 milliard. In early March, following the breakdown of national wage negotiations, Parliament approved a new stabilisation programme providing for a two-year extension of existing collective wage agreements. The programme also included a freeze on profit margins and dividends. At the end of April lending ceilings for the commercial and savings banks were further raised by 3 per cent. However, to offset part of the liquidity impact of the government's cash deficit, the banks' credit facilities at the Nationalbank were curtailed. In addition, the issue of up to D.kr. 6 milliard of medium-term government bonds is under consideration.

Norway. Thanks largely to a stimulative fiscal policy and activities related to the development of North Sea oil, economic expansion in Norway has continued, with real gross domestic product rising last year by around 3.6 per cent. A combination of tax relief, price subsidies and increased transfers helped to spur real disposable income and consumption, which grew faster than in 1973. Investment activity remained a robust demand component, though it expanded more slowly than in 1973. Exports showed continued strength early in the year but weakened, together with net receipts from shipping, with the onset of the international recession. With the labour market tight and registered unemployment below 1 per cent. of the work force, the rise in manufacturing wages accelerated to about 18 per cent. But for the use of selective subsidies, the rise in consumer prices would have been larger than the actual 9½ per cent.

To counteract the prospective effects of higher oil prices, fiscal policy was made more expansionary. In this respect policy action was less constrained than in most countries, as Norway will soon become a net oil exporter and has experienced no difficulty in attracting capital inflows. Including social security transactions, the government accounts showed a surplus of around 1 per cent. of gross domestic product, compared with about 3 per cent. in 1973. Although the budgetary stimulus emphasised food price subsidies, transfers and tax relief, there was also a 4 per cent. rise in real public consumption.

Credit policy had to adjust to a faster-than-expected rise in investment demand and price inflation, and lending guide-lines were revised upwards during the year. However, credit expansion was held below the growth of investment so as to encourage more self-financing. Total credit is estimated to have increased by around 15 per cent., with a leading rôle being played by capital imports, which rose by over one-half. Money and quasi-money rose by about 12 per cent., or slightly more than in the two previous years.

In March 1974 the discount rate was raised from 4½ to 5½ per cent., the first increase since 1970. At the same time, Treasury bill rates were increased from 3¾ to 5 per cent. and those on five-year government bonds from 5¼ to 6½ per cent. As commercial-bank lending during the spring and summer was unusually heavy, Norges Bank activated a supplementary reserve requirement scheme in September, under which any bank expanding its lending by over 3 per cent. between end-July and end-December would be required to deposit an amount equal to 50 per cent. of the excess with Norges Bank. Moreover, after intervention on the foreign exchange market in September and October had eased pressures on bank liquidity, primary reserve requirements for large commercial banks were raised from 6 to 8 per cent. Late in the year the growth of bank loans slowed. In contrast to that of commercial banks, the lending activity of savings banks was below guide-lines during the first part of the year. However, their reserve position deteriorated and primary reserve requirements were reduced from 5 to 4 per cent. in April and abolished altogether in June.

Following upon last year's reduced surplus, the 1975 budget, including social security transactions, provides for overall balance, with most of the change due to cuts in taxes. The credit budget for 1975 envisages faster domestic credit expansion coupled with a stabilisation of capital imports at the present high level. In order to facilitate realisation of the new credit targets, primary reserve requirements for commercial banks were lowered by 2 percentage points in mid-February and reserves were further eased on seasonal grounds in early April. A revised budget projection in May looked to a continuation of high consumption and strong investment demand, with real growth expected to be 6 per cent. or more in 1975. Overall economic policy is therefore to be kept moderately restrictive.

Sweden. Lagging behind developments elsewhere, real output growth in Sweden rose further last year, by 4.2 per cent., while unemployment fell from 2½ to 2 per cent. of the labour force. Fiscal measures helped to hold down the rise in consumer prices during the year to 10.5 per cent. and also to spur a large increase in real disposable income. Consequently, despite a further rise in the savings ratio, real consumption grew by 4.4 per cent., the fastest increase for some time. Moreover, after two years of inventory disinvestment, stocks were built up again at a rapid pace. Industrial investment continued to expand, while exports increased by 3.7 per cent. However, following the earlier long period of intensive activity, both residential construction and related local-authority investment dropped again last year.

In March 1974, in an effort to encourage expansion and moderate the wage/price spiral, the government adopted a fiscal package including higher transfer payments, food subsidies, a temporary reduction in value added taxes and special grants for energy-saving investments. The increased budget deficit was financed from monetary sources and government borrowing outside the banking system remained practically unchanged. Since the measures involved tax and transfer payments, real public consumption expanded only moderately, by 3 per cent.

Additional measures, partly structural, were introduced in the autumn. In October housing policy was changed, one aim being to make residential construction less sensitive to changes in interest rates. Other measures announced at that time, to take effect in January, included improvements in old-age pensions, the abolition of employees' sickness insurance contributions and a reduction in marginal tax rates for middle-income brackets. To finance these measures, social security contributions paid by employers and self-employed persons were raised. Also with a view to moderating wage demands, the government proposed that companies should place part of their net profits in 1974 in special non-interest-bearing accounts, to be earmarked for investment and improvements in working conditions.

With the external position weakening following the rise in oil prices, monetary policy was altered so as to stimulate capital imports. In early April the discount rate was raised from 5 to 6 per cent., the first change since 1971. Cash reserve requirements were increased from 1 to 5 per cent. and the banks were compelled to borrow more from the Riksbank, in some cases at penal rates. In addition, bank lending to the private sector, excluding housing, was made subject to growth limits in 1974 of 15 per cent. for commercial banks, 10 per cent. for savings banks and 13 per cent. for co-operative banks. Commercial-bank lending deriving from capital imports was exempted from the credit ceilings.

However, with business liquidity comfortably high and domestic interest rates still low relative to those abroad, these measures were insufficient to attract capital inflows. In mid-August, therefore, the discount rate was raised from 6 to 7 per cent. and restrictions on private borrowing abroad were further eased. In November the ceiling on commercial-bank lending was extended, the growth limit being set at 20 per cent. for the 18-month period ending on 30th June of this year. Although the lending guide-lines for savings banks and co-operative banks were not extended past the end of 1974, the banks were asked to show restraint and their recommended liquidity ratios were raised from 20 to 23 per cent. with effect from 30th June 1975.

Sweden: Net credit flows.

Lenders	Years	Borrowers: Govern-ment	Local authorities	Housing sector	Business sector	Total
		in millions of Swedish kronor				
Riksbank	1972	– 185	5	—	5	– 175
	1973	–1,535	5	—	20	–1,510
	1974	8,340	5	—	70	8,415
Commercial banks	1972	1,950	125	1,945	4,055	8,075
	1973	2,810	535	2,995	5,890	12,230
	1974	–2,880	260	2,750	5,935	6,065
Savings banks and co-operative banks	1972	1,830	675	2,685	1,330	6,520
	1973	145	– 125	1,765	2,400	4,185
	1974	385	– 110	2,440	3,270	5,985
Public insurance institutions	1972	1,935	765	2,675	2,795	8,170
	1973	1,870	685	3,595	3,130	9,280
	1974	1,525	645	3,595	3,050	8,815
Private insurance institutions	1972	460	290	1,400	1,090	3,240
	1973	830	145	1,700	1,370	4,045
	1974	1,175	50	2,170	2,045	5,440
Others	1972	350	40	20	745	1,155
	1973	2,030	90	– 255	130	1,995
	1974	2,175	90	185	1,085	3,535
Total	1972	6,340	1,900	8,725	10,020	26,985
	1973	6,150	1,335	9,800	12,940	30,225
	1974	10,720	940	11,140	15,455	38,255

Money and quasi-money grew by only 9.4 per cent. in 1974, the smallest rise for some years. The expansion of commercial-bank advances gradually slowed down, increasing over the year by 12.8 per cent., a rate well short of the permitted ceiling. Despite the restrictions placed on commercial-bank activity, the increase in total credit in all forms was appreciable, amounting to S.kr. 38 milliard compared with S.kr. 30 milliard in 1973. Most of the rise occurred in the first half and was ascribable to the central government's deficit and to business-sector borrowings. Although the level of interest rates was raised last year, private borrowing abroad showed little increase until the autumn.

The central government's 1975–76 budget presented in January envisaged a deficit of about S.kr. 12 milliard, or much the same as the estimated outcome for the current fiscal year. Recognising that the expansionary budget implied acceptance of a substantial external deficit, the government proposed that in 1975 it should borrow abroad for the first time. In mid-April the growth limit up to mid-year on commercial-bank loans for purposes other than housing was raised from 20 to 22 per cent. of the end-1973 level, the added margin being intended for loans to industry. At the same time, interest rates for new bond issues were increased by a full percentage point, with those on local-authority and industrial bonds going up to 9¼ per cent. This action was designed to facilitate S.kr. 2 milliard of long-term borrowing to finance industrial investment, preferably in export-related projects. Shortly afterwards, the government announced that over S.kr. 3 milliard of corporate funds blocked at the Riksbank on environmental protection and special investment accounts would be available for investment after mid-year. A new national wage agreement concluded at the end of April provided for basic wage increases in industry of about 25 per cent. spread over two years — somewhat more than this if social charges for enterprises and wage drift are included.

Finland. Economic growth was maintained over most of last year but a sharp increase in import prices aggravated inflation and contributed to a large current-account deficit. Real gross national product advanced by about 3.7 per cent., somewhat less than in 1973, with gross fixed investment expanding by 4.1 per cent. Residential construction eased late in the year and activity was not expected to recover quickly. In real terms export growth ceased as relatively strong gains in the metal-working and engineering industries were offset by a smaller export volume in the forestry industry. Despite a large increase in the labour force, the unemployment rate edged below 2 per cent. for the first time since 1966. Over the year consumer prices went up by 17 per cent., following a 10.7 per cent. rise in 1973.

Stabilisation efforts were characterised by a close co-ordination of fiscal and incomes policies. In March 1974 a central framework agreement on wage increases was concluded for the period up to the end of January 1976. Integral elements of the bargain included changes in direct tax rates, employers' social security contributions and food subsidies and price controls. In July the government and the forestry industry agreed to a temporary freezing of F.mk. 300 million (later reduced to approximately F.mk. 240 million) of the industry's export earnings. Price controls were relaxed to some extent in September, and this was followed in early October by temporary reductions in taxes on certain foods and fuel oil. The central government's budget surplus fell from F.mk. 1,200 million in 1973 to around F.mk. 900 million last year.

The overall thrust of the budget was somewhat less restrictive than in 1973. However, from the monetary standpoint, financial markets gradually tightened during the year. The commercial banks' borrowing quotas at the central bank were raised in February, May and June, but for most of the year their indebtedness exceeded their quotas. Deposit formation lagged behind bank credit expansion, which was stimulated by the investment boom, the limited availability of long-term foreign credit and the relatively low cost of domestic credit. Bank interest rates were held at their mid-1973 levels and the discount rate remained at 9¼ per cent., with penal rates for borrowing that exceeded the quotas. Bond interest rates rose from 9 per cent. to between 9¾ and 10¼ per cent. in the autumn. In November the central bank announced selective credit guide-lines emphasising priorities for industrial and related investment. The rise in commercial-bank lending slowed down to about 19 per cent. from almost 25 per cent. in 1973. The growth of money and quasi-money over the year rose to 17.6 per cent., as against 15.5 per cent. in 1973.

In early 1975 export demand fell off sharply and the current-account deficit widened. Against this background, some fairly extensive measures were taken in March. The emphasis was laid on selective demand restraint in which restrictive monetary and fiscal policies were combined with steps to foster a broadening of productive capacity. As a supplementary measure with immediate effect an import deposit scheme, covering some 50 per cent. of total imports, was introduced for one year. The deposits, which range from 5 to 30 per cent. of the import price, must be placed on non-interest-bearing account with the central bank for six months. The principal exempted categories are most raw materials and goods used directly in export production. At the same time, price controls were modified so as not to allow the cost of import deposits to be passed on to consumer prices and cuts in government expenditure were proposed. The policy of monetary restraint was maintained and the conditions governing personal loans were tightened. In March the central bank stated that credit to commercial banks exceeding their borrowing quota by 50 per cent. would in future be subject to negotiation.

Spain. Economic growth decelerated during 1974, particularly after mid-year, while price inflation continued at a high rate. The slow-down was especially pronounced in industrial fixed investment, housing, exports and tourism. The persistent weakening of demand, together with the return of workers from depressed economies elsewhere in Europe, caused the registered unemployment rate to increase appreciably. Despite the emerging slack and the continuation of price controls, the consumer price index rose over the year by almost 18 per cent., as against 14 per cent. in 1973.

While the higher oil prices sent the current account into deficit, Spain's comfortably high foreign exchange reserves, together with recourse to borrowing from abroad, precluded any immediate external constraint on expansionary policies. Thus, during the early months of 1974 the authorities took action designed to counteract the impact of higher oil prices on both demand and prices. A fiscal package included increased public expenditures, food subsidies, a lowering of government revenues from oil, postponement of planned increases in social security contributions and a temporary reduction of import tariffs. In October the government announced further stimulative measures involving increases in public and private investment.

Monetary restraint was continued in 1974, with some further tightening in the spring and summer when price inflation quickened. In early May the commercial banks' compulsory cash reserve coefficient was raised from 7½ to 8 per cent. At times security transactions and increases in rediscount lines were used to ease pressures but in the spring the tight liquidity situation contributed to a sharp temporary deceleration in the expansion of the monetary aggregates, so that at mid-year the compulsory cash coefficient was lowered from 8 to 7¾ per cent. In early August the discount rate was raised from 6 to 7 per cent. in order to bring it more into line with higher rates abroad. Over the year as a whole bank credit to the private sector went up by 26.7 per cent., compared with nearly 31 per cent. in 1973. The growth of money and quasi-money slowed down to 19 per cent., as against 24 per cent. in the previous year.

Although changes in most prices remained subject to varying degrees of government surveillance, rises in food prices and increased costs of imported fuel and raw materials gave a sharp twist to the inflationary spiral last year. The ceiling on wage increases introduced at the end of 1973 was abandoned in August but in November the government prolonged the price restraint programme. At the same time, tax concessions to help compensate for the effects of inflation were announced.

In early April 1975 the government adopted a more stringent incomes policy, under which profit margins and dividends were frozen, most wage increases were limited to the rise in the cost of living and industrial price increases were allowed only to offset rising costs of labour and raw materials. Other restrictive measures included a new 15 per cent. tax on interest from bank deposits and reforms designed to close certain income-tax loopholes.

Yugoslavia. Throughout most of last year domestic and external developments were under the influence of the expansionary policies adopted in the summer of 1973 when economic activity had begun to slow down. At that time final demand, particularly for investment, had started to weaken, industrial production and employment had levelled off and stocks of finished goods were sharply higher. Various steps were taken to stimulate both consumption and investment, and it was envisaged that imports would have to rise substantially for a time, even at the cost of a decline in the foreign exchange reserves. As a result of these policies industrial production picked up again, rising steadily during 1974 to register a growth of 10 per cent., while construction rose by 6 per cent. and imports expanded to show by the autumn a 20 per cent. increase over the year. By this time, exports, which had continuously slackened, stood 15 per cent. lower than in late 1973.

In nominal terms domestic demand advanced much faster than real output, so that price inflation accelerated considerably and a large balance-of-payments deficit opened up. However, since the National Bank was called upon to make large net sales of foreign exchange, whereas in 1973 it had made net purchases, the growth of the domestic monetary base last year was much smaller than in 1973. This contributed automatically to a slowing-down of demand expansion later in the year. In real terms investment rose sharply to reach a peak in the third quarter, when it was 32 per cent. above the corresponding period of 1973, but the twelve-month growth rate fell in the fourth quarter to about 10 per cent. Consumer demand rose throughout the summer but dropped back in the autumn to around its level of a year earlier. The monetary constraints on expenditure were supplemented in August by the introduction of curbs on imports. On the other hand, the growing pressure on bank liquidity was eased somewhat by the gradual lowering of reserve requirements and by other measures applied with the additional aim of promoting exports.

Bank credit is estimated to have risen over 1974 as a whole by 23 per cent., compared with 17 per cent. in 1973. Owing, however, to the swing round from external surplus to deficit, the increase in the money supply dropped off from 37 per cent. in 1973 to 26 per cent., with the cash holdings of the enterprise sector remaining virtually unchanged. Price increases during the year were again substantial, ranging from 19 per cent. for agricultural products to 36 per cent. for industrial products; the cost of living went up by approximately 22 per cent. and retail prices by 30 per cent. The rise in import prices was partly responsible, particularly from the autumn, when the effective dinar exchange rate was adjusted downwards by some 7 per cent. Last winter, when the broad lines of policy were laid down for 1975, emphasis was placed on the need for wide-ranging restraint, together with efforts to promote exports and curb imports. In the early months of 1975 a rise in unemployment caused increased attention to be given to labour-market policies and improvements in the social security system.

Hungary. Investment activity revived in 1974 following an easing of the restraints introduced in 1972. Total investment increased by 11 per cent. in value and by 9 per cent. in volume; investment financed by enterprises and co-operatives themselves grew slightly faster than that undertaken by the central authorities. These advances, together with increased wage incentives, helped to raise productivity in industry by 7.2 per cent. The largest output gains were achieved in certain branches of the engineering industry, while progress in the consumer goods industries — though speeding up — was comparatively slow. Housing construction exceeded the 1973 volume by 4.7 per cent. but it still remained below its 1972 peak. In the agricultural sector good results were reported for animal products, but some crops were affected by adverse weather. The growth in national income produced was thus rather smaller than in 1973. Average monthly wages rose by between 6.5 and 7.2 per cent. and total money income by around 11 per cent. Retail sales increased at a similar rate and thus more than in 1973. The rise in consumption and investment outpaced the growth of domestic supplies, and the trade balance shifted into deficit. With imports from industrial market economies rising by 54 per cent., the deficit vis-à-vis these countries widened in terms of transferable roubles from about 35 million in 1973 to 435 million in 1974. Net sales to Comecon countries dropped off sharply and the balance with developing countries shifted into deficit. Foreign currency requirements were covered partly by new borrowing on the Euro-credit markets and the issue of an international loan. The rise in import prices gave an additional push to the upward trend of domestic prices. However, with the help of government subsidies and other measures the rise in retail prices was kept down to about 2 per cent. for the year as a whole. The growth targets for 1975 have generally been set lower than the actual results achieved last year.

Czechoslovakia. In general terms the pace of economic activity last year was much the same as in 1973. In comparison with preceding years, however, developments were not altogether satisfactory, as growth rates in certain key sectors slowed down further and expectations of improvements in overall trends were not fulfilled. Since additional labour resources were very scarce, expansion was largely dependent on productivity gains. These, however, have edged downwards, falling in industry and construction from 6.4 per cent. in 1971 to 5.4 per cent. last year. In addition, the energy supply situation continued to act as a constraint on output. Some progress was made, however, towards a more efficient use of raw materials, with a slight reduction in unit production costs. Although agricultural results were disappointing, national income grew by nearly as much as in 1973. The increase in total money income fell behind 1973 results, but retail sales, particularly of consumer durables, advanced more strongly. Investment expanded by 8.7 per cent., more than in 1973 but short of the plan target of 9.6 per cent. The value of imports increased by rather more than that of exports, with the result that the overall trade balance moved further into deficit. Largely reflecting inflation abroad, net imports from

**Eastern European economies:
Sectoral output and national income produced.**

Countries	Years	Gross output: Industry	Gross output: Agriculture	Gross output: Construction	National income produced[1]
		annual average or annual volume changes, in percentages			
Bulgaria	1966–72	10.4	4.5	9.7	8.4
	1973	9.3	0.7	6.7	8.0
	1974	8.5	0.0[2]	10.0	7.5
Czechoslovakia	1966–72	6.7[3]	3.5	8.4	6.5
	1973	6.3	4.7	6.5	5.3
	1974	6.2	3.0	7.0	5.2
German Democratic Republic	1966–72	6.3	2.9	7.1	5.2
	1973	6.8	1.0	6.1	5.5
	1974	7.4	8.3	6.2	6.3
Hungary	1966–72	6.1	3.7	9.0	6.5
	1973	7.0	6.7	3.1	7.3
	1974	8.2	3.7	5.0	7.0
Poland	1966–72	8.7	3.8	8.4	6.9
	1973	11.3	7.3	20.5	11.6
	1974	12.2	2.0[2]	18.2	10.0[2]
Rumania	1966–72	11.8	7.0	10.5	8.8
	1973	14.7	0.2	7.3	10.8
	1974	15.0	0.0	6.6	12.5
USSR	1966–72	8.1	2.4	7.5	6.9
	1973	7.4	16.1	2.3	9.0
	1974	8.0	− 3.7	6.0	5.0

[1] Net material product. [2] Estimate. [3] 1971–72 only.
Source: UN Economic Commission for Europe, *Economic Survey of Europe in 1974.*

industrialised market economies increased substantially, while a high growth rate for imports from other Comecon countries shifted Czechoslovakia's intra-area balance into deficit. Vis-à-vis developing countries, however, there was a swing into surplus. Targets for 1975 have been set relatively high in order to make good the shortfalls recorded hitherto under the five-year plan. As the outcome will depend on improvements in productivity, priority is to be given not only to increasing exports but also to accelerating the completion of investment projects and the rationalisation of management methods.

German Democratic Republic. Following a slight moderation in 1973, the growth of national income amounted last year to 6.3 per cent., the best result for several years. The major factor was a speeding-up of industrial production to 7.4 per cent., thanks mainly to an advance in labour productivity. Productive resources were kept under considerable pressure and overtime working was extensive. Bottlenecks in transportation and the scarcity of spare parts in industry caused some interruptions in the flow of production. In the building sector, where priority was given to dwelling construction, output growth was maintained at the rate recorded in 1973. The generally favourable developments — also in agriculture — were largely ascribable to the fairly high rate of investment in recent years, i.e. about 29 per cent. of national output. However, after a large increase of 8.5 per cent. in 1973, investment growth slowed down, particularly in industry, to an overall rate of 4 per cent. in 1974. On the basis of retail sales figures, personal consumption appears to have risen by just over 6 per cent., or at much the same rate as in 1973, although the expansion in total money income slowed down from 5.6 to 4.8 per cent. Thus, saving grew more slowly, perhaps partly because of the improved supply of consumer goods. Imports grew again more than exports (23 and 16 per cent. respectively) and the trade deficit almost trebled. The trade balance with western industrial and Comecon countries deteriorated, whereas the deficit vis-à-vis developing countries was sharply reduced. Borrowing on Euro-markets appears to have increased considerably. The 1975 plan provides for a relatively strong increase in foreign trade, a rise in investment in line with previous years and a slightly slower growth in consumption.

Poland. The emphasis placed in recent years on a more effective utilisation of resources appears to have borne good results. Last year industrial output recorded a strong increase of 12.2 per cent., of which more than four-fifths was due to productivity gains, whereas in previous years the growth of output had depended more on recruitment of workers — then in abundant supply. A principal factor had been the growth of investment by some 25 per cent. over each of the past three years, but organisational improvements and higher wage incentives also played a part. Rapid progress was made in the construction sector, where total output rose by 18.2 per cent. and the number of new dwellings increased by 14.8 per cent. Although agricultural results were affected by bad weather, national income grew by 10 per cent. in 1974, or nearly as much as in 1973. A rise in nominal wages by 13 per cent. kept demand strong. In spite of higher subsidies consumer prices rose by about 5.6 per cent. after several years of stability. Thus, the increase in real wages came to roughly 8 per cent., as against 11 per cent. in 1973, and private consumption went up correspondingly. Partly in response to selective stimuli, exports surged ahead by almost 30 per cent. against 18 per cent. in 1973, while import growth remained constant at 33 per cent. Although the actual deficit widened substantially, developments were broadly in line with the aim of speeding up exports rather than cutting back imports. Trade positions with other Comecon and developing countries strengthened, but the deficit vis-à-vis market economies almost doubled. Euro-currency credits were again taken up in fairly large amounts. The plan for 1975 envisages an overall growth of about the same size as in 1974.

Rumania. Continuing its high growth rate of recent years, Rumania recorded a 12.5 per cent. increase in national income in 1974 despite a stagnation of agricultural production. Farm output suffered as a result of bad weather, but also because of continued losses of labour to industry, where employment rose by more than 7 per cent. This increase, combined with a productivity gain of about the same size, led to a 15 per cent. growth in industrial production, much the largest advance in eastern Europe. Nevertheless, actual results fell below plan targets in some sectors because of shortages of raw materials, delays in deliveries and the under-utilisation of capacity. The formation of fixed capital rose last year by about 18 per cent. — compared with an average rate of almost 10 per cent. in the preceding three years — and the share of investment in net material product was more than 38 per cent. Wages went up by 6.3 per cent. in nominal terms and by 4.4 per cent. in real terms. The supply of consumer goods improved, while prices rose by nearly 2 per cent., partly in reflection of rising import costs. Stringent measures to save energy and raw materials had been introduced late in 1973, but last year Rumania's trade deficit with non-Comecon countries deteriorated from $50 million to an estimated $250 million. In intra-Comecon trade, on the other hand, the surplus seems to have increased sharply to over $0.4 milliard. With targets for 1975 again set at high levels, emphasis is to be placed mainly on modernisation and labour productivity.

Bulgaria. Although economic growth slowed down only modestly last year, the results achieved were substantially below the plan targets. Poor agricultural yields due to a very dry spring and summer were partly to blame, but in addition investment resources have become more scarce and labour is no longer abundantly available. Greater policy emphasis was therefore laid on "intensive" growth and on promoting labour productivity, particularly in industry and construction. However, improvements in productivity slowed down for the second year in succession and the gain of 6 per cent. in industry was below expectations. A 10 per cent. decrease in fixed capital investment — which had increased by around 9 per cent. in 1972 and 1973 — played an important rôle in this context. Hence, efforts have been redoubled to modernise technology and to develop trade, partly by means of co-operation agreements with industrialised countries outside Comecon. With nominal wages rising more slowly, real income per head went up by 5 per cent., as against 7.4 and 7 per cent. in the preceding two years. The five-day working week will be introduced gradually in this and next year provided that production norms are met. It is hoped that this move will improve labour efficiency and reduce overhead expenditure. Imports increased faster than exports — 31 per cent. and 16.3 per cent. respectively — and the trade balance shifted into deficit for the first time in some years. The deficit stemmed mainly from trade with non-Comecon countries and was partly covered by Euro-currency credits. The overall plan target for 1975 is very similar to that for 1974 and priority will again be given to promoting productivity.

Soviet Union. At 5 per cent., the growth in the national income last year fell considerably short of the 9 per cent. achieved in 1973 and was also somewhat below the rate of 6.5 per cent. envisaged in the 1974 plan. Agricultural output fell back after the record grain harvests of the preceding year. This was largely a consequence of bad weather, as both mechanisation and acreage under cultivation had increased. House-building increased by less than 1 per cent. On the other hand, the production of basic materials and investment goods advanced by 8.3 per cent., or about the same as in 1973. The output of consumer goods, which was given greater priority last year, rose by 7.2 per cent. as against 5.9 per cent. the year before. The output of passenger cars recorded a noteworthy increase of 22 per cent. There were some production difficulties associated principally with delays in the completion of investment projects and a scarcity of certain raw materials. However, productivity in industry rose by 6.5 per cent., or slightly more than in 1973, and real per capita income went up by 4.2 per cent. With prices stable and goods more readily available, retail sales advanced by 5.9 per cent., compared with 5.3 per cent. in 1973. Fixed investment increased by 7 per cent., which compares favourably with the rate achieved in the previous year. Special efforts were made to expand capacity in the energy sector, in the chemical industries and in transportation facilities. The increase in domestic demand, particularly for investment, led to a faster growth in nominal imports, but export values accelerated even more. The overall trade surplus rose from R. 260 million to about R. 1.9 milliard. Deficits vis-à-vis both Comecon and western industrialised countries in 1973 were replaced by substantial surpluses, but net exports to developing countries declined somewhat. A publicly-announced Euro-currency credit of $100 million was raised in the fourth quarter of 1974.

The plan for 1975 aims at a consolidation of overall growth. This will depend largely on improvements in labour productivity and overall efficiency, particularly by means of a speeding-up of investment completions and a careful screening of new projects. Increases in income are to be kept within bounds, but a new "efficiency index" is to provide for a linkage of incentive payments to cost-saving.

South Africa. After a rather slow recovery in 1973, the economy moved into a phase of strong expansion last year as exports, productive investment and stock-building advanced. Agricultural and non-gold mining production both increased well, so that the real gross domestic product expanded by 7.2 per cent., compared with 4.3 per cent. in 1973. Towards the end of the year, however, industrial output and construction activity levelled off. In December consumer prices stood 14.1 per cent. higher than a year earlier but a deceleration was beginning to appear.

Early in the year the volume of imports rose steeply relative to exports, but, with the prices of commodity and gold exports going up more than those of imports, the current-account deficit of R. 836 million was proportionately much smaller than in previous upswings. It was almost covered by net inflows of R. 741 million on capital account, which occurred mostly late in the year in response to tighter monetary conditions and measures to facilitate borrowing abroad. From June 1974 onwards the authorities periodically adjusted the dollar exchange rate of the rand, and by March 1975 the rand had undergone a trade-weighted depreciation of about 3 per cent.

The government's budget proposals for the year ending March 1975 provided for cuts in direct and indirect taxes and increases in food subsidies designed both to moderate inflation and to stimulate output and productivity. However, following an exceptionally rapid rise in banks' deposit liabilities, the monetary authorities refrained in early 1974 from offsetting the restrictive effect that reserve requirements and the external deficit were having on free bank liquidity. Following sharp rises in money-market interest rates, Bank rate was increased from 6½ to 8 per cent. in June and August. Interest rates for the Reserve Bank's transactions in government securities, interest rate ceilings on bank deposits and the banks' prime rates were also increased during the summer. In August bank deposits of over R. 250,000 were freed of interest rate controls.

With its expenditure rising rapidly, the government's budgetary position deteriorated late in the year and for 1974 as a whole its net borrowing requirement came to R. 574 million, compared with R. 246 million in 1973. A part of this was covered by borrowing abroad, but the remainder was financed largely via the banking system. Reflecting also inflows of private capital, bank liquidity eased from September onwards and money-market interest rates came down.

The growth in bank credit to the private sector began to slow down after mid-year, so that the increase over 1974 came to nearly 19 per cent., following a rise of 36 per cent. in 1973. Money and quasi-money expanded by 22 per cent., compared with 23 per cent. in the previous year. On the security market, where yields continued to rise, total net bond issues fell from R. 960 million in 1973 to R. 650 million in 1974 as a result of a sharp cut-back in government and other public-sector issues. Share issues declined sharply but companies' recourse to fixed-interest issues, at R. 117 million, slightly exceeded the 1973 figure.

In early 1975, with demand pressures easier, the authorities took the view that continued restraint could contribute little to reducing inflation. While refraining from action to offset increases in bank liquidity, the Reserve Bank adopted a more flexible procedure involving variable market-related rates for its transactions in government securities. The 1975–76 budget is mildly stimulatory, providing for an 18.5 per cent. increase in expenditure and for increases in investment allowances and concessions in respect of tax on undistributed profits.

Australia. A sharp economic upswing, led by higher export earnings but increasingly based on a generalised upsurge of domestic demand, had by early 1974 brought resources under severe strain. Reflecting also the revaluations of the Australian dollar and anti-inflationary tariff cuts, imports were rising rapidly and the balance of payments had swung into deficit. With wages soaring in a climate of widespread industrial unrest, the increase in consumer prices, though largely insulated from rises in world oil prices, reached an annual rate of around 16 per cent. by mid-year.

Monetary policy was conducted in early 1974 so as to support the severe tightening in bank liquidity caused by the external deficit and seasonally large tax collections, sharply boosted by inflation. Reserve Bank purchases of securities and a lowering of banks' reserve requirements from 9 to 5 per cent. between June and August were designed to meet essential liquidity needs only, and interest rates continued to rise. In July interest rate ceilings on deposits and controlled overdraft rates were increased by 2 percentage points. Indicative of the severity of monetary restraint, the narrow money supply fell by 4 per cent. in the twelve months ending September, while the broad money supply rose by only 6½ per cent.

The economy weakened rapidly after mid-year. Exports continued to advance well but, with private consumption, housing and productive investment falling, adjusted industrial production declined by 5 per cent. between the second and fourth quarters and by December the adjusted unemployment ratio stood at 4.1 per cent., compared with 1.5 per cent. in June.

Beginning a dramatic reversal of its previous policies, the government devalued the Australian dollar in September by 12 per cent. and abandoned its fixed link to the US dollar in favour of a trade-weighted target rate. Moderately stimulatory budget proposals, presented in the same month, were followed by a series of increasingly expansionary measures including reductions in personal and corporate income taxes in November, a temporary doubling of depreciation allowances in December, a temporary cut in the sales tax on cars in January and a substantial increase in grants to State governments in February. Reflecting also an acceleration in other spending, the budget for the year ending June 1975 was by then expected to record a deficit of some A$ 2½ milliard, compared with one of A$ 290 million in the previous year.

With regard to monetary policy, the commercial banks' reserve requirement was lowered further to 3 per cent. in stages in September and October, and the banks were offered a special temporary credit facility at the central bank. In November savings banks' compulsory investment coefficients were changed so as to increase housing credit and in December, to assist corporate liquidity, a scheduled payment of company tax under a recently introduced scheme was postponed. In November the ban on short-term borrowing abroad by residents was liberalised and the blocked deposit requirement against longer-term borrowings, already lowered from 33⅓ to 5 per cent. in two stages in June and August, was removed. Other steps, underscoring the high priority now being given to reducing unemployment, included the suspension of immigration in October, the introduction of import quotas for cars and the reversal of policies tending to discourage foreign investment in Australia.

Imports declined late in the year, but for 1974 as a whole the external current account recorded a deficit of A$ 1,790 million, following a surplus of A$ 400 million in 1973. With a resumption of net capital inflows in the final quarter, there was a surplus of A$ 460 million on capital account in 1974, compared with a deficit of A$ 630 million in the preceding year.

By the turn of 1975 bank credit and money were again expanding rapidly and more recently private domestic demand has shown signs of recovery. The prospects for consumer prices and wage earnings, which had risen by 16.2 and 27.7 per cent. respectively in the course of 1974, seemed less assuring. In April the national wage-fixing tribunal undertook on a provisional basis to adjust wages in line with the rise in consumer prices.

New Zealand. Following two years of rapid economic growth, a fall in export incomes led to a general cooling-down in the economy last year. Rising real wages helped to sustain domestic demand and output until late in the year. As a consequence also of the earlier revaluation of the New Zealand dollar and a fairly liberal increase in import licences, payments for imports rose by 53 per cent. in 1974, causing a drain on liquidity which was only partly offset by monetary measures.

The external current account on a cash basis recorded a deficit of NZ$ 815 million last year, following a surplus of NZ$ 150 million in 1973. On capital account there was a surplus of NZ$ 425 million, following a deficit of NZ$ 20 million in the preceding year. Private capital inflows were fostered by new exchange measures and by the tight domestic credit conditions prevailing after mid-year. Moreover, the government approached capital markets abroad, taking up NZ$295 million in total between August 1974 and February 1975, and also drew NZ$101 million from the IMF oil facilities around the turn of the year. In September, following the devaluation of the Australian dollar, the New Zealand dollar was devalued by 9 per cent.

The government's budget for the year ending March 1975 provided for a 19 per cent. increase in spending but steps to slow down the rise were announced in August, together with a tightening of hire-purchase regulations for motor vehicles and increases in sales tax on cars with high petrol consumption. In October the government announced a compulsory personal saving requirement, designed to freeze NZ$50 million early in 1975 for release later in the year and tightened personal income tax in certain respects. On the other hand, beginning in August steps were taken to relieve severe liquidity pressures in the economy, the savings banks' government-stock investment requirements were lowered progressively so as to make more funds available for housing, and as from October the Reserve Bank made special deposits with the trading banks to enable them to meet urgent liquidity needs of their clients. Special credit facilities were provided for exporters and farmers and for financing price stabilisation schemes for farm products, while firms with liquidity difficulties were permitted to defer tax payments. Building controls were eased and in early 1975 new incentives for land development were provided.

Comprehensive controls over prices and profit margins and a freeze on wages were maintained. In June the government announced a general 9 per cent. increase in wages and authorised an additional 2¼ per cent. for negotiated increases. In place of a scheduled cost-of-living adjustment, a general increase of 4 per cent. on the first NZ$75 of gross weekly earnings was authorised for January 1975. During the year nominal wage rates increased by 14½ per cent. and consumer prices went up by 12.6 per cent.

Commercial-bank lending slowed down towards the end of the year but increased by 29 per cent. in 1974 as a whole, following a rise of 55 per cent. in 1973. In a context of large external deficit, money and quasi-money rose by only 6 per cent., following a rise of 34 per cent. in the previous year. With economic activity slowing down further, unemployment began to rise steeply in early 1975. The balance-of-payments deficit remained very large but imports were slowing down. The government's 1975–76 budget, presented in May, provided for cuts in income tax and envisaged a substantial increase in the deficit.

III. INTERNATIONAL TRADE AND PAYMENTS.

World trade.

In parallel with the slow-down in the growth of real world output from about 6.5 per cent. in 1973 to practically nil in 1974, the expansion in the volume of international trade dropped off from 13 to 4½ per cent. However, the average unit value of internationally-traded goods in dollar terms surged ahead, rising by 39 per cent., against 22 per cent. in 1973. Thus, world trade turnover (based on customs data) grew by \$235 milliard to \$755 milliard, doubling in two years.

The developed countries accounted for \$135 milliard of the expansion in the value of world exports, the biggest gains being recorded by the United States (\$27 milliard), Germany (\$20 milliard) and Japan (\$19 milliard). France, Italy, Canada and the United Kingdom also showed significant increases, ranging from \$11 to 8 milliard. Exports from developing areas went up by some \$100 milliard. Over four-fifths

International trade.[1]

Areas	Exports (f.o.b.)		Imports (c.i.f.)		Rates of increase in exports		Rates of increase in imports	
	1973	1974	1973	1974	1973	1974	1973	1974
	in milliards of US dollars				in percentages			
Developed areas								
Western Europe:								
EEC[2]	211	274	215	291	37	30	40	35
Other countries	47	62	62	88	39	32	39	42
Total	258	336	277	379	37	30	40	37
United States	71	98	74	108	43	38	25	46
Canada	26	34	25	34	24	31	24	36
Japan	37	56	38	62	29	51	63	63
Other countries[3]	17	20	19	29	43	18	49	53
Total developed areas	409	544	433	612	37	33	38	41
(Volume index 1972 = 100)	*(114)*	*(122)*	*(113)*	*(113)*	*(14)*	*(7)*	*(13)*	*(0)*
Developing areas								
OPEC[4]	37	122	20	33	50	230	42	65
Other areas	72	88	76	114	41	22	33	50
Total developing areas	109	210	96	147	44	93	34	53
(Volume index 1972 = 100)	*(111)*	*(111)*	*(111)*	*(135)*	*(11)*	*(0)*	*(11)*	*(22)*
Grand total	518	754	529	759	38	46	37	43
(Volume index 1972 = 100)	*(113)*	*(119)*	*(112)*	*(116)*	*(13)*	*(5)*	*(13)*	*(4)*

[1] Represents roughly 90 per cent. of world trade, as the exports and imports of centrally-planned economies are included only to the extent that they are reflected in trade with the rest of the world. [2] Nine countries. [3] Australia, Israel, New Zealand, South Africa. [4] Algeria, Ecuador, Gabon, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, United Arab Emirates, Venezuela.

of this rise was accounted for by oil exports, which declined slightly in volume but increased nearly fourfold in unit value. The remainder ($16 milliard) largely reflected the 25 per cent. rise in primary commodity prices between 1973 and 1974.

Since the spring of 1974, when commodity prices reached their peak, the terms of trade have moved in favour of manufactured products. From 1970 to the third quarter of 1972 internationally-traded manufactured and primary products showed price gains of around 15 and 20 per cent. respectively. Then, in the one and a half years to end-March 1974 the prices of basic commodities rose by 120 per cent., while those of manufactured products recorded an increase of 28 per cent. However, in the year ending March 1975 the prices of primary products showed little change, while those of manufactured goods went up by nearly 30 per cent. Non-oil developing countries face a difficult situation because of the higher cost of oil and the rising prices of industrial products on the one hand, and the decline in the price of their basic products on the other. Indeed, with an increase of almost $40 milliard in imports to a total of about $115 milliard in 1974, their trade deficit showed a roughly fivefold increase between 1973 and 1974.

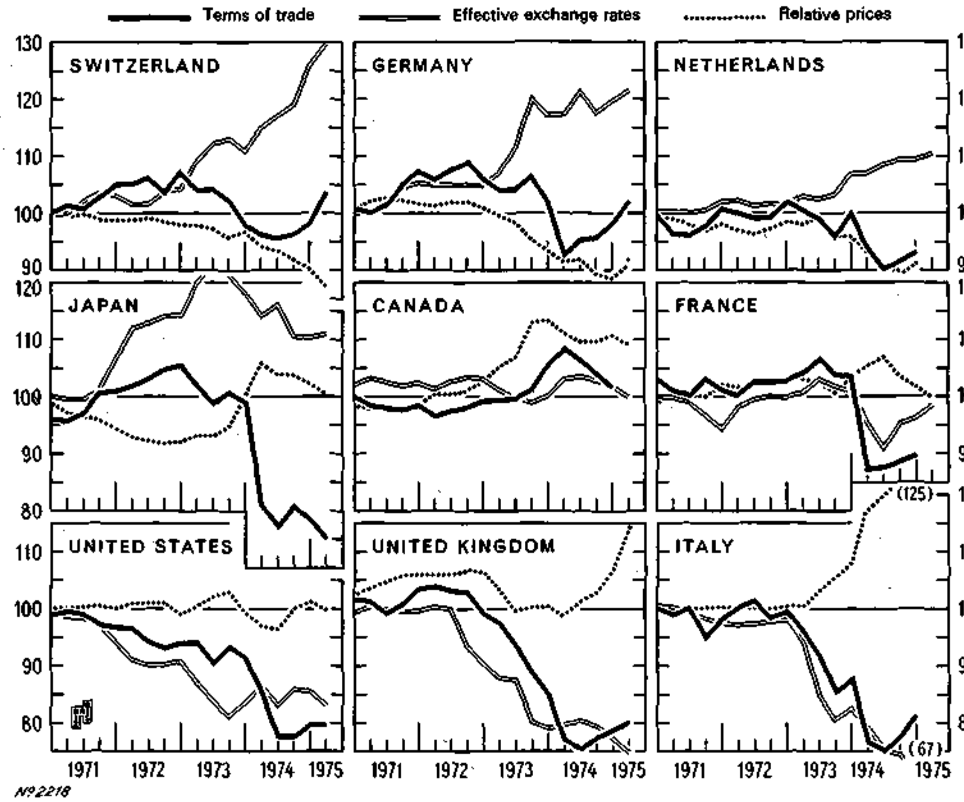
Imports of the OPEC countries increased by two-thirds to a total of $33 milliard last year, but their trade surplus nevertheless shot up to nearly $90 milliard.

Imports of the developed countries went up by $180 milliard, or over 40 per cent., the most substantial rises being recorded by the United States ($34 milliard), Japan ($24 milliard), the United Kingdom and France ($15 milliard each). The aggregate trade deficit of the developed countries increased by $44 to 68 milliard, the most adverse change occurring in the United Kingdom, where the deficit nearly doubled to $16 milliard. The main exception was Germany, whose surplus rose by $7 milliard.

The worsening in the trade position of the developed countries was attributable to the adverse shift in their terms of trade. In volume terms, their exports rose by 7 per cent., half as much as in 1973, while their imports were level after a rise of 13 per cent. a year earlier. There were largely counterbalancing changes in the developing areas; their imports expanded in volume by 22 per cent., twice as much as in 1973, while there was no change in the volume of their exports, which had risen by 11 per cent. in 1973.

In the case of the major industrialised net oil-importing countries, the extent to which trade volumes adjusted in 1974 is striking: total imports showed a marginal decline as a result of domestic recession, while exports recorded a gain of 9 per cent. However, as the following graph shows, by the first quarter of 1975 the terms of trade were also contributing significantly to the readjustment of trade accounts: with the exception of Japan, where early in 1975 export prices were declining more than import prices, all of these countries (including those whose currency depreciated) experienced a modest reversal of the previous adverse movement in terms of trade in the course of 1974 and some clear improvement in early 1975. On the other hand, Canada — which had earlier benefited as an exporter of primary products and a net exporter of oil — recorded a deterioration in its terms of trade as from mid-1974.

Terms of trade, effective exchange rates and relative prices.*
Quarterly indexes: 1970 = 100.



* Wholesale price index (in domestic currency) of each country divided by the weighted average of wholesale price indexes (in domestic currencies) of other Group of Ten countries and Switzerland.

Up to the beginning of 1973 changes in effective exchange rates of industrial countries were generally accompanied by parallel movements in their overall terms of trade and were instrumental, over the period 1970–73, in bringing about broad realignments of competitive positions. This tendency was upset first by the boom in commodity prices and subsequently by the oil-price rise. However, during 1974 effective exchange rate changes were not always associated even with parallel movements in the terms of trade of manufactured goods and thus did not necessarily result in short-run adjustments in competitive positions. In fact, inverse movements in relative rates of domestic inflation sometimes offset or more than offset exchange rate variations. This can be seen in the relationship in 1974 between changes in effective exchange rates and in relative wholesale prices expressed in national currencies. In Italy, for instance, relative wholesale prices showed a rise of 16 per cent. between the last quarter of 1973 and the corresponding quarter of 1974, and the effective exchange rate depreciated by an equivalent amount over the same period. In the United Kingdom the rise in relative prices came to 6 per cent., while the effective exchange rate declined by 2 per cent. In the other direction, both in the Netherlands and Germany relative prices showed declines of about 5 per cent., while the effective appreciation amounted to 2 per cent. In the United

Volume of exports and imports, relative export unit values of manufactured products (in US dollar terms) and domestic demand.

Countries	Volume of exports			Relative export unit values of manufactures[1]			Volume of imports			Real domestic demand		
	1973	1974 Year	1974 2nd half	1972	1973	1974	1973	1974 Year	1974 2nd half	1973	1974 Year	1974 2nd half[2]
	percentage changes from previous year											
Belgium-Luxembourg	14	½	− 3	4½	1	− 1	16½	2½	− 1½	7	4½	2
Canada . . .	8½	− 1½	0	− 6	−11	2½	15	12	11	8½	7	5
France	10½	10	6½	0	5½	− 4½	12½	4	0	6½	3½	3
Germany . .	15½	12½	8	1½	7	− 5	6	− 1½	1	3½	− 2½	− 2
Italy	4	8½	1½	1	− 3½	− 3½	13½	− 1	− 7	7½	1½	− 1
Japan	5	17	22	4	3	7	28	− 2½	− 8½	12	− 3	− 3½
Netherlands .	12	7½	6	½	4½	14½	12½	− ½	− 2	4	0	− 2
Sweden	16	4	5	4½	½	− ½	7½	10	13	1	4	3
Switzerland .	20½	4½	0	4½	8	− 3½	6	− 1½	− 5	3	− 1½	− 4
United Kingdom . .	13½	5	4½	− 1	− 7½	½	14½	½	− 1½	6	− 1	− ½
United States.	24	8½	4½	− 7½	− 9	1	5	− 1½	½	5	− 2½	− 3½
Total	14	9	6	(9)[3]	(18)[3]	(20)[3]	12	1	− ½	6	− 1	− 2

[1] Index of export unit values (in terms of US dollars) of each country divided by weighted average of export unit value indexes (in US dollars) of other Group of Ten countries and Switzerland. [2] Data partially estimated. [3] Actual change in the weighted index for all Group of Ten countries and Switzerland.

States, on the other hand, relative prices went up by nearly 2 per cent., and there was a corresponding effective appreciation.

Broadly similar conclusions may be drawn from a comparison of changes in relative export prices of manufactured goods — which accounted last year for three-quarters of total exports from Group of Ten countries and Switzerland. These price relationships, in spite of their shortcomings, provide a useful direct measure of changes in competitive positions. As shown in the table, the country which recorded the biggest year-on-year competitive improvement (5 per cent.) was Germany, in spite of the appreciation of the currency, while the United Kingdom's competitiveness weakened slightly, notwithstanding the trade-weighted depreciation. Italy and Switzerland both showed some improvement, although for the former this was associated with an effective year-on-year depreciation of 13 per cent. while the latter registered an appreciation of 7 per cent. The competitive position of the Netherlands, on the other hand, deteriorated markedly, a relatively large increase in its export prices for manufactured goods having been magnified by the appreciation of its currency.

Developments in 1974 again suggested that in the short run cyclical factors have greater effects on the volume of trade flows than changes in relative prices. But last year, with world demand weakening and credit generally tight, payment terms probably played an important rôle, whereas in the recent past, with generalised capacity limitations, it was chiefly the sheer availability of goods that mattered. The two biggest gains in export volume last year were recorded by Japan and Germany (17 and 12½ per cent. respectively), and may be explained largely as the result of export drives by domestic firms (including the granting of substantial credit facilities) in the face of declines of about 3 per cent. in domestic demand in both countries and the consequent build-up of excess capacity. In fact, Japan's competitive position, as measured by relative export prices in manufacturing, registered, on average, a further deterioration last year; Germany, on the other hand, showed an improvement in 1974, but this came on the heels of substantial previous losses. The United States increased its market share as a result of earlier competitive gains as well as of a 2½ per cent. fall in domestic demand, after a 5 per cent. growth in 1973. The only decline in export volume (1½ per cent.) was registered by Canada. It occurred in spite of previous improvements in competitiveness as measured by relative export unit values in manufacturing; the explanation probably lies both in the expansion of domestic demand, which went up last year by 7 per cent., and in labour disputes which affected exports and imports. The smallest increase in export volume (½ per cent.) was recorded by the Belgium-Luxembourg Economic Union, where the rise in domestic demand came to 4½ per cent. France, on the other hand, managed to achieve a well-above-average increase in export volume despite a 3½ per cent. expansion in domestic demand.

On the import side, there was a general tendency for volume changes to follow movements in real demand. There were, however, some exceptions. In the United Kingdom, for example, domestic demand fell but imports rose marginally, while in Italy imports showed a small decline despite the expansion of domestic demand.

The development of invisible transactions.

There were significant changes in the development of all major categories of invisible transactions in 1974.

Transportation was of course directly affected by the increase in costs resulting from the oil-price rise, although shipping freight rates responded to this general impact in different ways, depending on the particular supply/demand situation. Thus, both ocean time-charter and trip freight rates for dry cargoes showed sizable year-on-year increases in 1974. But the levelling-off and then the actual decline in world oil exports led to a marked fall in tanker rates (those on large tonnage ships nearly halved between December 1973 and December 1974) so that at times increased operating costs could not be fully recouped on freight and charter earnings. The way in which countries were affected by these divergent movements in rates depended therefore on the structure of their commercial fleets. The substantial shifts in trade flows were obviously another factor influencing transportation balances. These seem to have been a major element in the near-halving — to $0.6 milliard — of Germany's traditionally large deficit on transport, since German ship-owners are more involved in export than import traffic. In the Netherlands, on the other hand, the $0.5 milliard rise in the net surplus seems to have stemmed mainly from the increase in net earnings from bunker transactions. The largest adverse changes

Balances of invisible transactions.

Countries	Years	Transportation[1]	Travel	Investment income: Private	Investment income: Public	Private remittances[2]	Other private transactions	Government transactions[3]	Total
		in millions of US dollars							
Austria	1972	− 30	+1,130	− 80		+ 40	− 90	+ 20	+ 990
	1973	− 40	+1,380	− 130		+ 60	− 140	+ 30	+ 1,160
	1974	− 60	+1,190	− 100		+ 60	− 130	+ 20	+ 980
Belgium-Luxembourg	1972	+ 100	− 280	+ 170		+ 300	+ 10	− 190	+ 110
	1973	+ 60	− 430	+ 190		+ 420	+ 90	− 420	− 90
	1974	+ 70	− 460	+ 310		+ 340	+ 10	− 370	− 100
Canada	1972	− 130	− 240	−1,080		+ 230	− 840	− 260	− 2,320
	1973	− 170	− 300	−1,340		+ 290	− 820	− 320	− 2,660
	1974	− 180	− 310	−1,530		+ 520	−1,030	− 430	− 2,960
France	1972	− 270	+ 350	+ 190		−1,170	+ 720	− 830	− 1,010
	1973	− 390	+ 300	+ 400		−1,700	+ 580	− 640	− 1,450
	1974	− 930	+ 270	+ 380		−1,600	+ 800	−1,020	− 2,100
Germany	1972	− 850	−2,700	− 840	+1,170	−3,110	−1,200	+ 30	− 7,500
	1973	−1,140	−4,330	−1,280	+1,870	−4,100	−1,630	− 110	−10,720
	1974	− 580	−4,780	−2,130	+2,150	−4,250	−2,340	− 520	−12,450
Greece	1972	+ 80	+ 300	− 60		+ 570	+ 40	0	+ 930
	1973	0	+ 400	− 60		+ 730	+ 60	+ 40	+ 1,170
	1974	+ 180	+ 310	− 100		+ 640	+ 40	+ 40	+ 1,110
Italy	1972	− 230	+1,550	− 80		+1,330	− 480	− 140	+ 1,950
	1973	− 310	+1,660	− 240		+1,440	− 660	− 440	+ 1,450
	1974	− 370	+1,780	− 780		+1,260	− 650	− 580	+ 660
Japan	1972	− 960	− 570	+ 370		− 140	−1,380	+ 340	− 2,340
	1973	−1,700	−1,040	+ 490		− 100	−1,950	+ 460	− 3,820
	1974	−2,580	−1,120	− 490		− 90	−2,350	+ 450	− 6,180
Netherlands	1972	+ 770	− 130	+ 150		+ 70	+ 80	− 90	+ 850
	1973	+ 890	− 210	+ 360		+ 90	+ 160	+ 40	+ 1,330
	1974	+1,390	− 310	+ 400		+ 60	− 60	− 80	+ 1,400
Portugal	1972	− 30	+ 260	+ 20		+ 880	− 40	0	+ 1,090
	1973	− 60	+ 320	+ 90		+1,110	− 180	0	+ 1,280
	1974	.	+ 190	.		+1,030	.	.	+ 1,130
Spain	1972	− 10	+2,240	− 290	+ 110	+ 910	− 60	0	+ 2,900
	1973	− 50	+2,870	− 350	+ 260	+1,450	− 20	− 70	+ 4,090
	1974	− 100	+2,800	− 470	+ 570	+1,260	− 60	− 110	+ 3,890
Sweden	1972	− 60	− 500	− 30		− 70	− 110	− 180	− 950
	1973	− 60	− 520	0		− 100	− 180	− 210	− 1,070
	1974	− 290	− 510	+ 20		− 110	− 360	− 320	− 1,570
Switzerland	1972	− 310	+ 670	+1,040		− 840	+ 780	− 70	+ 1,270
	1973	− 420	+ 840	+1,500		−1,130	+1,020	− 130	+ 1,680
	1974	− 560	+ 890	+1,890		−1,310	+1,180	− 130	+ 1,960
Turkey	1972	− 50	+ 40	− 100		+ 740	− 160	+ 40	+ 510
	1973	− 90	+ 80	− 90		+1,180	− 80	+ 40	+ 1,040
	1974	− 230	+ 40	− 170		+1,430	+ 50	+ 50	+ 1,170
United Kingdom	1972	+ 40	+ 50	+ 1,620	− 340	− 140	+2,100	−1,410	+ 1,920
	1973	− 30	0	+ 3,160	− 480	− 250	+2,440	−1,940	+ 2,900
	1974	− 410	+ 300	+ 3,760	− 840	− 230	+2,850	−2,080	+ 3,350
United States	1972	− 830	−2,220	+ 6,410	−1,890	−1,050	+3,480	−6,720	− 2,820
	1973	− 580	−2,130	+ 8,300	−3,010	−1,250	+3,880	−5,240	− 30
	1974	− 550	−1,890	+12,920	−3,240	−1,080	+4,360	−8,670	+ 1,850
Yugoslavia	1972	− 30	+ 220	− 160		+1,050	+ 70	0	+ 1,150
	1973	− 40	+ 590	− 180		+1,400	+ 20	0	+ 1,790
	1974	− 170	+ 650	− 160		+1,650	+ 80	0	+ 2,030

[1] Including merchandise insurance. [2] Earnings of frontier workers and workers temporarily employed abroad, emigrants' remittances and other private remittances. [3] Excluding investment income.

Note: The above data, with the exception of those for Belgium-Luxembourg, Greece and Portugal, are derived from transactions balances, with trade on a (partly estimated) f.o.b. basis; they generally exclude processing and merchanting, which are considered to belong to trade. In the case of Belgium-Luxembourg and Portugal the figures are partly based on cash data and in that of Greece cash data alone were used. These factors account for certain discrepancies between the figures in this table and those in the national tables in the last part of this chapter.

occurred in Japan, France and the United Kingdom ($0.9, 0.5 and 0.4 milliard respectively) and reflected a combination of unfavourable developments in trade and in freight charges.

Both *travel* and *private remittances* were affected by last year's recessionary conditions in the world economy. In the post-war period international tourism has been one of the fastest-growing major export industries, especially in some western European countries. In 1974, however, tourist trade was slack almost everywhere. Even in nominal terms and measured in US dollars, surpluses of traditional recipient countries either failed to grow or actually shrank; inversely, deficit countries recorded a decline in net outpayments or at least a deceleration in the growth rate compared with recent years. Thus, in Spain — the country with the largest surplus on travel — net earnings totalled $2.8 milliard and were practically stable, after a $0.6 milliard rise in 1973. Greece, Turkey and Portugal were severely affected because of the additional difficulties brought about by political crises: the net earnings of the first two fell back to the levels recorded in 1972, while the surplus in Portugal was the same as in 1971. Two strong-currency countries weathered the situation better than might have been expected: Austria's net earnings declined by only $0.2 milliard to $1.2 milliard, while Switzerland recorded a slight increase to a total of $0.9 milliard (in Swiss francs, however, net receipts showed no change). Among weak-currency countries, both Italy and Yugoslavia experienced small rises in net earnings, to $1.8 and 0.7 milliard respectively. In the United Kingdom the nil balance in 1973 gave way to a surplus of $0.3 milliard, owing to higher receipts from overseas visitors combined with a levelling-off of expenditure abroad by residents.

Among countries customarily showing relatively large deficits, that of the United States contracted by $0.2 to 1.9 milliard, while that of Germany reached $4.8 milliard, some 10 per cent. more than in 1973 but 80 per cent. above the 1972 amount. Over the same two-year period Japan's deficit doubled, to reach $1.1 milliard, with most of the increase occurring in 1973.

Under the influence of recession, the flows of migrant workers underwent considerable changes, particularly in western Europe. New immigration into host countries levelled off and return flows increased, so that net movements were generally reversed. Although remittances fell in real terms, the decline was often not apparent in nominal terms, and in US dollar terms it was concealed both by inflation and exchange rate movements. Germany's net outpayments last year totalled $4.3 milliard; this represented a further rise of $0.2 milliard on top of a $1 milliard jump in 1973. In Switzerland, too, the deficit went up (to $1.3 milliard), but the increase was smaller than that recorded in the preceding year. The French deficit, on the other hand, contracted somewhat to $1.6 milliard, after an expansion of $0.5 milliard in 1973.

Yugoslavia and Turkey — the two countries showing the largest earnings from private remittances — saw a further improvement in their net receipts to $1.6 milliard and $1.4 milliard respectively; however, the rises were far smaller than in 1973. On the other hand, the net earnings of both Italy and Spain contracted by $0.2 milliard to nearly $1.3 milliard. In Portugal, too, net receipts fell marginally to $1 milliard.

Balances on *investment income* were influenced in 1974 by a combination of factors. The oil-price rise had a generally favourable effect on the profits of international oil companies, although this was partly offset by the move towards nationalisation of oil installations by exporting countries, while the interest charges connected with the financing of oil-related payments deficits already began to be felt in a number of countries. Higher interest rates caused gross income flows on portfolio investments to increase while, pulling in the opposite direction, the recessionary forces generally depressed earnings from direct investments.

Japan's $0.5 milliard net surplus on investment income in 1973 was turned into a deficit of about the same size, probably largely reflecting both the decline of net official assets in 1973 and the expansion in the Japanese banks' net liabilities last year. In Germany the balance on private investment income deteriorated, with net outpayments totalling $2.1 milliard. This was partly due to an expansion in the profit receipts of foreign investors, who had in the past refrained from calling for profits on exchange rate grounds. However, total net investment income still showed a small surplus, to a large extent reflecting earnings on the Bundesbank's net foreign assets. In Italy the sizable increase in the external indebtedness of the public sector contributed to a $0.5 milliard widening of the deficit on investment income account. A deterioration of the same kind occurred in the UK public-sector deficit; however, this was outweighed by the expansion in the private sector's surplus, attributable largely to reduced outpayments because of the industrial recession, notably in the motor sector, and to higher earnings from British oil companies. Higher earnings from oil also played a prominent rôle in the $4.6 milliard rise, to $12.9 milliard, in the net surplus on US private investment income account.

As a group, the countries shown in the table on page 79 recorded a surplus on total investment income of as much as $12.4 milliard. This was more than offset, however, by the deficit on *government transactions* other than investment income (chiefly unilateral transfers), which totalled $13.8 milliard, largely as the result of the net outpayments of the United States ($8.7 milliard) and the United Kingdom ($2.1 milliard).

In some countries the overall balances showed substantial changes; in particular, the German deficit reached $12.5 milliard, compared with $10.7 milliard in 1973 and $7.5 milliard in 1972. An even larger deterioration occurred in the Japanese deficit, which totalled $6.2 milliard, against $3.8 and 2.3 milliard respectively in the two preceding years. The Swedish deficit grew by $0.5 to 1.6 milliard, while the Italian surplus contracted by $0.8 milliard. Sizable improvements occurred in the United Kingdom ($0.5 milliard) and, especially, in the United States, where, in spite of special grants to India, Israel and Vietnam amounting to $3.1 milliard, the total invisible account showed a surplus of $1.9 milliard, compared with near-balance in 1973 and a deficit of $2.8 milliard in 1972.

International payments.

Key changes in the balance-of-payments situation of developed countries are summarised in the accompanying table. Comparative trends are presented here in terms of US dollars and, so far as possible, on a uniform basis, although exchange

Developed areas: Balances of payments.

Balances and periods	EEC[1]	Other northern and central Europe[2]	Other southern Europe[3]	Total western Europe	United States	Canada	Japan	Southern hemisphere countries[4]	Total developed areas
	In milliards of US dollars								
Trade balance[5]									
1972	+ 8.7	− 2.3	− 5.4	+ 1.0	− 7.0	+ 1.7	+ 9.0	+ 3.0	+ 7.7
1973	+ 6.5	− 2.4	− 8.5	− 4.4	+ 0.5	+ 2.3	+ 3.7	+ 4.5	+ 6.6
1974	− 4.7	− 5.2	− 16.2	− 26.1	− 5.9	+ 1.1	+ 1.4	− 0.6	− 30.1
Services and transfers									
1972	− 3.0	+ 2.6	+ 6.6	+ 6.2	− 2.8	− 2.4	− 2.4	− 2.6	− 4.0
1973	− 5.5	+ 3.0	+ 9.5	+ 7.0	0	− 2.7	− 3.8	− 3.6	− 3.1
1974	− 7.8	+ 1.9	+ 9.8	+ 3.9	+ 1.9	− 3.0	− 6.1	− 4.3	− 7.6
Current balance									
1972	+ 5.7	+ 0.3	+ 1.2	+ 7.2	− 9.8	− 0.7	+ 6.6	+ 0.4	+ 3.7
1973	+ 1.0	+ 0.6	+ 1.0	+ 2.6	+ 0.5	− 0.4	− 0.1	+ 0.9	+ 3.5
1974	− 12.5	− 3.3	− 6.4	− 22.2	− 4.0	− 1.9	− 4.7	− 4.9	− 37.7
Capital balance									
1972	− 0.6	+ 0.6	+ 1.9	+ 1.9	− 3.8	+ 0.2	− 1.9	+ 2.7	− 0.9
1973	+ 9.7	+ 1.6	+ 1.8	+ 13.1	− 5.0	+ 0.2	− 10.0	− 1.2	− 2.9
1974	+ 5.2	+ 5.0	+ 2.7	+ 12.9	− 2.1	+ 2.7	− 2.1	+ 2.3	+ 13.7
Overall balance[6]									
1972	+ 5.1	+ 0.9	+ 3.1	+ 9.1	− 13.6	− 0.5	+ 4.7	+ 3.1	+ 2.8
1973	+ 10.7	+ 2.2	+ 2.8	+ 15.7	− 4.5	− 0.2	− 10.1	− 0.3	+ 0.6
1974	− 7.3	+ 1.7	− 3.7	− 9.3	− 6.1	+ 0.8	− 6.8	− 2.6	− 24.0
of which, changes in: Banks' net external position[7]									
1972	− 1.1	0	− 0.5	− 1.6	− 2.5	− 0.7	+ 2.0	− 0.4	− 3.2
1973	− 0.3	+ 0.4	+ 0.2	+ 0.3	+ 0.6	+ 0.3	− 4.0	0	− 2.6
1974	− 0.1	+ 1.8	− 0.9	+ 0.8	+ 2.0	+ 0.8	− 8.2	− 0.1	− 4.7
Net official assets									
1972[8]	+ 6.2	+ 0.9	+ 3.6	+ 10.7	− 11.1	+ 0.2	+ 2.7	+ 3.5	+ 6.0
1973	+ 11.0	+ 1.8	+ 2.6	+ 15.4	− 5.3	− 0.5	− 6.1	− 0.3	+ 3.2
1974	− 7.2	− 0.1	− 2.8	− 10.1	− 8.1	0	+ 1.4	− 2.5	− 19.3

[1] Nine countries. [2] Austria, Finland, Iceland, Norway, Sweden, Switzerland. [3] Greece, Portugal, Spain, Turkey, Yugoslavia. [4] Australia, New Zealand, South Africa. [5] On an f.o.b. balance-of-payments basis, partly estimated. [6] Equal to changes in monetary items, excluding, wherever possible, valuation gains or losses on stocks. [7] Excluding long-term transactions, where data allow. [8] Excluding, for ease of comparison, the SDR allocations.

rate changes and recourse to new financing arrangements relating partly to oil deficits have affected both the underlying quality and the comparability of statistics. For instance, a satisfactory distinction between short and long-term capital flows via the banks has become more and more difficult and reported changes in net official assets do not always reflect symmetrical accounting treatment. Wherever possible an attempt at uniformity has been made, particularly in the netting-out of valuation losses or gains in "monetary" positions resulting from exchange rate movements.

The current balance of the United States recorded a deficit of $4 milliard, following a small surplus in 1973. The deficit was, however, less than half that of 1972, despite the oil-price impact and the special grants to India, Israel and South Vietnam mentioned above. In fact the US current balance vis-à-vis other developed countries continued to improve last year, showing a surplus of $2 milliard, with a $12 milliard swing from 1972.

The position of other developed countries, taken as a group, took a sharp turn for the worse as the change vis-à-vis the United States was compounded by the oil and commodity price rises; their 1972 aggregate current surplus of $13.5 milliard contracted to $3 milliard in 1973 and turned round last year to a deficit of about $34 milliard. The EEC current account shifted to a deficit of $12.5 milliard last year from a surplus of $1 milliard in 1973. While the German surplus doubled to $9.4 milliard, the deficits of the United Kingdom, Italy and France widened by $6.3, 5.3 and 5.2 milliard to $9.0, 7.8 and 5.9 milliard respectively. The surpluses of the Netherlands and Belgium declined somewhat, but still amounted to $1.6 and 0.9 milliard. In both Denmark and Ireland the deficits rose by $0.5 milliard, reaching $1 and 0.7 milliard. With the exception of Switzerland, whose small surplus showed no change, all other western European countries showed a current-account deficit last year and nearly all a deterioration from 1973. The largest deteriorations occurred in Spain, where the $0.6 milliard surplus recorded in 1973 gave way to a deficit of $3.1 milliard, and in Sweden, where there was a $2.2 milliard swing to a deficit of $1 milliard.

Notwithstanding the beneficial effect of the oil-price rise on Canada's trade balance, its current-account deficit widened by $1.5 to 1.9 milliard. In Japan there was a deficit of $4.7 milliard, compared with approximate balance in 1973. Taken as a group, the three southern hemisphere countries (Australia, New Zealand and South Africa) experienced a turn-round from a surplus of $0.9 milliard in 1973 to a deficit of nearly $5 milliard.

In spite of the huge swing in the current-account balances of the developed countries, the financing of the deficits presented no major difficulties last year. For developed countries other than the United States nearly half of the aggregate $34 milliard deficit was covered by net capital inflows; one-fifth was met by net short-term borrowing via the banks, and one-third by a decline in net official assets. In the United States, on the other hand, the current-account deficit was accompanied by net capital outflows on non-bank and bank account each amounting to $2 milliard, the resulting financing requirement being met wholly through a $8 milliard decline in net official assets, with increased liabilities vis-à-vis OPEC countries more than accounting for the total.

Preliminary information on developments in the first quarter of 1975 suggests that significant changes have occurred in the developed countries' balances on current account. On a seasonally adjusted basis and at an annual rate, the total deficit for the group as a whole may have shrunk to some $20 milliard from $38 milliard in 1974, reflecting mainly a decline in the deficit vis-à-vis oil-exporting countries but also an increase in the surplus vis-à-vis other developing countries. However, the improvement appears to have been unevenly distributed. In fact the four largest countries — the United States, Japan, Germany and France — probably recorded a total current-account surplus of around $15 milliard, with only France still showing a small deficit. Compared with the 1974 results, this represented a total gain of around $20 milliard, which was shared between the United States, Japan and France, while there was a slight decline in the German surplus. Italy and the United Kingdom achieved sizable reductions in their current-account deficits compared with 1974, while the aggregate balance for the remaining Group of Ten countries changed little. It would thus appear that the deficit of the smaller developed countries increased further in the first quarter of 1975.

Developments in individual countries.

United States. The trade balance worsened in 1974 by $6.4 milliard, turning round to a deficit of $5.9 milliard. Nevertheless, this was $1.1 milliard less than the record deficit registered in 1972, in spite of a rise of approximately $21 milliard in the net oil bill between the two years. The growth of exports, which was broadly based, totalled $26.8 milliard last year, while the expansion in imports came to $33.2 milliard. Apart from oil, the largest increase in net imports occurred in metals ($2.5 milliard), whereas net export gains were recorded on capital goods ($6.4 milliard), food products ($1.9 milliard) and chemicals ($1.8 milliard). While the dollar showed an effective appreciation of some 2 per cent. in 1974 over the year before, the competitive position of the United States had been strengthened by an exchange depreciation of 13½ per cent. from the first half of 1971 to the 1974 average. As a result of a $5 milliard improvement in the balance on invisibles (netting out here the special transactions with India, Israel and South Vietnam from the 1974 balance-of-payments data), there was a current-account deficit of $0.9 milliard, mostly accruing in the middle months of the year, whereas in 1973 there had been a surplus of $0.5 milliard.

There was an even greater deterioration in the balance on long-term private capital transactions, which registered a net outflow of $7.6 milliard, compared with a small net inflow in 1973. The abolition at end-January 1974 of controls on capital outflows, the easier availability of funds in the United States compared with other national markets and the depressed state of the equity market all contributed to the turn-round. For instance, foreign purchases of US equities fell by $2.3 milliard, while US direct investments abroad increased by $1.9 milliard. The basic balance thus recorded a deficit of $10.6 milliard, against one of $1 milliard in 1973.

However, the overall deficit — excluding short-term bank movements — came to only $6.1 milliard, or $1.6 milliard more than in 1973, because the errors and omissions item turned round from net outpayments of $2.3 milliard in 1973 to net inflows of $5.2 milliard last year. This unprecedented surplus probably largely reflects as yet unidentified oil-related inflows, both those arising purely from timing differences in trade and payments transactions and those involving longer-term movements. There may also have been some reversal of unidentified outflows which occurred at the time of the dollar crisis early in 1973.

During the year US banks played a major part in the recycling of funds from surplus to deficit areas: in particular, short-term liabilities to foreigners increased by $15.7 milliard, and loans to foreigners soared by $17.7 milliard. The official reserve transactions balance showed a deficit of $8.1 milliard. This was $2.8 milliard more than in 1973, but last year the increase in net US official liabilities overwhelmingly reflected desired asset accumulation by oil-exporting countries.

United States: Balance of payments.[1]

Items	1973	1974 Year	1974 1st quarter	1974 2nd quarter	1974 3rd quarter	1974 4th quarter	1975 1st quarter
	in millions of dollars						
Merchandise trade (f.o.b.)							
Exports	70,275	97,080	22,210	23,925	24,730	26,215	26,820
Imports	69,805	102,960	22,385	25,595	27,205	27,775	25,480
Trade balance	+ 470	− 5,880	− 175	− 1,670	− 2,475	− 1,560	+ 1,340
Other current items[2]	− 20	+ 5,000	+ 2,050	+ 385	+ 1,225	+ 1,340	.
Current balance	+ 450	− 880	+ 1,875	− 1,285	− 1,250	− 220	.
Long-term capital							
US Government[2]	− 1,535	− 2,100	− 660	− 235	− 220	− 985	.
Private	+ 60	− 7,600	+ 505	− 1,040	− 2,405	− 4,660	.
Total	− 1,475	− 9,700	− 155	− 1,275	− 2,625	− 5,645	.
Basic balance	− 1,025	− 10,580	+ 1,720	− 2,560	− 3,875	− 5,865	.
Short-term capital	− 1,175	− 750	− 1,540	+ 80	+ 790	− 80	.
Errors and omissions	− 2,305	+ 5,195	+ 1,305	+ 1,460	+ 840	+ 1,590	.
Overall balance	− 4,505	− 6,135	+ 1,485	− 1,020	− 2,245	− 4,355	.
of which, changes in:							
Banks' net short-term external position	+ 795	+ 1,935	+ 435	+ 3,500	− 1,925	− 75	.
Net official assets[3]	− 5,300	− 8,070	+ 1,050	− 4,520	− 320	− 4,280	− 2,805
Memorandum item: Changes in liabilities to foreign official agencies	*5,100*	*9,500*	*− 800*	*4,900*	*1,300*	*4,100*	.
of which:							
OPEC	*400*	*9,700*	*1,000*	*2,400*	*3,900*	*2,400*	.
Other	*4,700*	*− 200*	*− 1,800*	*2,500*	*− 2,600*	*1,700*	.

[1] Seasonally adjusted. [2] Excluding from 1974 data special transactions with India, Israel and South Vietnam amounting to $3.1 milliard [3] Excluding valuation adjustments.

In the first quarter of 1975 the trade balance showed a surplus of $1.3 milliard. This was the first surplus since the last quarter of 1973 and represented a swing of $2.8 milliard from the deficit recorded in October-December 1974; exports were slightly higher, while imports contracted by 8 per cent. In volume terms exports showed little change but imports went down by 10 per cent. Two-fifths of the decline occurred in imports of petroleum, which fell by $0.9 milliard; imports of consumption goods also declined, while those of capital goods remained unchanged.

Canada. Relatively well-sustained domestic demand, together with labour disputes, adversely affected Canada's foreign trade balance. Thus, while the surplus on petroleum and natural gas increased from $1 to 1.5 milliard, the overall merchandise surplus declined from $2.2 milliard in 1973 to $1 milliard in 1974. The total value of exports rose by $7 milliard, or 27 per cent., mainly as a result of higher revenues from energy products, wheat, wood pulp and newsprint, but imports increased by $8.2 milliard, or 35 per cent. With imports rising sharply and exports virtually stationary, the trade deficit in respect of cars and parts reached $1.7 milliard, nearly

Canada: Balance of payments.

Items	1972	1973	1974	1973 1st half	1973 2nd half	1974 1st half	1974 2nd half
	in millions of Canadian dollars						
Merchandise trade (f.o.b.)							
Exports	20,220	25,500	32,490	12,330	13,170	15,605	16,885
Imports	18,575	23,270	31,470	11,300	11,970	14,790	16,680
Trade balance	+ 1,645	+ 2,230	+ 1,020	+ 1,030	+ 1,200	+ 815	+ 205
Services and transfers	− 2,300	− 2,655	− 2,895	− 1,510	− 1,145	− 1,625	− 1,270
Current balance	− 655	− 425	− 1,875	− 480	+ 55	− 810	− 1,065
Long-term capital	+ 1,760	+ 660	+ 945	+ 475	+ 185	+ 450	+ 495
Basic balance	+ 1,105	+ 235	− 930	− 5	+ 240	− 360	− 570
Short-term capital and errors and omissions	− 1,640	− 440	+ 1,745	− 350	− 90	+ 1,255	+ 490
Overall balance	− 535	− 205	+ 815	− 355	+ 150	+ 895	− 80
of which, changes in:							
Banks' net short-term external position	− 755	+ 260	+ 790	− 165	+ 425	+ 545	+ 245
Net official assets[1]	+ 220[2]	− 465	+ 25	− 190	− 275	+ 350	− 325

[1] Excluding valuation adjustments. [2] Excluding, for ease of comparison, the SDR allocation of $117 million.

twice as much as in 1973. Imports of steel, sugar and chemical products also went up significantly. The customary deficit on invisibles increased by a further $0.2 milliard, so that the current account was in deficit by $1.9 milliard, or $1.5 milliard more than in 1973.

As fiscal policy had become more stimulatory, the relaxation of the monetary stance from the late summer onwards was fairly cautious, so that interest rate movements gave an incentive for net inflows of capital, in particular from the United States, at both long and short term. This, together with the de facto abandonment of the borrowing guide-lines introduced in 1970, contributed last year to the $2.5 milliard increase in net capital inflows, which more than offset the deterioration on current account. The surplus in the overall balance had as its counterpart an improvement in the banks' short-term external position, reflecting the effect of significantly wider spreads which developed between Euro-dollar interest rates and the slowly-adjusting Canadian term-deposit rates, combined with the lifting of restrictions on Canadian bank lending abroad in January 1974, shortly after the removal of capital outflow controls in the United States. Over the year there was little change in net official assets, or in the effective exchange rate.

Japan. 1974 was a year of huge changes for the Japanese balance of payments, initially because of higher oil prices but later because of the domestic recession together with the continuing policy of monetary restraint. Merchandise transactions on a seasonally adjusted basis turned round from an average quarterly surplus of $1.1 milliard in January-September 1973 to an average quarterly deficit of $0.5 milliard in the first half of last year. In the third and fourth quarters there was a return to surpluses, amounting to $0.7 and 1.5 milliard respectively. Excluding the rise in net oil expenditure, the trade surplus in the second half of 1974 came to about $10 milliard, equivalent to some 4 per cent. of gross national product. The shift into surplus reflected a sizable increase in exports as well as a stagnation in imports following the large rises recorded in January-June.

For the year as a whole exports rose in value by $18.2 milliard, but imports expanded by $20.5 milliard, two-thirds of which represented the increase in the oil bill. With invisible trade deteriorating further, the current account recorded a deficit of $4.7 milliard, against near-balance the year before.

This deterioration was more than offset, however, by a sharp contraction in net capital outflows, which fell to $2.1 milliard from their record $10 milliard in 1973. As a result, the deficit on the overall balance declined by $3.2 milliard to stand at $6.8 milliard. The cut-back in outflows occurred mainly in long-term transactions and in the errors and omissions item. The latter, reflecting largely payments leads and lags, was practically nil last year, whereas in 1973 there had been a net outflow of $2.6 milliard. The reduction in long-term outflows stemmed chiefly from a decline in loans to non-residents ($1.1 milliard, compared with $3 milliard in 1973), a contraction in purchases of foreign securities ($0.1 milliard, against $1.8 milliard) and an inflow of funds from oil-exporting countries, which can be put at roughly $1 milliard. These changes were influenced not only by tight monetary conditions but also by the measures taken around the turn of 1973–74 to encourage capital inflows and discourage outflows. For much the same reasons there was an increase of $4.2 to 8.2 milliard in net short-term bank inflows (treated as a below-the-line item).

Japan: Balance of payments.

Items	1973	1974					1975
		Year	1st quarter	2nd quarter	3rd quarter	4th quarter	1st quarter
	In millions of US dollars						
Merchandise trade (f.o.b.)							
Exports	36,265	54,480	10,095	13,475	14,680	16,230	12,960
Imports	32,575	53,045	11,945	14,320	13,165	13,615	12,150
Trade balance	+ 3,690	+ 1,435	− 1,850	− 845	+ 1,515	+ 2,615	+ 810
Services and transfers	− 3,825	− 6,130	− 1,440	− 1,560	− 1,650	− 1,480	− 1,610
Current balance	− 135	− 4,695	− 3,290	− 2,405	− 135	+ 1,135	− 800
Long-term capital	− 9,750	− 3,880	− 1,590	− 1,015	− 550	− 725	+ 135
Basic balance	− 9,885	− 8,575	− 4,880	− 3,420	− 685	+ 410	− 665
Short-term capital and errors and omissions	− 190	+ 1,735	+ 740	+ 355	+ 85	+ 555	− 25
Overall balance	−10,075	− 6,840	− 4,140	− 3,065	− 600	+ 965	− 690
of which, changes in:							
Banks' net short-term external position	− 3,975	− 8,200	− 4,365	− 4,130	− 375	+ 670	− 1,295
Net official assets*	− 6,100	+ 1,360	+ 225	+ 1,065	− 225	+ 295	+ 605

* Excluding estimated valuation adjustments.

On a seasonally adjusted basis the trade surplus grew further in the first quarter of this year, reaching \$2 milliard; with net outpayments on invisibles continuing to run at a monthly average of \$0.5 milliard, the current-account surplus amounted to \$0.4 milliard, compared with a roughly nil balance in October-December 1974. However, in view of adverse seasonal factors, the unadjusted current account slipped back into a deficit of \$0.8 milliard; since total net capital inflows amounted to \$0.1 milliard, the overall balance recorded a deficit of \$0.7 milliard. In the corresponding period of last year the deficit had amounted to \$4.1 milliard.

United Kingdom. The United Kingdom was the only major industrial country last year to experience a trade deterioration larger than the rise in its oil bill. The trade balance showed a deficit of £5.3 milliard, over twice as much as in the previous year. Exports increased by some 35 per cent. but imports rose by over 50 per cent. On invisible account the surplus came to just over £1.4 milliard, compared with £1.2 milliard in 1973, so that the current-account deficit climbed from £1.1 milliard in 1973 to £3.8 milliard. Roughly one-tenth of this is estimated to represent imports for the development of North Sea oilfields.

Capital transfers in implementation of the guarantee clauses of the Sterling Agreements totalled £75 million. These arrangements were discontinued from the end of 1974.

United Kingdom: Balance of payments.

Items	1972	1973	1974	1973		1974	
				1st half	2nd half	1st half	2nd half
	in millions of pounds sterling						
Merchandise trade (f.o.b.)							
Exports	9,145	11,510	15,590	5,505	6,005	7,400	8,190
Imports	9,830	13,810	20,850	6,405	7,405	10,155	10,695
Trade balance	− 685	− 2,300	− 5,260	− 900	− 1,400	− 2,755	− 2,505
Services and transfers	+ 765	+ 1,185	+ 1,435	+ 350	+ 835	+ 705	+ 730
Current balance	+ 80	− 1,115	− 3,825	− 550	− 565	− 2,050	− 1,775
Capital transfers	—	− 60	− 75	− 55	− 5	− 30	− 45
Capital movements							
Official long-term	− 140	− 180	− 195	− 75	− 105	− 60	− 135
UK public-sector borrowing abroad	0	+ 1,100	+ 1,260	+ 380	+ 720	+ 845	+ 415
Other identified	− 105	+ 320	+ 475	+ 300	+ 20	+ 720	− 245
Balancing item	− 675	+ 175	+ 1,145	+ 200	− 25	+ 345	+ 800
Total	− 920	+ 1,415	+ 2,685	+ 805	+ 610	+ 1,850	+ 835
Overall balance	− 840	+ 240	− 1,215	+ 200	+ 40	− 230	− 985
of which, changes in:							
Net official assets	− 1,170*	+ 210	− 565	+ 445	− 235	+ 70	− 635
Other net monetary items	+ 330	+ 30	− 650	− 245	+ 275	− 300	− 350

* Excluding, for ease of comparison, the SDR allocation of £124 million.

Total net capital inflows, including unidentified transactions, came to £2.7 milliard and were £1.3 milliard higher than in 1973. The net outflow of official long-term capital, at £0.2 milliard, was about the same as in 1973. Net foreign currency borrowing by the public sector amounted to £1.3 milliard, or £0.2 milliard more than in 1973; in both years nine-tenths of these inflows came under official exchange guarantees. The 1974 figure does not include a £0.6 ($1.5) milliard first drawing, in the fourth quarter, on a $2.5 milliard Euro-currency facility arranged on behalf of the government early in 1974 which is treated here as a compensatory item. The balancing item rose sharply to £1.1 milliard last year, as a result of inflows associated with both the financial squeeze on UK companies and the swelling import bill. The net inflow of private investment and other identified capital amounted to £0.4 milliard, only slightly more than the year before, but there were some significant changes within the total. A rise in overseas investment in the UK private sector, together with a decline in net UK private investment abroad, totalled nearly £0.5 milliard, but this was approximately offset by increased net outflows on account of recorded export and import credit.

In the first quarter of this year exports were 13 per cent. higher and imports 5 per cent. lower than in the last three months of 1974 on a seasonally adjusted basis. As a result the trade deficit contracted from £1.5 to 0.7 milliard, so that, with little change in net earnings from invisibles, the current deficit was as low as £0.3 milliard, against £1.1 milliard in the previous quarter. However, these figures may, to a certain extent, overstate the improvement in the British current-account position, because trade transactions — particularly those involving imports — were affected by the London dockers' strike and the fishermen's blockade of some ports in March.

Germany. The outstanding developments in 1974 were the doubling of the current-account surplus — which reached DM 24.2 milliard — and its smooth financing through long and short-term private capital outflows. In consequence, the overall balance closed with a surplus of DM 7.8 milliard, compared with one of DM 31.6 milliard in 1973. Indeed, as there was a sizable expansion in the banking system's net short-term assets, the official reserve transactions balance recorded a deficit of DM 1.9 milliard, against a surplus of DM 26.4 milliard the year before, with the average effective year-on-year appreciation of the Deutsche Mark amounting to 4½ per cent. The structural deficit on invisibles grew further to reach DM 32.2 milliard. Remarkably, especially in view of a DM 15.6 milliard rise in the net oil bill, the trade surplus increased by DM 16.4 milliard to a record DM 56.3 milliard.

In Germany the cyclical downturn led that of its major competitors, so that its export expansion was most pronounced early in the year when world demand was still holding up. With domestic demand weakening, non-oil imports showed only a moderate rise in value (14 per cent.) and declined in volume, while enterprises made special efforts to shift output into exports. In this context trade credits granted by the enterprise sector resulted in net outflows of DM 12.9 milliard, after net inflows of DM 4.6 milliard in 1973.

This huge turn-round was facilitated in the main by a progressive lowering of domestic short-term market interest rates but, after mid-year, to some extent also by a decline in domestic long-term yields relative to those abroad, while expectations

Germany: Balance of payments.

Items	1971	1972	1973	1974	1974 1st quarter	1975 1st quarter
	In millions of Deutsche Mark					
Merchandise trade (f.o.b.)						
Exports	136,020	148,705	178,040	229,850	54,535	53,015
Imports	112,750	122,320	138,150	173,535	39,805	40,335
Trade balance	+23,270	+26,385	+39,890	+56,315	+14,730	+12,680
Services and transfers	−20,190	−23,910	−28,395	−32,165	− 7,330	− 6,995
Current balance	+ 3,080	+ 2,475	+11,495	+24,150	+ 7,400	+ 5,685
Long-term capital	+ 6,295	+15,545	+12,440	− 5,745	− 710	− 3,400
Basic balance	+ 9,375	+18,020	+23,935	+18,405	+ 6,690	+ 2,285
Short-term capital	+ 3,150	− 3,115	+ 5,425	−10,015	− 9,205	+ 2,135
Errors and omissions	+ 2,660	+ 1,205	+ 2,220	− 565	+ 2,530	+ 1,655
Overall balance	+15,185	+16,110	+31,580	+ 7,825	+ 15	+ 6,075
of which, changes in:						
Banks' net short-term external position	− 1,175	+ 420	+ 5,150	+ 9,730	+ 525	+ 1,075
Net official assets*	+16,360	+15,690	+26,430	− 1,905	− 510	+ 5,000

* For ease of comparison, SDR allocations of DM 627 and 620 million in 1971 and 1972 respectively are excluded, as are valuation adjustments.

of a further strengthening of the Deutsche Mark did not, on balance, play any major offsetting rôle. For the year as a whole all the main private capital items showed sizable swings into deficit, with the exception of direct investment; the latter recorded somewhat higher net inflows totalling DM 1.5 milliard, partly as a result of OPEC placements. Security transactions led to net outpayments of DM 4.2 milliard, against net receipts of DM 6.4 milliard in 1973, reflecting chiefly net sales of German securities by non-residents but also a swing towards net purchases of foreign securities by residents. With regard to "loans and credits", liabilities increased by only DM 1 milliard (compared with DM 3.9 milliard a year earlier), but assets rose by DM 2.8 milliard after being run down in 1973 by DM 4.1 milliard. Thus, notwithstanding a contraction in the deficit on official long-term transactions, there was an outflow on long-term capital account of DM 5.7 milliard, against a net inflow of DM 12.4 milliard in 1973. This turn-round was larger than the increase in the surplus on current account, so that the basic balance closed with a surplus of DM 18.3 milliard, or DM 5.6 milliard less than a year previously.

In the first quarter of 1975 exports were slightly lower and imports marginally higher than in the corresponding period of last year, so that the trade surplus declined by DM 2.1 to 12.7 milliard. With little change in net outpayments on invisibles, the current account showed a broadly corresponding contraction to DM 5.7 milliard. Net capital inflows amounted to DM 0.4 milliard, since long-term outflows were more than offset by short-term and unidentified inflows. The overall surplus amounted to DM 6.1 milliard and was largely reflected in an increase in net official assets, which helped to contain the effective appreciation of the Deutsche Mark over the quarter to less than 1 per cent.

France. The trade balance turned round from a surplus of Fr.fr. 3.4 milliard in 1973 to a deficit of Fr.fr. 18.6 milliard last year. The deterioration occurred mainly in the first half of the year under the combined influence of the increase in oil prices and relatively strong domestic demand. In the second half merchandise transactions reflected the rapid shift towards domestic slack. According to customs data, total imports (c.i.f.) rose for the year as a whole by Fr.fr. 88 milliard, or by more than one-half; some 40 per cent. of this increase represented higher expenditure on oil. Exports continued to expand quite satisfactorily, increasing by Fr.fr. 61 milliard, or nearly 40 per cent.; the largest rise was recorded by semi-manufactured products (Fr.fr. 32 milliard, or over one-half). The trend towards market diversification, an official objective, was still in evidence, with a rapid expansion in sales to the oil-producing area, the third world and European countries outside the EEC.

As a result of a further Fr.fr. 3.1 milliard increase in net outpayments on invisible items, the current-account deficit came to Fr.fr. 28.2 milliard, against Fr.fr. 3 milliard in 1973.

In the customary presentation of the external accounts, net long-term capital outflows totalled Fr.fr. 2.3 milliard. Against this, net short-term capital inflows outside the banking system amounted to Fr.fr. 19.2 milliard, so that the overall balance closed with a deficit of Fr.fr. 11.2 milliard, compared with one of Fr.fr. 3.7

France: Balance of payments.

Items	1972	1973	1974	1973 1st half	1973 2nd half	1974 1st half	1974 2nd half
	in millions of French francs						
Merchandise trade (f.o.b.)							
Exports	131,890	159,410	219,360[1]	78,505	80,905	107,750[1]	111,610[1]
Imports	125,370	155,970	238,000[1]	75,655	80,315	120,500[1]	117,500[1]
Trade balance	+ 6,520	+ 3,440	−18,640	+ 2,850	+ 590	−12,750	− 5,890
Services and transfers	− 5,065	− 6,445	− 9,555	− 2,670	− 3,775	− 4,110	− 5,445
Current balance	+ 1,455	− 3,005	−28,195	+ 180	− 3,185	−16,860	−11,335
Long-term capital							
Official	− 235	− 1,110	− 2,350	− 740	− 370	− 545	− 1,805
Private non-bank	+ 540	− 930	+ 7,970	+ 260	− 1,190	+ 3,720	+ 4,250
Banks	− 3,660	− 7,725	− 7,875	− 2,185	− 5,540	− 4,140	− 3,735
Total	− 3,355	− 9,765	− 2,255	− 2,665	− 7,100	− 965	− 1,290
Basic balance	− 1,900	−12,770	−30,450	− 2,485	−10,285	−17,825	−12,625
Short-term capital and errors and omissions	+ 3,100	+ 9,110	+19,205	+ 4,770	+ 4,340	+11,085	+ 8,120
Overall balance	+ 1,200	− 3,660	−11,245	+ 2,285	− 5,945	− 6,740	− 4,505
of which, changes in:							
Banks' net short-term external position	− 6,855	+ 3,790	− 9,195	− 310	+ 4,100	− 3,615	− 5,580
Net official assets	+ 8,055[2]	− 7,450	− 2,050	+ 2,595	−10,045	− 3,125	+ 1,075

[1] Partly estimated. [2] Excluding, for ease of comparison, the SDR allocation of Fr.fr. 883 million.

milliard in 1973. However, these conventional distinctions do not reveal the ease with which the current account was actually financed. For example, at the instigation of the authorities, the enterprise sector borrowed some Fr.fr. 4.3 milliard via the French banking system on a roll-over basis; conceptually these inflows are more akin to long-term than to short-term capital and are really ascribable to the non-bank sector; this alone would transform the deficit of Fr.fr. 2.3 milliard on long-term capital account into a surplus of Fr.fr. 2 milliard.

In addition, the long-term capital item includes Fr.fr. 7 milliard of loans to non-residents granted by French banks — loans which represent a kind of maturity transformation and which are effectively a direct counterpart to the increase in the banks' short-term liabilities. With these adjustments the effective long-term capital balance would show net inflows of Fr.fr. 9 milliard. Together with the short-term non-bank inflows of Fr.fr. 19.2 milliard, the overall balance would then come to approximately nil, having as a counterpart an increase in the banks' net short-term assets of some Fr.fr. 2.1 milliard matched by a decline in net official reserve assets (less than one-third of the decrease recorded in 1973).

In the first quarter of 1975 the French current account continued to improve. On a seasonally adjusted basis the trade balance moved back into a surplus of Fr.fr. 0.7 milliard, but net payments on invisibles grew by Fr.fr. 0.6 to 1.8 milliard. As a result, the Fr.fr. 1.1 milliard current-account deficit was only half that recorded in the final quarter of 1974.

Italy. The current-account deficit widened from Lit. 1,500 milliard in 1973 to Lit. 5,100 milliard last year, two-thirds of which accrued in the first six months. The decline in domestic demand brought a clear improvement in the second half, when the non-oil trade balance swung round to a surplus of Lit. 200 milliard from a deficit of Lit. 1,200 milliard in January–June.

For the year as a whole the export gain amounted to Lit. 6,500 milliard (50 per cent.), with the semi-manufactured goods and capital goods sectors turning in a particularly good performance. The total rise in imports came to Lit. 9,700 milliard (65 per cent.), nearly half of which consisted of oil. Non-oil imports went up by 40 per cent. compared with about 15 per cent. in 1973, with those of raw materials and semi-manufactures increasing faster than a year earlier but those of consumer goods rising much more slowly. The net surplus on invisible transactions contracted again, to Lit. 430 milliard.

On the conventional accounting basis, the overall deficit widened from Lit. 200 to 3,600 milliard — about the same deterioration as that on current account. Overall capital movements (including errors and omissions) recorded a net inflow of Lit. 1,500 milliard, or Lit. 200 milliard more than in 1973. Compensatory public-sector borrowing, which had brought in some Lit. 2,600 milliard in 1973, yielded only Lit. 1,300 milliard last year. On the other hand, net private capital outflows of some Lit. 1,300 milliard in 1973 were followed by net inflows of Lit. 200 milliard as a result of the introduction of the import deposit scheme and domestic monetary restraint. Efforts to maintain gross reserve assets by means of officially-induced compensatory borrowing by public entities virtually ceased in the second half of

Italy: Balance of payments.

Items	1972	1973	1974	1973 1st half	1973 2nd half	1974 1st half	1974 2nd half
	in milliards of lire						
Merchandise trade (f.o.b.)							
Exports	10,755	12,870	19,405	5,555	7,315	8,560	10,845
Imports	10,725	15,185	24,905	6,630	8,555	11,655	13,250
Trade balance	+ 30	− 2,315	− 5,500	− 1,075	− 1,240	− 3,095	− 2,405
Services and transfers	+ 1,135	+ 840	+ 430	+ 235	+ 605	− 75	+ 505
Current balance	+ 1,165	− 1,475	− 5,070	− 840	− 635	− 3,170	− 1,900
Identified capital movements							
Compensatory public-sector borrowing	+ 350	+ 2,570	+ 1,325	+ 555	+ 2,015	+ 1,345	− 20
Other	− 1,920	− 835	+ 265	− 640	− 195	− 975	+ 1,240
Total	− 1,570	+ 1,735	+ 1,590	− 85	+ 1,820	+ 370	+ 1,220
Errors and omissions	− 345	− 470	− 110	+ 10	− 480	− 150	+ 40
Capital balance	− 1,915	+ 1,265	+ 1,480	− 75	+ 1,340	+ 220	+ 1,260
Overall balance[1]	− 750	− 210	− 3,590	− 915	+ 705	− 2,950	− 640
of which, changes in:							
Banks' net external position	− 255	− 30	− 475	− 370	+ 340	− 1,040	+ 565
Net official assets	− 495[2]	− 125	− 2,995	− 485	+ 360	− 1,815	− 1,180
Valuation adjustments	0	− 55	− 120	− 60	+ 5	− 95	− 25

[1] Excluding valuation adjustments. [2] Excluding, for ease of comparison, the SDR allocation of Lit. 66 milliard.

1974 as Euro-market borrowing became difficult. The necessary financing was then obtained largely by a direct increase in the monetary authorities' medium and long-term liabilities, which in 1974 amounted to Lit. 3,600 milliard and effectively brought total net compensatory public-sector inflows up to Lit. 5,000 milliard, thus helping to contain the effective depreciation of the lira.

The improvement in the external position continued in the first quarter of 1975; imports were 4 per cent. lower and exports 28 per cent. higher than in the corresponding period of 1974. As a result, the visible deficit (f.o.b./c.i.f.) contracted from Lit. 1,955 to 605 milliard, while that in the overall balance shrank from Lit. 1,340 to 110 milliard. The improved situation was also reflected in the early repayment of public-sector indebtedness amounting to Lit. 240 milliard over the period January–April 1975.

Belgium-Luxembourg Economic Union. Last year total net capital outflows showed little change compared with 1973. Hence a decline of B.fr. 8.2 milliard in the current-account surplus was reflected in the overall surplus, which dropped to B.fr. 24.6 milliard. However, the incidence of leads and lags on the break-down between capital and current transactions must have been substantial. Payments data show the trade surplus contracting from B.fr. 48 to 36 milliard, while customs data on an adjusted f.o.b. basis indicate a swing from a surplus of B.fr. 52 milliard to a deficit of B.fr. 4 milliard. This latter deterioration is about the same as the increase in the net oil bill. There were sizable deteriorations in the trade balances vis-à-vis the Netherlands, Germany and the United States, partly offset by improvements vis-à-vis the United Kingdom, the eastern bloc and South America.

Net recorded capital outflows totalled B.fr. 12.2 milliard, or B.fr. 0.5 milliard more than in 1973. A B.fr. 6.5 milliard increase in the net inflow on direct investment was accompanied by a B.fr. 9.7 milliard decline in net outflows on security transactions, mainly reflecting the weakness of international security markets. However, other identified capital flows and the errors and omissions item showed a deterioration of nearly B.fr. 17 milliard, which to a large extent must reflect a reversal of the speculative inflows which had occurred in 1973.

Netherlands. Although the Netherlands last year became a net exporter of energy in terms of calories, the energy account showed a deficit of some Fl. 2 milliard, Fl. 1.7 milliard more than in 1973, as the export price of natural gas rose much less than the import price of oil. However, the overall trade surplus contracted by only Fl. 1.5 milliard to Fl. 0.8 milliard, with imports and exports rising by about 40 and

Other EEC countries: Balances of payments.

Countries and years	Merchandise trade (f.o.b.)			Services and transfers	Current balance	Capital movements[1]	Overall balance	*Of which, changes in:*	
	Exports	Imports	Balance					Banks' net external position	Net official assets[2]
Belgium-Luxembourg Economic Union[3] (milliards of francs)									
1972	586.5	540.1	+ 46.4	+ 4.8	+ 51.2	− 30.7	+ 20.5	− 5.9	+ 26.4
1973	732.8	684.5	+ 48.3	− 3.3	+ 45.0	− 11.7	+ 33.3	− 3.1	+ 36.4
1974	982.6	947.3	+ 35.5	+ 1.3	+ 36.8	− 12.2	+ 24.6	+ 17.1	+ 7.5
Denmark (millions of kroner)									
1972	30,445	33,450	− 3,005	+ 2,605	− 400	+ 1,570	+ 1,170	+ 540	+ 630
1973	37,260	44,565	− 7,305	+ 4,360	− 2,945	+ 4,990	+ 2,045	− 715	+ 2,760
1974	46,775	57,765	−10,990	+ 4,915	− 6,075	+ 5,285	− 790	+ 1,820	− 2,610
Ireland (millions of pounds)									
1972	635	825[4]	− 190	+ 135	− 55	+ 15	− 40	− 85	+ 45
1973	855	1,125[4]	− 270	+ 190	− 80	+ 110	+ 30	+ 25	+ 5
1974	1,120	1,670[4]	− 550	+ 250	− 300	+ 360	+ 60	0	+ 60
Netherlands (millions of guilders)									
1972	50,550	48,945	+ 1,605	+ 2,545	+ 4,150	− 1,940	+ 2,210	− 550[5]	+ 2,760
1973	61,875	59,580	+ 2,295	+ 3,315	+ 5,610	− 4,545	+ 1,065	− 975[5]	+ 2,040
1974	83,345	82,545	+ 800	+ 3,540	+ 4,340	− 2,390	+ 1,950	− 715[5]	+ 2,665

[1] Including errors and omissions. [2] Excluding, for ease of comparison, the SDR allocations in 1972. [3] Balance of payments on a partly cash basis; exports and imports are partly c.i.f. [4] Imports c.i.f. [5] Excluding long-term transactions.

35 per cent. respectively. Net earnings from invisible transactions showed little change from 1973, totalling Fl. 3.5 milliard. As a result, the current surplus amounted to Fl. 4.3 milliard, compared with Fl. 5.6 milliard in 1973.

This relatively small decline in the current surplus was more than offset, however, by a contraction in net capital outflows, so that the overall surplus nearly doubled to Fl. 2 milliard. Net banking short-term inflows amounted to some Fl. 0.7 milliard. Consequently, net official assets rose by Fl. 2.7 milliard, and there was a continued effective appreciation of the guilder in the course of the year.

The Fl. 2.2 milliard decline in net capital outflows stemmed from widely divergent movements in the major categories of transactions. On the one hand, for example, the Fl. 0.2 milliard surplus on direct investment in 1973 gave way to a deficit of Fl. 1.6 milliard, as Dutch investment abroad increased sharply. On the other hand, (i) the deficit on security transactions contracted by Fl. 2 milliard to Fl. 0.7 milliard; this partly reflected the abolition at the end of January 1974 of the "closed bond circuit", which meant that non-residents could purchase Dutch securities again, encouraged by both the relatively high yields and the good prospects for the currency, whereas uncertain conditions in international markets led to a significant decline in residents' purchases of foreign securities; (ii) the balance on long-term loans and credits turned from a deficit of Fl. 1.0 milliard in 1973 to a surplus of Fl. 0.7 milliard; and (iii) net short-term capital inflows (including errors and omissions, but excluding banks' transactions) amounted to Fl. 0.6 milliard, or Fl. 0.5 milliard more than in 1973.

Denmark. The current-account deficit rose in 1974 by D.kr. 3.1 milliard to D.kr. 6.1 milliard, but this increase was only about half as much as the additional cost of energy imports. Most of the deficit was incurred in the first half of the year.

Exports went up by one-quarter in value and by 7 per cent. in volume. The 30 per cent. rise in imports was more than accounted for by an increase in unit values, as their volume declined by about 6 per cent. owing to the rapid slow-down in domestic demand, the increase in sales taxes on most non-food consumer goods in May, and the aftermath of the bulge in imports that had occurred in 1973 after the import surcharge had been phased out at the beginning of that year. The deficit on merchandise account therefore rose from D.kr. 7.3 milliard in 1973 to D.kr. 11 milliard in 1974. The net surplus on invisibles grew last year by D.kr. 0.6 to 4.9 milliard, most of the increase coming from higher earnings from shipping.

The restrictive stance of monetary policy helped in the financing of the deficit on current transactions. Net private capital imports amounted to D.kr. 4.8 milliard, and public-sector loans accounted for a net inflow of D.kr. 0.5 milliard. The overall balance thus closed with a deficit of D.kr. 0.8 milliard. It had as counterpart a build-up in net bank assets and a larger decline in net official reserves, which prevented any depreciation of the krone during the year; in fact, the improvement in the current account towards the end of 1974 coincided with an appreciation of the currency.

The improvement on trade continued in the first quarter of 1975, when the visible deficit (f.o.b/c.i.f.) totalled D.kr. 1.9 milliard, compared with D.kr. 4.8 milliard in the corresponding period of last year. Imports declined by 16 per cent., while exports rose by 4 per cent.

Ireland. The trade deficit widened further to total £550 million, compared with £270 million in 1973 and £190 million in 1972. Whereas in 1973 the deterioration had been caused by changes in volume, last year it resulted from an adverse shift in the terms of trade, largely due to the rise in the price of oil but also reflecting a slump in cattle prices. The increase in the net cost of imports of oil and petroleum products accounted for approximately half the total deterioration in the visible balance. As a result of the decline in domestic economic activity, imports showed a slight drop in volume, although some stock replenishment occurred in the first part of 1974 following the boom in economic activity in 1973. However, the rise in value amounted to nearly one-half. Exports went up in value terms by about one-third, with those of agricultural products rising by 16 per cent. and those of industrial products by 43 per cent. As net invisible earnings amounted to £250 million — £60 million more than in 1973, mainly because of larger net transfers from the EEC — the current-account deficit totalled £300 million, against £80 million a year earlier.

Nevertheless, the overall surplus doubled last year to £60 million, since net capital inflows showed a threefold increase to £360 million. Net private inflows went up by £90 million, but the bulk of the rise represented long-term borrowing by the government (+ £130 million) and the rest of the public sector (+ £45 million).

Other European countries.

Austria. In spite of an increase of roughly Sch. 9 milliard in the net oil bill and a fairly marked expansion in real domestic demand, Austria's trade deficit contracted by Sch. 0.9 to 32.7 milliard in 1974.

Merchandise exports recorded an increase of almost one-third in value and 13 per cent. in volume, with semi-processed goods and chemical products showing particularly good results. The relative buoyancy of demand from the traditional eastern markets and the sharp rise in exports to oil-producing and other developing countries were contributory factors. Exports to the EEC countries rose by about half as much as the overall total. Imports grew by 22 per cent. in value and by 4 per cent. in volume. As a result partly of the strength of the schilling, there was, on average, hardly any deterioration in the terms of trade in 1974; indeed, on a December-December basis they improved by over 5 per cent.

Net identified receipts on invisible items declined by Sch. 3.2 milliard, but this was partly offset by a Sch. 0.9 milliard improvement under the errors and omissions item, believed to reflect mainly unrecorded current-account transactions. Including this item, the current-account deficit came to Sch. 5.9 milliard, Sch. 1.5 milliard more than in 1973.

A large turn-round occurred on long-term capital account as net outflows of Sch. 3.8 milliard in 1973 gave way to net inflows of Sch. 7.4 milliard last year.

Austria and Switzerland: Balances of payments.

Countries and years	Merchandise trade			Services and transfers	Current balance	Capital move-ments	Overall balance	Of which, changes in:	
	Exports (f.o.b.)	Imports (c.i.f.)	Balance					Banks' net external position	Net official assets
Austria (millions of schillings)									
1972 . .	95,910	126,200	−30,290	+26,400	+ 455[1]	+ 2,000	+2,455	−5,590[2]	+8,045[3]
1973 . .	114,960	148,480	−33,520	+26,595	−4,400[1]	− 265	−4,665	− 880[2]	−3,785[3]
1974 . .	155,980	188,650	−32,670	+23,360	−5,905[1]	+ 6,930	+1,025	−4,945[2]	+5,970[3]
Switzerland (millions of francs)									
1972 . .	26,190	30,750	− 4,560	+ 5,400	+ 840	− 925[1]	− 85	− 140[4]	+ 55[5]
1973 . .	29,950	34,750	− 4,800	+ 5,690	+ 890	+1,140[1]	+2,030	− 370[4]	+2,400[5]
1974 . .	35,350	40,750	− 5,400	+ 6,160	+ 760	+2,420[1]	+3,180	+2,960[4]	+ 220[5]

[1] Including errors and omissions. [2] Excluding changes in long-term positions. [3] Excluding valuation adjustments and, in 1972, the SDR allocation of Sch. 708 million. [4] Including trustee accounts. [5] Including dollars received from the banks under swaps, except swap dollars redeposited.

There was a major change in the public sector which, after net repayments of indebtedness abroad amounting to Sch. 0.7 milliard in 1973, borrowed some Sch. 3 milliard last year.

Net capital inflows totalled Sch. 6.9 milliard, against a small net outflow in 1973, so that the overall balance shifted to a surplus of Sch. 1 milliard from the deficit of Sch. 4.7 milliard in 1973.

In the first quarter of 1975 the trade deficit came to Sch. 9.1 milliard, against Sch. 10.6 milliard in the corresponding period of last year. Imports contracted by 4 per cent., while exports remained level.

Switzerland. In aggregate, Switzerland's current-account position recorded little change from the previous year. The traditional deficit on trade widened by Sw.fr. 0.9 milliard to reach Sw.fr. 7.6 milliard, but this increase was considerably less than the net rise in the oil bill, which came to some Sw.fr. 1.6 milliard. On the other hand, net earnings from invisibles increased by Sw.fr. 0.8 milliard to Sw.fr. 8.3 milliard. The fall in domestic demand and the strength of the Swiss franc held the growth of imports in value terms to moderate proportions; in particular, imports of investment and consumption goods increased by only 5 per cent. in value, while falling by 3 per cent. in volume. The expansion of exports was, on the whole, satisfactory; there was a gradual slow-down as the year progressed, but exports of chemical and mechanical products held up in value terms. However, with the sharp appreciation of the Swiss franc between November 1974 and March 1975 and the recession in other countries, many exporters encountered acute difficulties. In the first three months of 1975 exports were 7 per cent. lower in value and 14 per cent. lower in volume than in January-March 1974, but imports fell by even more (almost 17 per cent. in both value and volume), so that the trade gap contracted to Sw.fr. 1.2 milliard, rather less than half that recorded in the corresponding period of last year.

Information on capital movements is scanty. The Swiss franc was subject to pressure, especially in the second half of the year, from a combination of factors, including domestic credit restraint, reserve diversification by oil-exporting countries, the covering of large open speculative positions and, more generally, the traditional security considerations. The expansion of the banks' net foreign asset position totalled nearly Sw.fr. 3 milliard (after elimination of end-of-year swap operations with the central bank) and, as a result of the fairly "clean" floating of the franc, net official assets rose by only Sw.fr. 0.2 milliard. Taking into account the Sw.fr. 0.8 milliard current surplus, there was a net inflow of non-bank capital amounting to Sw.fr. 2.4 milliard. Total capital movements (including banking flows) thus resulted in a net outflow of some Sw.fr. 0.5 milliard.

Finland. The current-account deficit rose from F.mk. 1.5 milliard in 1973 to F.mk. 4.5 milliard last year, amounting to nearly 6 per cent. of the gross national product. With net earnings from invisibles practically unchanged, most of the F.mk. 3 milliard deterioration stemmed from merchandise transactions. In value, imports increased by over one-half and exports by some 40 per cent. On average the terms of trade worsened only marginally between 1973 and 1974 in spite of the rise in oil prices. In terms of volume, imports grew by 7 per cent., showing an elasticity to domestic demand close to unity, while exports stagnated, mainly on account of the recession in building activity abroad, but also as a consequence of capacity limitations in the paper and metal industries, whose foreign sales recorded large unit-value gains.

As domestic credit became progressively tighter than elsewhere, two-thirds of the current-account deficit was financed by capital inflows. Net long-term inflows amounted to F.mk. 0.9 milliard, compared with F.mk. 0.4 milliard in 1973, while short-term net capital imports, mainly trade credit, amounted to F.mk. 2.1 milliard, against only F.mk. 0.3 milliard in 1973. The overall deficit thus came to F.mk. 1.5 milliard, nearly twice that recorded in the previous year, and was covered equally by reductions in the net external position of the Bank of Finland and that of the commercial banks, accompanied by a small effective appreciation of the markka in 1974.

In the first quarter of 1975 the merchandise account showed a sharp deterioration. Compared with the corresponding period of last year, imports were up by 30 per cent. and exports by 11 per cent., so that the deficit worked out at F.mk. 2.3 milliard, twice that recorded in January-March 1974. In order to contain the deficit, an import deposit requirement was introduced towards the end of March.

Iceland. The joint impact of relatively strong domestic demand growth, the increase in oil prices and a decline in the fish catch resulted in a turn-round in the current balance from a surplus of $15 million in 1973 to a deficit of $135 million last year. This occurred in spite of the introduction of an import deposit scheme in May and a 17 per cent. devaluation of the króna vis-à-vis the US dollar in August. Imports rose by two-thirds in value, and by almost 10 per cent. in volume. Exports expanded in value by 40 per cent., but declined in volume by 8 per cent.

Nordic countries: Balances of payments.

Countries and years	Merchandise trade			Services and transfers	Current balance	Capital move-ments[1]	Overall balance	Of which, changes in:	
	Exports (f.o.b.)	Imports (c.i.f.)	Balance					Banks' net external position	Net official assets[2]
Finland (millions of markkas)									
1972 . . .	12,010	13,085	− 1,075	+ 595	− 480	+ 985	+ 505	+ 320	+ 185
1973 . . .	14,525	16,560	− 2,035	+ 555	−1,480	+ 695	− 785	− 295	− 490
1974 . . .	20,610	25,610	− 5,000	+ 490	−4,510	+3,035	−1,475	− 735	− 740
Iceland (millions of US dollars)									
1972 . . .	190	215[3]	− 25	+ 5	− 20	+ 20	0	− 5	+ 5
1973 . . .	270	300[3]	− 30	+ 45	+ 15	− 10	+ 5	− 5	+ 10
1974 . . .	375	505[3]	− 130	− 5	− 135	+ 65	− 70	− 5	− 65
Norway (millions of kroner)									
1972 . . .	21,795	29,240	− 7,445	+7,060	− 385	+1,275	+ 890	− 70	+ 960[4]
1973 . . .	27,385	37,300	− 9,915	+7,905	−2,010	+3,735	+1,725	+ 350	+1,375[4]
1974 . . .	34,860	48,525	−13,665	+8,105	−5,560	+6,810	+1,250	− 365	+1,615[4]
Sweden (millions of kronor)									
1972 . . .	41,750	38,665	+ 3,085	−1,810	+1,275	+ 800	+2,075	− 5[5]	+2,080
1973 . . .	53,155	46,450	+ 6,705	−1,415	+5,290	−1,405	+3,885	− 40[5]	+3,925
1974 . . .	70,390	72,945	− 2,555	−1,840	−4,395	+1,105	−3,290	+ 235[5]	−3,525

[1] Including errors and omissions. [2] Excluding, for ease of comparison, the SDR allocations in 1972. [3] Imports f.o.b. [4] Excluding valuation adjustments. [5] Excluding changes in time position.

Notwithstanding a $75 million turn-round in capital movements, which recorded a net inflow of $65 million, net monetary assets declined by $70 million, compared with an increase of $5 million in 1973.

Norway. Although the current-account deficit widened from N.kr. 2 milliard in 1973 to N.kr. 5.6 milliard last year, its financing presented no particular difficulty, doubtless also owing to the favourable repercussions on the current account that can be expected in future from oil exports. Thus, the overall balance still showed a surplus of N.kr. 1.3 milliard, or about N.kr. 0.5 milliard less than in 1973.

The current-account deterioration was largely accounted for by the rise in the net oil bill (some N.kr. 1.5 milliard) and in net imports directly related to offshore oil activities (about N.kr. 1.2 milliard). Trade in ships took a favourable turn, with the deficit of N.kr. 0.7 milliard recorded in 1973 giving way to a surplus of N.kr. 1.1 milliard. Excluding ships, merchandise imports increased in value by nearly 40 per cent. and in volume by 11 per cent. The increase in volume was about the same as in 1973, despite the relatively strong growth of real domestic demand last year. Exports of goods other than ships fell slightly in volume terms, but increased in value by 30 per cent. The terms of trade for merchandise, excluding ships, improved by 4 per cent. on average in 1974, about the same as the effective appreciation of the krone. The largest gains in export unit value were recorded in respect of wood products.

Net long-term capital inflows — mainly representing borrowing abroad by the shipping sectors — amounted to N.kr. 5.5 milliard, or N.kr. 0.5 milliard more than in 1973. Net short-term inflows came to N.kr. 1.3 milliard, which compares with net outflows of N.kr. 1.2 milliard in 1973.

Sweden. The trade balance turned round from a surplus of S.kr. 6.7 milliard in 1973 to a deficit of S.kr. 2.6 milliard last year. Owing to the relatively strong increase in domestic demand and the high rate of inventory accumulation, the deterioration on trade account exceeded the S.kr. 7 milliard increase in the oil bill.

Imports rose in value by nearly 60 per cent. and in volume by 10 per cent. The volume expansion was larger than that recorded in 1973 and was accounted for mainly by ships and other manufactured goods. Exports grew by one-third in value and by 4 per cent. in volume, compared with 27 and 16 per cent. respectively in 1973. The slow-down in volume terms was largely ascribable to the weakening of world demand, but domestic supply limitations also played a rôle, especially in the case of wood and wood products, which nevertheless showed a more rapid expansion in value terms because of higher prices. The net deficit on services and transfers increased, chiefly as a result of outflows of government funds to developing countries. The current account thus shifted from a surplus of S.kr. 5.3 milliard in 1973 to a deficit of S.kr. 4.4 milliard.

Only one-quarter of the almost S.kr. 10 milliard deterioration on current account was offset by a swing in net capital flows, with net outflows of S.kr. 1.4 milliard in 1973 giving way to net inflows of S.kr. 1.1 milliard for 1974 as a whole. In the course of the year credit policy was tightened and restrictions on foreign borrowing were eased, partly with a view to encouraging capital inflows. This strategy began to show results later in the year. Thus, while in the first half of 1974 there were still net capital outflows of S.kr. 1.8 milliard, in the second half net inflows of S.kr. 2.9 milliard covered most of the current-account deficit. As a result, the overall deficit dropped from S.kr. 2.8 milliard in January-June to only S.kr. 0.5 milliard in July-December, with the effective exchange rate showing a slight appreciation in the course of the year.

Portugal. The current-account balance turned round from a surplus of Esc. 13 milliard in 1973 to a deficit of Esc. 14 milliard last year. Net earnings from invisibles showed a slight decline, while the trade deficit more than doubled to Esc. 43 milliard. Exports increased by less than 10 per cent., while imports grew by nearly one-half. The net capital outflow came to about Esc. 2 milliard last year, nearly half the amount recorded in 1973.

Spain. The current account was characterised in 1974 by a large swing into deficit after many years of surplus. The trade deficit doubled to Pts. 405 milliard, while net earnings on invisibles, at Pts. 224 milliard, showed a slight decline from 1973.

Portugal and Spain: Balances of payments.

Countries and years	Merchandise trade (f.o.b.)			Services and transfers	Current balance	Capital movements[1]	Overall balance	Of which, changes in:	
	Exports	Imports	Balance					Banks' net external position	Net official assets
Portugal[2] (milliards of escudos)									
1972 . . .	36.9	53.1	− 16.2	+ 29.4	+ 13.2	− 5.6	+ 7.6	− 0.8	+ 8.4
1973 . . .	47.4	65.2	− 17.8	+ 31.1	+ 13.3	− 4.9	+ 8.4	0	+ 8.4
1974 . . .	51.2	94.1	− 42.9	+ 28.7	− 14.2	− 2.3	− 16.5	0	− 16.5
Spain (milliards of pesetas)									
1972 . . .	252.8	402.1	− 149.3	+186.1	+ 36.8	+ 56.9	+ 93.7	− 7.8[3]	+101.5[4]
1973 . . .	313.5	519.2	− 205.7	+238.0	+ 32.3	+ 48.2	+ 80.5	+ 8.6[3]	+ 71.9[4]
1974 . . .	420.7	826.0	− 405.3	+224.3	−181.0	+ 83.0	− 98.0	− 53.3[3]	− 44.7[4]

[1] Including errors and omissions. [2] Metropolitan Portugal vis-à-vis the rest of the world; transactions with the escudo area are on a cash basis. [3] Excluding changes in long-term positions. [4] Excluding valuation adjustments and, in 1972, the SDR allocation of Pts. 2.9 milliard.

Two-thirds of the deterioration in the trade balance reflected a Pts. 130 milliard increase in the net oil bill — the effect of the price rise having been compounded by a volume expansion of nearly 10 per cent., partly in consequence of a drought which affected the output of hydro-electric power but also because the domestic price of oil products was not allowed fully to reflect the increase in world market prices. Otherwise, the increase in the trade deficit is ascribable mainly to the relatively strong expansion of real domestic demand. Agricultural and food products accounted for most of the rise in the deficit on non-oil trade. The surplus on manufactured products showed a small increase.

To help meet expected current-account financing needs, the Spanish authorities encouraged long-term borrowing abroad by the public sector amounting to Pts. 52 milliard in 1974. In consequence, total long and short-term net capital inflows went a long way towards balancing external payments, thereby limiting the decline in reserves to Pts. 45 milliard, with little effective change in the value of the peseta.

Greece. The relatively strong decline in domestic demand, together with the increase in deposit requirements on selected imports, helped to limit the rise in import payments to 15 per cent. despite higher oil prices. In volume terms imports appear to have shown a certain decline. Export earnings, on the other hand, went up by nearly one-half; mainly owing to larger sales of manufactured products, exports probably also showed some increase in volume terms. Thus, there was only a marginal widening of the trade deficit to $2.9 milliard and, since net earnings on invisibles also rose slightly, the current account closed in 1974 with a deficit of about $1.2 milliard, about the same as that recorded in 1973.

Net capital imports totalled $1.1 milliard, or $0.1 milliard less than in 1973, so that the overall balance shifted from near-equilibrium in 1973 to a small deficit.

Turkey. As a result of the rapid expansion of domestic demand, the additional cost of imported oil and poor agricultural crops, the current-account balance turned

Mediterranean countries: Balances of payments.

Countries	Years	Merchandise trade			Services and transfers	Current balance	Capital move-ments[1]	Overall balance	Of which, changes in:	
		Exports (f.o.b.)	Imports (c.i.f.)	Balance					Banks' net external position	Net official assets[2]
		in millions of US dollars								
Greece[3] . .	1972	835	2,440	−1,605	+1,205	− 400	+ 900	+ 500	+ 10	+ 490[4]
	1973	1,230	4,045	−2,815	+1,625	−1,190	+1,180	− 10	0	− 10[4]
	1974	1,775	4,660	−2,885	+1,645	−1,240	+1,100	− 140	+ 15	− 155[4]
Turkey . . .	1972	885	1,405[5]	− 520	+ 645	+ 125	+ 215	+ 340	− 410[6]	+ 750
	1973	1,320	1,880[5]	− 560	+1,185	+ 625	− 265	+ 360	− 175[6]	+ 535
	1974	1,530	3,390[5]	−1,860	+1,450	− 410	+ 50	− 360	0[6]	− 360
Yugoslavia .	1972	2,240	3,230	− 990	+1,410	+ 420	+ 90	+ 510	+ 15[6]	+ 495
	1973	2,850	4,510	−1,660	+2,150	+ 490	+ 210	+ 700	+ 90[6]	+ 610
	1974[7]	3,800	7,550	−3,750	+2,650	−1,100	+ 250	− 850	− 20[6]	− 830

[1] Including errors and omissions. [2] Excluding, for ease of comparison, the SDR allocations in 1972. [3] Balance of payments on a cash basis. [4] Excluding valuation adjustments. [5] Imports f.o.b. [6] Excluding changes in long-term positions. [7] Data partly estimated.

round from a surplus of \$0.6 milliard in 1973 to a deficit of \$0.4 milliard. With a swing to net capital inflows, the overall deficit totalled \$0.4 milliard, after a surplus of about the same size in 1973.

The value of imports shot up by over 80 per cent., while exports grew by only 16 per cent., so that the deficit on visible trade, at \$1.9 milliard, was three times as large as in the previous year. The export expansion in respect of manufactured products was again particularly strong (nearly 40 per cent.). Net invisible earnings rose by \$0.3 milliard to \$1.5 milliard, after having nearly doubled in 1973.

Yugoslavia. The current-account balance turned round from a surplus of \$0.5 milliard in 1973 to a deficit of \$1.1 milliard last year. The deterioration was wholly due to merchandise transactions, since net earnings from invisibles rose by \$0.5 milliard to \$2.6 milliard.

The trade deficit of \$3.7 milliard was \$2 milliard larger than in 1973. Yugoslavia is less dependent on oil imports than many other countries and the increase in the net oil bill amounted to only \$0.5 milliard. The bulk of the 1974 deterioration in trade reflects the sizable growth and acceleration in real domestic demand, in contrast to the trend elsewhere. Thus, although exports went up by \$1 milliard, the expansion in imports was three times as great.

Data on capital flows are incomplete, but it appears that the current deficit was financed partly by long-term capital inflows — largely of an official nature and on favourable terms — but mainly by drawing on official reserves.

IV. GOLD, RESERVES AND FOREIGN EXCHANGE.

Gold production, markets and reserves.

In 1974 production of gold by non-communist countries declined for the fourth successive year. At 100 tons, or 9 per cent., the contraction was considerably sharper than in the three preceding years, bringing the cumulative decrease since 1970 to 22 per cent. South African production fell by 94 tons and that of Canada, the second largest western producer, by 8 tons. A number of small and largely offsetting changes were recorded in other producer countries.

World gold production.

Countries	1929	1940	1946	1953	1970	1971	1972	1973	1974
	in metric tons								
South Africa . . .	323.9	436.9	371.0	371.4	1,000.4	976.3	908.7	852.3	758.5
Canada	60.0	165.9	88.5	126.1	74.9	70.3	64.7	59.9	52.2
United States . . .	64.0	151.4	49.0	60.9	54.2	46.5	45.1	36.2	35.1
Ghana	6.4	27.6	18.2	22.7	22.0	21.7	22.5	22.7	24.9
Philippines	5.1	34.9	—	14.9	18.7	19.9	18.9	18.6	18.7
Australia	13.3	51.1	25.6	33.4	19.3	20.9	23.5	17.2	16.8
Rhodesia	17.4	25.7	16.9	15.6	15.6	15.6	15.6	15.6	15.6
Colombia	4.3	19.7	13.6	13.6	6.3	5.9	5.8	6.5	8.7
Japan.	9.3	12.6	1.3	7.1	7.9	7.9	7.6	6.7	6.2
Mexico	20.4	27.4	13.1	15.0	6.2	4.7	4.5	4.0	4.7
Zaïre	4.9	17.4	10.3	11.5	5.6	5.4	4.3	4.2	4.4
Total listed .	529.0	970.6	607.5	692.2	1,231.1	1,195.1	1,121.2	1,043.9	945.8
Other countries . .	41.5	194.4	59.0	62.0	36.4	34.1	46.5	42.5	39.2
Estimated world total*	570.5	1,165.0	666.5	754.2	1,267.5	1,229.2	1,167.7	1,086.4	985.0

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

In South Africa, with the average price received by the mines 63 per cent. higher than in 1973, the average grade of ore mined fell by 11 per cent. in 1974, about the same as the year before. On top of this, the total quantity of ore processed declined slightly last year, recruitment difficulties causing a 6 per cent. drop in the industry's labour force despite further large wage increases. The latter contributed to pushing average production costs up by 40 per cent.; nevertheless, average profits from gold-mining, which had doubled in 1973, showed a further rise of 80 per cent. last year.

In contrast to the three previous years, increased market sales of gold by communist countries did not offset the fall in western production. On the contrary, they dropped from an estimated 330 to 150 tons. Consequently, although market sales out of western countries' reserves were a little higher than the year before, the total amount of gold available for meeting non-monetary demand fell by 19 per cent., to an estimated 1,180 tons.

Estimated sources and uses of gold, 1970-74.

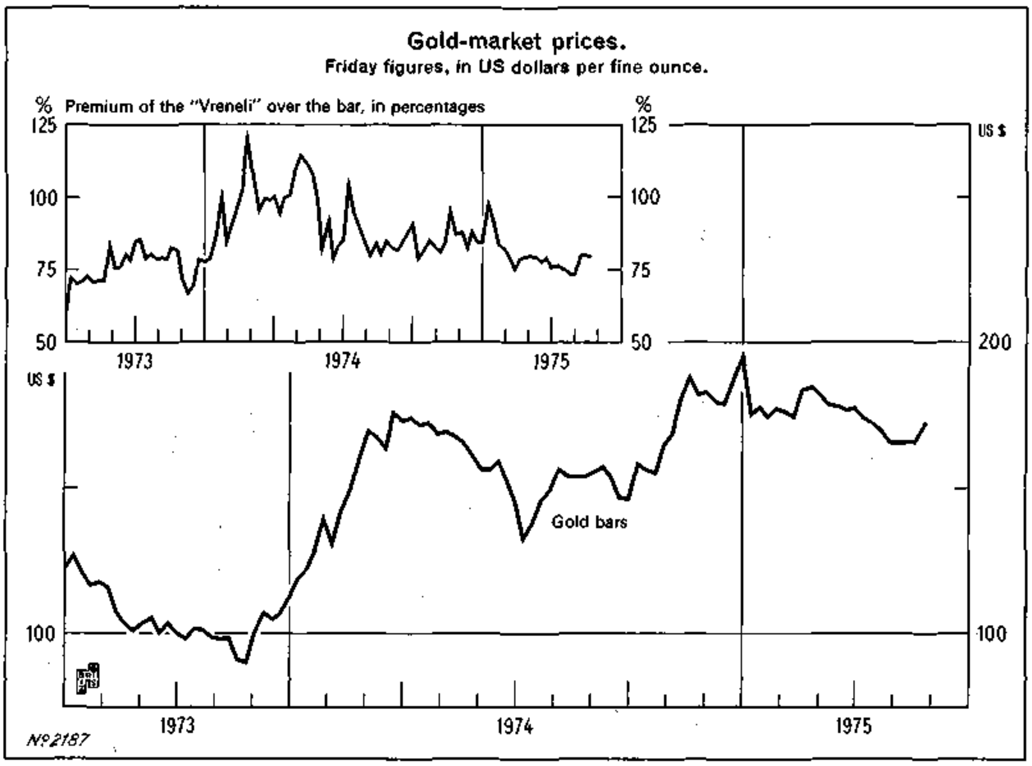
Items	1970	1971	1972	1973	1974
	In metric tons				
Production	1,265	1,230	1,170	1,085	985
Estimated sales by communist countries	50	90	200	330	150
Total	1,315	1,320	1,370	1,415	1,135
Change in western official gold stocks	285	— 125	90	— 35	— 45
Sales on the free market*	1,030	1,445	1,280	1,450	1,180

* Residual figures.

This fall in supplies occurred at a time of accelerating inflation, weak security markets and continuing currency unrest — a combination which strongly stimulated investment demand for gold. The demand came largely from western Europe as well as from the United States and Japan. While the bulk of these purchases was in the form of bars, there was also a sharp increase in purchases of coins, particularly those commanding only a modest premium over their metal value. In South Africa alone 100 tons of coins (Krugerrand) were produced in 1974. Total new coin output for the year has been estimated at over 250 tons, equal to more than one-quarter of western production. A large proportion of these coins was bought by residents of the United States and the United Kingdom, in both of which countries holdings of gold bullion by residents were prohibited. Coin purchases by US residents were facilitated by a Treasury announcement in December 1973 permitting the holding of coins dated 1959 or earlier; previously, only coins minted before 1934 could be held. The result of this investment demand for gold was a sharp further rise in the gold price that squeezed the other non-monetary uses of the metal. The absorption of new gold for industrial purposes (mainly jewellery) was substantially reduced, while in addition there was actually some release of gold onto the market from countries in the Middle and Far East where it is traditionally used as a savings medium.

On the London gold market, the fixing price rose by a further 75 per cent. between the end of 1973 and 30th December 1974, from $112.75 per ounce to a peak of $197.50 per ounce. There were two periods of strong price increase, covering the first four and the last two and a half months, separated by a phase of consolidation during part of which prices fell substantially. Demand for gold was probably at its strongest in the early part of 1974. The London fixing price, which during the last few weeks of 1973 had come up from $90 per ounce, continued to rise sharply after the turn of the year. Under the impact of heavy investment and speculative purchases quotations touched $185 per ounce on 26th February. At that point they had more than doubled in three months. Demand remained high throughout the next two months, sustained by the renewed weakness of the dollar and by expectations that the EEC countries might agree on official gold transactions between themselves at a high fixed price.

From May onwards the trend was reversed, despite a statement by the US Secretary of the Treasury on the 9th of that month favouring freedom for US residents to buy and own gold. The sharp upward movement of short-term interest



Gold-market prices.
Friday figures, in US dollars per fine ounce.

rates increased the cost of holding gold and at the same time the dollar began to recover in the exchange markets. In mid-year the downward trend was reinforced by the failure of the Herstatt bank, which was rumoured to have had long positions in gold. On 4th July the fixing price was down to $129 per ounce; before the end of the month, however, it had recovered to above $150 per ounce. Prices then moved within a fairly narrow range on either side of that figure until mid-October.

At that point the combination of renewed weakness of the dollar on the exchanges, the decline in short-term interest rates and the impending legalisation of US private gold ownership (the bill providing for this was passed by Congress on 31st July) led to a renewed strengthening of demand. Quotations picked up strongly and on 18th November the fixing price touched $190.50. The announcement that the US Treasury would auction a part of the US official gold stock in January 1975 pushed the price down to $170.50 at one point in early December, but the market remained bullish. On 30th December, the eve of the legalisation of private gold ownership in the United States, the fixing price was $197.50.

In the event US private demand proved very small. Nor did the US Government's gold auction attract much interest from non-resident buyers. Of the two million ounces offered on 6th January, just under half was bid for and 750,000 ounces actually sold at or above $153 per ounce. The market price of gold soon dropped to between $175 and $180 per ounce. Unfounded rumours of central-bank support for the market pushed it up to about $185 at one point in February, but demand soon fell off again, with signs that investors were returning to the stock markets. By mid-April quotations had fallen to $165 per ounce, around which level they fluctuated narrowly until going over $170 per ounce again in late May. Demand for coins, too, has declined and in April UK residents were forbidden to purchase from non-residents gold coins minted after 1837.

The size of the payments imbalances resulting from the oil price increases led to some attempts to reactivate monetary gold stocks. Reference has already been made in Chapter I to the EEC countries' initiative in this field in April 1974, to the Group of Ten countries' June 1974 agreement on the use of gold as collateral for central-bank credits and to the $2 milliard gold-backed loan from the Deutsche Bundesbank to the Bank of Italy. That credit was, however, the only transaction of any size during 1974 in which monetary gold played a rôle.

On 16th December a press communiqué issued after a conference between the Presidents of the United States and France stated, inter alia, that the Presidents had agreed that it would be appropriate for any government that wished to do so to value its gold holdings on the basis of current market prices. On 9th January 1975 the French official gold stock was revalued at $170.40 per ounce, the average London market price on 7th January. This increased the dollar valuation of France's gold reserves by $12.9 milliard. In future, the French authorities are to adjust the valuation every six months, on the basis of the average of international market quotations during the preceding three months. So far no other country has revalued its gold stock on the basis of market prices.

Global reserves.

1974 was the fifth successive year of rapid global reserve expansion. Countries' total official holdings of gold, foreign exchange and special drawing rights, together with their IMF reserve positions, may be estimated to have gone up in dollar terms by $40.3 milliard, or 22 per cent. In absolute figures it was easily the highest increase ever recorded in a single year and in relative terms second only to the 43 per cent. rise in 1971. It brought the cumulative expansion of global reserves since the beginning of the 1970s — which was also the time when SDRs were first introduced — to some $150 milliard.

As in other recent years, the increase in the global total was partly a matter of changes in the dollar values of non-dollar reserve assets. In 1974, however, this appears to have accounted for less than one-tenth of the overall reserve increase, as against about one-third the year before, when the dollar was devalued by 10 per cent. against gold. By types of reserve assets, the dollar value of countries' total gold reserves and claims on the IMF went up by $0.9 milliard in 1974 as a result of the 1½ per cent. depreciation of the dollar against the SDR basket between its introduction on 1st July and the end of the year. In addition, valuation changes may have added $2–2½ milliard to the dollar values of countries' non-dollar exchange reserves.

With the significant exception of a major increase in official sterling holdings, last year's rise in foreign exchange reserves essentially took the same form as in other recent years — an increase in dollar reserves held either in the United States or in the Euro-currency market. But whereas earlier reserve growth could be attributed to the US payments deficit, and to some extent to the investment of dollar reserves

Changes in global reserves.[1]

Areas and periods	Gold	Foreign exchange	IMF reserve positions	SDRs	Total
	in millions of US dollars				
Group of Ten					
1972	− 680	+ 6,920	− 80	+ 2,060	+ 8,220
1973	+ 3,490	+ 4,985	+ 105	+ 740	+ 9,320
1974	+ 520	+ 1,865	+ 1,740	+ 390	+ 4,515
Amounts outstanding at end-1974	*35,420*	*64,065*	*6,755*	*7,995*	*114,235*
Other developed countries					
1972	+ 290	+ 7,750	+ 45	+ 405	+ 8,490
1973	+ 485	+ 3,265	+ 170	+ 150	+ 4,070
1974	+ 50	− 2,230	− 100	− 185	− 2,465
Amounts outstanding at end-1974	*4,445*	*21,180*	*1,020*	*950*	*27,595*
Developing countries other than oil-exporting countries					
1972	−	+ 5,410	− 100	+ 430	+ 5,740
1973	+ 185	+ 7,050	+ 240	+ 255	+ 7,730
1974	− 50	+ 2,115	− 190	− 25	+ 1,850
Amounts outstanding at end-1974	*2,355*	*25,205*	*720*	*1,485*	*29,765*
Total oil-importing countries					
1972	− 390	+20,080	− 135	+ 2,895	+22,450
1973	+ 4,160	+15,300	+ 515	+ 1,145	+21,120
1974	+ 520	+ 1,750	+ 1,450	+ 180	+ 3,900
Amounts outstanding at end-1974	*42,220*	*110,450*	*8,495*	*10,430*	*171,595*
Oil-exporting countries[2]					
1972	− 5	+ 3,155	+ 55	+ 160	+ 3,365
1973	+ 160	+ 4,365	+ 110	+ 45	+ 4,680
1974	+ 55	+34,410	+ 1,935	+ 40	+36,440
Amounts outstanding at end-1974	*1,485*	*50,335*	*2,335*	*415*	*54,570*
All countries					
1972	− 395	+23,235	− 80	+ 3,055	+25,815
1973	+ 4,320	+19,665	+ 625	+ 1,190	+25,800
1974	+ 575	+36,160	+ 3,385	+ 220	+40,340
Amounts outstanding at end-1974	*43,705*	*160,785*	*10,830*	*10,845*	*226,165*

[1] Including valuation changes. [2] Ecuador, Venezuela, Iran, Iraq, Kuwait (central bank's holdings plus BIS estimate of government holdings), Oman, Saudi Arabia, Indonesia, Algeria, Libya and Nigeria. For Bahrain, Qatar and the United Arab Emirates only IMF reserve positions are included.

outside the United States, last year it was primarily a consequence of the oil-price increases and of the efforts of oil-importing countries to avoid, by means of borrowing, reserve losses. It was therefore different both in character and in economic implications. First, there was its concentration on a small number of countries with, except for oil, a very limited importance in the world economy and international payments. Secondly, the short-run general inflationary potential of the oil countries' huge reserve increases is limited by the inability of some of the biggest producers to spend on goods and services more than a modest proportion of the sums at their disposal. Thirdly, the vast majority of oil-importing countries feel their reserve positions to have deteriorated — even though as a group they managed, by a combination of autonomous and compensatory capital inflows, to show a slight statistical reserve increase last year. In other words their potential demand for reserves has been increased. Thus the distribution of reserve changes last year was more significant than the global expansion.

The reserves of the oil-exporting countries, on the basis shown in the table on page 107, are estimated to have risen by $36.4 milliard in 1974, bringing these countries' share of the total up from 10 to nearly 25 per cent. Apart from the $1.9 milliard expansion of claims on the IMF resulting from their contributions to the Fund's oil facility, virtually the whole of this was added to foreign exchange holdings. It may be estimated that these countries increased their dollar reserves in the United States by roughly $10 milliard and their sterling reserves in the United Kingdom by some $5 milliard. For the rest, the great bulk of their reserve gains was placed in the Euro-currency market. Two low-population countries together accounted for over 40 per cent. of the total OPEC reserve expansion — Saudi Arabia with a $10.4 milliard increase and Kuwait with one estimated at $5 milliard. Very large reserve gains were also recorded by Iran ($7.1 milliard), Nigeria ($5 milliard) and Venezuela ($4.1 milliard).

The oil-importing countries' total reserves went up by $3.9 milliard in dollar terms. With the exception of the $1.4 milliard increase in Fund reserve positions, most of this can be accounted for by valuation changes resulting from the depreciation of the dollar against other reserve assets. As regards the way in which the non-oil countries held their exchange reserves, it seems that within the $1.8 milliard overall increase during 1974 there was a decline of about the same size in traditional currency reserves — apparently all of it in sterling held in London — which was more than offset by a rise in other types of exchange reserves. Most of this rise can be accounted for by the German and EEC credits to Italy, which added $3.9 milliard to that country's gross reserves while reducing the reported reserves of the lending countries by only $0.6 milliard.

Looked at by groups of countries, or individually, changes in oil-importing countries' reserves last year were uneven and by no means always related to the underlying payments positions. In the Group of Ten, total reserves went up by $4.5 milliard, including gains of $1.7 milliard in the United States, $1.3 milliard in Japan and $0.5 milliard each in Italy and the United Kingdom — all countries with very large increases in their oil import bills and/or substantial current payments deficits. Germany on the other hand, despite its record current payments surplus, showed a reserve loss of $0.3 milliard — the only Group of Ten country apart from Sweden ($0.8 milliard) to do so.

Among the developed countries outside the Group of Ten, where official and private compensatory borrowing was relatively limited, total reserves went down by $2.5 milliard. Australia recorded a $1.4 milliard loss, virtually all of it before the 12 per cent. September devaluation. But Denmark, New Zealand, Portugal, Spain, Turkey and Yugoslavia too showed losses ranging from $0.3 to 0.5 milliard. Austria, Norway and Ireland on the other hand registered significant reserve gains.

Non-oil developing countries added $1.9 milliard to their total reserves in 1974. In this group too there were very divergent movements. Certain Arab non-oil countries showed significant reserve gains — Lebanon with $0.8 milliard and Syria with $0.4 milliard. Substantial reserve growth was also shown by Thailand ($0.6 milliard) and the Philippines ($0.5 milliard). On the other hand, Brazil's reserves, despite further Euro-dollar borrowing, dropped by $1.2 milliard and Israel's by $0.6 milliard.

Looking at developments during the course of the year, the rate of global reserve growth more than tripled between the first and second quarters, to $14 milliard. This reflected the lag between the announcement of the second, and larger, oil-price increase in December 1973 and its actual impact on payments. In the second half of the year the rate of expansion was about $11 milliard in both quarters, but with some shift in the composition from foreign exchange towards higher IMF positions. Two developments were involved: a less rapid reserve accumulation by oil-exporting countries; and greater use of the Fund to finance deficits. During the third quarter the reserves of the non-oil developing countries, after a $3.2 milliard gain in the first half of the year, had declined by $1.6 milliard; and in the final quarter, despite $0.9 milliard of Fund credit and substantial assistance from oil countries, they only rose by $0.3 milliard. Group of Ten countries, on the other hand, showed reserve losses of $1.4 milliard in the first quarter of 1974, followed by cumulative gains of $5.9 milliard during the rest of the year. Other developed countries too did better as the year went on, their combined reserves showing no change for the second half of the year after a $2.5 milliard loss in the first half.

While full information on reserve changes in the first quarter of 1975 is not yet available, it would appear that the growth of global reserves slowed down quite significantly. The reserves of the oil-exporting countries, reflecting their lower current payments surplus, will have increased much less than in preceding quarters, while in addition there were probably declines in the total reserves both of non-oil developing countries and of developed countries outside the Group of Ten. On the other hand, the combined reserves of the Group of Ten increased during the quarter by $4½ milliard. Their exchange reserves increased by nearly $3 milliard, of which Germany accounted for about two-thirds. In addition, Group of Ten countries' gold reserves and their claims on the IMF rose during the quarter by $1.6 milliard, with $1 milliard of this being accounted for by valuation changes.

Monetary movements.

United States. During the course of 1974 the net external monetary position of the United States deteriorated by $7 milliard. In the official sector net liabilities rose by $8.3 milliard; in the banking sector, where short-term claims and liquid liabilities both showed exceptionally large increases, they declined by $1.3 milliard. The main influences during the year on the components of the external monetary position were the payments disequilibrium between the oil countries and the rest of the world, and the dismantling in January of restrictions on US bank lending to non-residents.

In the official sector, US monetary assets went up by $1.5 milliard, mainly as a result of other countries' drawings of dollars from the IMF. In addition, liabilities to foreign official holders of dollars increased during the year by $9.8 milliard, with the oil-exporting countries accounting for the whole of the rise. The additions to these countries' dollar reserves held in the United States, while showing up as an increase in US official monetary liabilities, in fact had the character of autonomous rather than accommodating inflows of funds. Nearly half of them took place in the third quarter alone, when there was a temporary loss of confidence in the Euro-currency market.

In the non-official external monetary sector, the removal on 29th January 1974 of all controls on US bank lending to non-residents coincided with an upsurge of other countries' balance-of-payments financing requirements caused by the oil-price increases. Moreover, during the last quarter of the year there was a significant easing of US monetary policy. The first of these factors by itself might well have had a substantial once-for-all effect, after nine years of restrictions. Together the three of them produced a $18 milliard increase during 1974 in US banks' short-term claims on the rest of the world. By far the largest borrower was Japan, with $6.1 milliard. In addition the short-term indebtedness of the Latin American area to banks in the United States went up by $6.0 milliard, that of Europe by $2.1 milliard and that of Asian countries other than Japan by $1.8 milliard.

Largely offsetting the exceptional increase in the US banks' short-term foreign lending, their liquid liabilities to non-official foreigners rose by the very large figure of $16.7 milliard. The growth of liquid liabilities to foreign commercial banks

United States: External monetary movements.

Items	1973	1974 Year	1974 1st quarter	1974 2nd quarter	1974 3rd quarter	1974 4th quarter	1975 1st quarter
	in millions of dollars (+ = increase in assets, decrease in liabilities)						
Reserves	+ 1,225	+ 1,505	+ 210	+ 360	+ 945	− 10	+ 375
of which							
Gold	*+ 1,165*	—	—	—	—	—	*− 30*
Foreign exchange	*− 235*	*− 5*	—	*+ 85*	*+ 150*	*− 240*	*+ 15*
SDRs	*+ 205*	*+ 210*	—	*+ 30*	*+ 90*	*+ 90*	*+ 50*
IMF gold tranche position	*+ 90*	*+ 1,300*	*+ 210*	*+ 245*	*+ 705*	*+ 140*	*+ 340*
Liabilities to foreign official agencies	− 5,270	− 9,760	+ 1,285	− 4,470	− 2,610	− 3,965	− 2,500
of which							
Liquid	*− 4,595*	*− 8,505*	*+ 1,005*	*− 3,840*	*− 2,550*	*− 3,120*	*− 1,700*
Non-liquid	*− 675*	*− 1,255*	*+ 280*	*− 630*	*− 60*	*− 845*	*− 800*
Net official position	− 4,045	− 8,255	+ 1,495	− 4,110	− 1,665	− 3,975	− 2,125
Short-term claims on foreigners	+ 5,040	+ 17,985	+ 5,090	+ 6,595	+ 1,750	+ 4,550	+ 3,195
Liquid liabilities to foreign non-official institutions and persons	− 4,245	− 16,745	− 4,515	− 3,925	− 3,990	− 4,315	+ 1,915
Banks' net position	+ 795	+ 1,240	+ 575	+ 2,670	− 2,240	+ 235	+ 5,110
Total	− 3,250	− 7,015	+ 2,070	− 1,440	− 3,905	− 3,740	+ 2,985

Note: The 1973 figures include the effects on reserves and on official foreign currency obligations of the devaluation of the dollar. From the third quarter of 1974 onwards data for SDRs and the IMF gold tranche position are valued on the basis of the exchange rate between the dollar and the SDR basket.

amounted to $12.6 milliard, one important element no doubt being the indirect placement of oil countries' funds in the United States through foreign commercial banks. In this connection it is perhaps significant that liabilities to residents of Switzerland increased during 1974 by $6.6 milliard. Moreover, the banks added $2.3 milliard to their liabilities to foreign commercial banks in 1974 through borrowing from their own overseas branches.

The main feature of external monetary movements in the first quarter of 1975 was a $5.1 milliard net outflow through the banks, no doubt largely owing to the US lead in the downward movement of short-term interest rates. The banks' short-term lending to non-residents, which had already gone up very sharply in the fourth quarter of 1974, rose by a further $3.2 milliard. Furthermore, and in contrast to 1974, liquid liabilities to non-official foreign holders declined by $1.9 milliard. This can essentially be accounted for by repayments from banks in the United States to the Euro-dollar market through their overseas branches. The large net outflow through the banks was partly counterbalanced by a $2.1 milliard deterioration in the net official position. Liabilities to foreign official holders increased by $2.5 milliard, to a considerable extent as a result of official intervention to moderate the downward movement of the dollar. In this connection the Federal Reserve drew a total of $0.7 milliard on the swap network during the quarter.

United Kingdom. Thanks to large-scale inflows of oil money and continued foreign currency borrowing by public-sector institutions (nearly all of it under government exchange guarantees), the direct official financing problems of the United Kingdom in 1974 proved rather easily manageable. Borrowing under the official exchange cover scheme financed $2.6 milliard out of the total $5.8 milliard external deficit on current and autonomous capital account (itself considerably reduced by $2.7 milliard of unidentified capital inflows). On top of that, and even more important, was the $5.3 milliard equivalent that the oil-exporting countries added last year to their sterling reserves. The build-up of OPEC official sterling balances was to a considerable extent offset by other countries drawing down their sterling reserves by $2 milliard, as well as by a $1.8 milliard net outflow on account of those foreign currency operations of the banks that are not included in the capital account of the balance of payments. Nevertheless, the total official financing requirement for the year, at $1.2 milliard, was relatively modest.

In fact, during the first three quarters of the year the United Kingdom's official monetary assets increased by $0.7 milliard. The balance-of-payments deficit, after $2.5 milliard of foreign currency borrowing by public-sector institutions, was only $0.5 milliard; and this, together with the outflows through the banks' foreign currency positions and the reduction of non-oil countries' sterling balances, was more than covered by the increase in oil-exporting countries' sterling reserves.

In the fourth quarter, however, there was a large increase in private capital outflows, partly related to the announcement in December by Saudi Arabia that it would take all future oil payments in dollars instead of (as previously) one-quarter in sterling. The authorities supported sterling on a large scale in November and December, total official financing for the quarter amounting to $1.9 milliard. The

United Kingdom: External monetary movements.

Items	1973[1]	1974 Year	1974 Jan.–Sept.	1974 Oct.–Dec.	1975 Jan.–March
	In millions of US dollars (+ = increase in assets, decrease in liabilities)				
Official financing					
Gold and foreign exchange reserves	+ 750	+ 100	+ 515	− 415	+ 305
SDRs	+ 65	+ 105	+ 85	+ 20	—
IMF	+ 15	+ 110	+ 95	+ 15	+ 25
Government foreign currency borrowing	—	− 1,500	—	− 1,500	− 1,000
Total	+ 830	− 1,185	+ 695	− 1,880	− 670
Other monetary movements					
Sterling balances (gross) official[2]	− 370	− 3,300	− 2,390	− 910	.
private	+ 15	− 360	− 395	+ 35	.
Sterling claims of UK banks[3]	+ 325	+ 340	+ 90	+ 250	.
Foreign currency transactions of UK banks[4]	+ 140	+ 1,765	+ 1,505	+ 260	.
Total	+ 110	− 1,555	− 1,190	− 365	.
Overall balance	+ 940	− 2,740	− 495	− 2,245	.

[1] Includes the effects on gold reserves, SDR holdings and the IMF position of the devaluation of the dollar.
[2] Includes sterling holdings of international institutions other than the IMF. [3] Excludes export credit.
[4] Excludes trade credit, UK residents' foreign currency borrowing in London to finance UK investment overseas and UK banks' foreign currency borrowing to finance lending to the public sector.

reserves fell by $0.4 milliard and in addition the government drew $1.5 milliard on the $2.5 milliard Euro-dollar credit line established in May.

In the first quarter of 1975, when the government drew the remaining $1 milliard on its Euro-dollar credit line, the reserves rose by $0.3 milliard. Market intervention in support of sterling was again substantial in January. Subsequently, however, the situation improved and in March the authorities were able to purchase exchange in the market.

France. The overall external monetary position deteriorated in 1974 by $2.9 milliard, mostly in the form of a $2.4 milliard increase in the banking system's net short-term foreign liabilities. Net official monetary assets therefore declined by only $0.5 milliard, and almost all of this simply reflected the disappearance from the reserves in December 1974 of France's share in the March 1974 EEC short-term support loan to Italy, following its renegotiation on a longer-term basis. Excluding this operation, therefore, France's net official monetary position was about the same at the end of the year as it had been at the beginning. Consequently it was not necessary for the government to draw on the $1.5 milliard Euro-dollar credit line established in April 1974.

Both in the official and banking sectors the course of external monetary movements during 1974 divides into two main phases. The first of these covered the first twenty days of January, when the franc came under pressure which led to its being withdrawn from the European "snake". There was a $1.3 milliard net outflow of funds through the banks in January, partly financed by a $0.7 milliard decline in net official assets. The second phase covered the whole of the rest of the year when cumulative net banking inflows of $3.7 milliard — the combined result of tight domestic monetary conditions and of a deliberate policy of encouraging foreign borrowing through the banks by public and private corporations — were sufficient to permit a rebuilding of net official monetary assets to just above the end-January level.

In the first four months of 1975 net official assets rose by $1 milliard. During January and February there were further net short-term banking inflows of $0.9 milliard.

Italy. During 1974 Italy experienced the greatest external financing problems of any major industrial country. Although public-sector institutions borrowed a further net $2.3 milliard in the Euro-currency market, the official monetary position deteriorated by $4.8 milliard. Net new external monetary indebtedness incurred during the year amounted to $5.3 milliard, so that the reserves actually put on $0.5 milliard.

Looking at the course of events during the year, exchange reserves fell by $1 milliard in January and February. They were then replenished to the extent of $1.3 milliard in March when, in addition to a $0.4 milliard inflow through the banks, $1.9 milliard equivalent of short-term assistance was obtained from Italy's EEC partners. During the second quarter, despite a further $1 milliard banking-sector inflow, the whole of the March gain was lost and by the middle of the year exchange reserves were below the end-February level. To safeguard the position, in the third quarter the authorities undertook further external borrowing well in excess of current financing requirements: $1.8 milliard was drawn on the IMF and the Bank of Italy obtained a $2 milliard six-month loan (renewable for up to two years) from the Deutsche Bundesbank, with gold collateral. Despite a $1.1 milliard reduction in the banking sector's short-term foreign indebtedness, these operations helped to add $2.9 milliard to the exchange reserves during the quarter, bringing them up to $4 milliard by the end of September. Pressure on the reserves resumed in the fourth quarter, though it was less strong than in the first half of the year. Official monetary assets declined by $0.8 milliard, despite further drawings of $0.5 milliard on the IMF. In addition, $1.4 milliard of the short-term assistance obtained from other EEC members in March was converted into medium-term credits with an average maturity of 3½ years.

In the first part of 1975 the situation showed a dramatic further improvement, with the overall deficit for the first four months of the year down to only $0.2 milliard. Net official monetary assets actually showed a small increase of $0.1 milliard during these months, the authorities making quite substantial market purchases of exchange in March and April. Also in March $0.5 milliard was repaid on the German loan while a further $0.4 milliard was drawn on the IMF.

Germany. Despite its record current-account surplus, substantial capital outflows reduced Germany's overall external surplus in 1974 to $3.3 milliard, as compared

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

Countries	End of year	Gold	Net foreign exchange	Claims on, or liabilities to, IMF	Total official assets (net)	Commercial banks (net)	Total foreign assets (net)	Changes (+ = increase in assets, decrease in liabilities) Official assets (net)	Commercial banks (net)
		In millions of US dollars							
Austria	1973	880	1,730	255	2,865	— 740	2,125	+ 150	— 145
	1974	880	2,260	265	3,405	—1,145	2,260	+ 540	— 405
Belgium-Luxembourg .	1973	1,780	1,860	1,350	4,990	—1,935	3,055	+ 1,165	— 870
	1974	1,780	2,275	1,340	5,395	—1,885	3,510	+ 405	+ 50
Denmark	1973	75	915	290	1,280	— 40	1,240	+ 485	— 85
	1974	75	555	200	830	330	1,160	— 450	+ 370
Finland	1973	35	510	160	705	15	720	— 55	— 30
	1974	35	400	160	595	— 190	405	— 110	— 205
France	1973	4,260	3,385	545	8,190	—3,430	4,760	— 1,185	+ 715
	1974	4,260	2,705	770	7,735	—5,840	1,895	— 455	— 2,410
Germany	1973	4,965	25,275	3,130	33,370	—2,865	30,505	+ 9,725	+ 2,120
	1974	4,965	24,615	3,345	32,925	835	33,760	— 445	+ 3,700
Greece	1973	150	825	70	1,045	15	1,060	+ 15	—
	1974	155	745	— 10	890	30	920	— 155	+ 15
Iceland	1973	—	65	15	80	— 20	60	+ 10	— 5
	1974	—	25	— 10	15	— 25	— 10	— 65	— 5
Ireland	1973	20	910	95	1,025	— 35	990	— 100	+ 35
	1974	20	1,145	100	1,265	— 25	1,240	+ 240	+ 10
Italy	1973	3,480	2,130	770	6,380	— 955	5,425	+ 145	— 180
	1974	3,480	— 460	—1,460	1,560	—1,300	260	— 4,820	— 345
Netherlands . . .	1973	2,295	2,605	945	5,845	— 80	5,765	+ 1,160	— 295
	1974	2,295	3,430	1,135	6,860	— 140	6,720	+ 1,015	— 60
Norway	1973	40	1,330	185	1,555	— 25	1,530	+ 250	+ 30
	1974	40	1,610	195	1,845	— 90	1,755	+ 290	— 65
Portugal	1973	1,160	1,630	35	2,825	315	3,140	+ 515	+ 100
	1974	1,175	1,005	35	2,215	260	2,475	— 610	— 55
Spain	1973	600	5,920	280	6,800	— 195	6,605	+ 1,795	—
	1974	600	5,115	310	6,025	— 100	5,925	— 775	+ 95
Sweden	1973	245	1,985	235	2,465	625	3,090	+ 945	+ 335
	1974	245	1,210	235	1,690	980	2,670	— 775	+ 355
Switzerland . . .	1973	3,515	4,965	—	8,480	3,635	12,115	+ 1,480	+ 405
	1974	3,515	5,410	—	8,925	5,795	14,720	+ 445	+ 2,160
Turkey	1973	150	775	80	1,005	.	.	+ 450	.
	1974	150	110	90	350	.	.	— 655	.
Canada	1973	925	3,850	905	5,680	— 390	5,290	— 270	+ 255
	1974	940	3,620	1,105	5,665	495	6,160	— 15	+ 885
Japan.	1973	890	9,935	1,155	11,980	—3,485	8,495	— 6,065	— 3,960
	1974	905	11,185	1,270	13,360	-11,595	1,765	+ 1,380	— 8,110

[1] For most of the countries shown in the table the figures given do not correspond exactly to published figures. In addition, the methods used for converting non-dollar assets and liabilities into dollars are not all uniform.

with \$11.8 milliard in 1973. As in addition there were net short-term outflows of \$3.7 milliard through the banking system, net official monetary assets actually showed a small decline of \$0.4 milliard for the year as a whole, the first since 1969.

Looking at developments in the course of the year, the banking outflows were concentrated in two periods. The first of these, amounting to \$0.9 milliard, was in January when there was a reversal of end-year window-dressing operations. The main outflows, however, came in the last four months of the year when, with liquidity increasing as a combined result of the domestic recession and the related easing of monetary policy, the banks added \$3 milliard to their net short-term claims on non-residents, four-fifths of it in Deutsche Mark. The Herstatt failure, on the other hand, does not appear to have given rise to any net outflow of banking funds. It is true that during July and August non-residents reduced their short-term balances at German banks by \$2 milliard; but this was virtually offset by a reduction in the German banks' short-term claims on the rest of the world.

In the official sector, net assets fluctuated considerably during the year. After falling by \$0.9 milliard in January, they rose by \$2.3 milliard during the following four months and then declined by about the same amount between end-May and mid-September, most of the latter movement taking place before the large-scale banking outflow began. About two-thirds of the reserve increase during February-May and over half of the subsequent decline occurred as a result of market intervention within the "snake". In addition, during the first of these periods Federal Reserve drawings on the swap line with the Bundesbank added \$0.4 milliard to Germany's dollar reserves, all of which was repaid by the end of August. In the final quarter of the year, when the overall balance of payments went into very substantial surplus, net official assets rose by \$0.8 milliard parallel with a net banking outflow of \$1.7 milliard.

In the first quarter of 1975, when the overall payments surplus rose a little further to \$2.7 milliard, net official assets put on \$2.2 milliard. This figure includes substantial official purchases of dollars from the market, as well as renewed swap drawings by the Federal Reserve; on the other hand, the German authorities did not intervene during this period to support the currencies of other participants in the "snake". In April, when the Deutsche Mark weakened in the exchange market, there was a \$1.8 milliard short-term outflow through the banks and net official assets declined by \$1.1 milliard.

Switzerland. With the authorities abstaining entirely from intervention in the exchange market, it was not surprising that the \$2.6 milliard improvement in Switzerland's net external monetary position during 1974 was mainly reflected in a \$2.2 milliard increase in the commercial banks' net foreign assets. The \$0.4 milliard growth in net official monetary assets broadly reflected the fact that over the end of 1974 the National Bank absorbed some \$0.6 milliard more from the banks than it had done a year earlier.

Excluding the effects of end-month swap transactions between the banks and the National Bank, the net outflow of banking funds was strongest during the period February-April 1974 when, partly as a result of high yields on Euro-franc deposits, it reached $1.7 milliard. There was also some further increase during the final quarter of the year, despite the strong demand for Swiss francs that developed from late October onwards, including from oil-exporting countries.

By early 1975 this movement had generated such upward pressure on the franc that the authorities intervened in January and February with market purchases of dollars totalling $0.8 milliard. For the whole of the quarter, however, reserves showed a slight decline, mainly owing to a $0.7 milliard reduction in dollars held by the National Bank under swaps with the commercial banks. Altogether the banks' net foreign assets increased by $2.4 milliard during the quarter.

Belgium-Luxembourg. In 1974 the overall external monetary position of the BLEU showed a further improvement of $0.5 milliard, nearly all of which was added to reserves. Dollar reserves went up by $0.7 milliard, while official holdings of lire declined by $0.4 milliard as a result of the progressive liquidation of swaps with the Bank of Italy.

Net official assets dropped by $0.5 milliard in the first five months and then rose by nearly $1 milliard over the rest of the year. The earlier decline went with a $0.9 milliard net outflow through the banking sector. Under the influence of high dollar interest rates the banks continued on balance to reduce their net foreign liability position until September. During the fourth quarter, however, when dollar interest rates fell, a $1 milliard net inflow through the banks reversed virtually the whole of the previous nine months' outflow.

In the first quarter of 1975, when there was a large overall external surplus, net official assets rose by a further $0.5 milliard and in addition there was a $0.7 milliard net short-term outflow through the banks.

Netherlands. In the Netherlands, too, the overall external surplus for 1974, amounting to $1 milliard, was almost exactly reflected in an increase of net official assets. Both the exchange reserves and claims on the International Monetary Fund went up over the year by $0.2 milliard, the latter including contributions of $106 million to drawings on the IMF oil facility — the only ones, apart from Canada's, to come from a non-OPEC source. In addition, $0.6 milliard of debts to other EEC countries outstanding through the European Monetary Co-operation Fund at the end of 1973 were repaid in January 1974.

Within their basic upward trend net official assets fluctuated considerably during the course of the year, to a considerable extent as the counterpart to changes in the banks' net foreign position. In the first half of the year, when the authorities returned to the banks $0.9 milliard of dollars taken in from them under swaps during the last quarter of 1973, net official assets declined by $0.4 milliard while the total net short-term outflow through the banking system was $0.6 milliard. During the third quarter, on the other hand, there was a $0.8 milliard largely seasonal short-term banking inflow and the reserves rose by $1.1 milliard. And in the fourth quarter their further rise, amounting to $0.3 milliard, was held back by $0.2 milliard of short-term outflows through the banks as well as by the transfer out of reserves of the Netherlands' share in the March 1974 short-term EEC assistance to Italy, also amounting to $0.2 milliard, following its renegotiation on a longer-term basis.

During the first quarter of 1975 net official assets rose by a further $0.2 milliard and there appears to have been a continuation of short-term banking outflows.

Sweden. Net official assets went down during the year by $0.8 milliard, or about one-third. Nearly one-half of this was the counterpart to net outflows through the banking system. The banking outflow, essentially the result of interest rate differentials, was concentrated in the first half of the year while the reserve losses continued into July. The reserves then increased slightly over the last four months of the year. In the first quarter of 1975 there was a $0.2 milliard overall surplus, divided about equally between increases in reserves and in the banks' net foreign assets, while in April the surplus reached the high figure of $0.4 milliard, with reserves going up by $0.3 milliard.

Austria. Net official assets rose last year by $0.5 milliard, three-quarters of which had a counterpart in an increase in the banks' net foreign liabilities. Both reserve increases and the banking inflow were concentrated in the latter half of the year, when in fact they amounted to $0.7 and 0.5 milliard respectively. The banking inflow was caused by an increase in short-term foreign currency credits to domestic customers. During the first quarter of 1975 reserves went up by a further $0.3 milliard, though the inflow through the banks came to an end.

Denmark. Last year's total deterioration of $0.1 milliard in the external monetary position was the outcome of a $0.5 milliard reduction in net official assets largely offset by a $0.4 milliard short-term outflow through the banking system. In the first five months of the year alone the banks' net spot purchases of foreign exchange amounted to $0.5 milliard, as a counterpart to forward exchange purchases by Danish enterprises hedging against the possibility of devaluation. Mainly because of this the reserves fell by $0.6 milliard over this period. In June, as confidence revived, the banks' net foreign currency assets fell by $0.2 milliard, half of which was added to reserves. During the rest of the year there was on balance very little change in either reserves or the banks' foreign position. In the first quarter of 1975, however, there were renewed reserve losses totalling $0.2 milliard.

Finland. The overall payments deficit widened between 1973 and 1974 from $0.1 to 0.3 milliard, two-thirds of which was financed by inflows through the banks. Most of the deficit occurred in the final quarter of the year. The unfavourable trend apparently came to a halt in the early months of 1975, when reserves remained virtually unchanged at the end-1974 level of $0.6 milliard.

Norway. Despite an increase in the current payments deficit, higher capital imports permitted a further $0.2 milliard improvement in Norway's external monetary position during 1974. As the banks' net foreign liabilities increased by

$0.1 milliard, $0.3 milliard was added to official reserves. Two-thirds of the reserve increase resulted from support given to the currencies of other members of the European "snake". The movement in reserves was reversed, however, in the first quarter of 1975, when the krone required considerable support within the "snake" and net foreign exchange reserves declined by $0.3 milliard.

Spain. After increasing nearly eightfold during the four preceding years, Spain's monetary reserves began to decline in the first quarter of 1974, owing to a deterioration in the foreign trade balance. Except for an interruption during the seasonally favourable summer months, this decline continued throughout 1974 and accelerated in 1975. During the fifteen-month period to the end of March 1975 the cumulative net reserve loss was $1.3 milliard, nearly half of which occurred in the first quarter of this year, when $0.5 milliard was drawn on the International Monetary Fund.

Portugal. In 1974 the official reserves declined by $0.6 milliard, to stand at $2.2 milliard at the end of the year. During the first quarter of 1975 there was a further reserve loss of $0.2 milliard.

Other European countries. In *Greece* net official assets declined by $0.2 milliard in 1974, with very little change in the banks' net foreign position. In *Turkey* net official assets, which in 1973 had almost doubled to $1.0 milliard, showed an even more pronounced decline in 1974, to only $0.4 milliard at the end of the year. The reserve drain accelerated in 1975 and by the end of the first quarter the net official monetary position was slightly negative. In *Ireland,* on the other hand, net official monetary assets rose by $0.2 milliard during 1974, despite some outflow of funds through the banks. In the first four months of 1975, however, reserves declined slightly.

Canada. The overall external monetary position showed a surplus of $0.9 milliard in 1974, entirely in the form of an improvement in the banks' net foreign position. Nearly all of the banking outflow took place in the first three quarters of the year, before the easing of US monetary policy. Net official monetary assets, virtually unchanged over the year as a whole, increased by $0.5 milliard during the first four months as the Canadian dollar went to a considerable premium over the US dollar; by the end of September, however, the reserve gain had been fully reversed as the currency weakened. As regards the composition of reserves, claims on the IMF rose during the last four months of the year by $0.2 milliard as a result of drawings on Canada's contribution to the Fund's oil facility, with a corresponding decline in exchange reserves.

In January and February 1975 there was little change in the overall external monetary position. In March, with the Canadian dollar continuing to weaken, there was an overall deficit of $0.5 milliard, mostly covered by an inflow through the banks. In April, however, when the currency dropped to below par on the US dollar, reserves fell by $0.3 milliard.

Japan. Following a reserve loss of over $6 milliard in 1973, Japan chose to meet its 1974 financing needs entirely through the banking system; in fact the net short-term inflow through the Japanese banks was $8.1 milliard, considerably in excess of the $6.7 milliard overall external deficit. Thus, net official monetary assets went up by $1.4 milliard.

Last year's financing needs were concentrated mainly in the first six months. During that period the banks' net short-term foreign borrowing amounted to $8.4 milliard, enough to cover the overall deficit and leave $1.3 milliard for adding to reserves. In mid-year the authorities greatly slowed down the banks' foreign borrowing by effectively limiting their further recourse to the Euro-market. Although the banks' overall indebtedness grew by a further $0.4 milliard during the third quarter, net official assets fell by $0.5 milliard in July and August, reversing the previous trend. In the fourth quarter the overall external balance turned into strong surplus, so that although the banks reduced their net short-term foreign liabilities by $0.7 milliard net official assets put on $0.3 milliard.

In the first quarter of 1975, a $1.2 milliard overall deficit in January, entirely financed by renewed short-term banking inflows, was followed by a surplus of $0.6 milliard in the months of February and March, with corresponding increases in net official assets.

International Monetary Fund.

In 1974 member countries' use of the Fund's resources was the largest ever. Total gross drawings came to SDR 4,053 million while countries' net use of the Fund's resources, after deducting SDR 1,603 million of repurchases, was also a record, at SDR 2,450 million.

To a considerable extent the larger use of the Fund's resources resulted from the establishment in June 1974 of the facility for assisting member countries to meet the impact of the higher cost of imported oil. To finance this, the Fund entered into borrowing arrangements with seven oil-exporting members, plus Canada and the Netherlands, for a total of SDR 3,051 million. The largest contributions were made by Saudi Arabia (1,000), Iran (580), Venezuela (450) and Kuwait (400). Thirty-three Fund members drew a total of SDR 1,716 million on the oil facility during 1974, the largest drawings being by Italy (675), India (200), Yugoslavia (139), Pakistan (98), Korea (90) and New Zealand (86). Full repayment of these drawings may be extended over a period of up to seven years, as compared with five years for regular drawings. In addition, interest rates were set higher than for the Fund's usual operations, lenders receiving 7 per cent. on their money and borrowers being charged the same rate.

Outside the oil facility gross drawings last year totalled SDR 2,337 million. Eight European countries drew a total of SDR 1,351 million, of which Italy accounted for SDR 968 million. Four other European countries — Denmark, France, Germany and the Netherlands — drew a total of SDR 312 million to enable them to repay debts incurred through their currencies having been supported within the European "snake" by the monetary authorities of other participants. Developing countries drew a total of SDR 936 million, of which India accounted for SDR 373 million. By far the largest repurchases in 1974 were those of the United States, totalling SDR 1,007 million. Nine-tenths of this amount resulted from other countries' drawings of US dollars.

In addition to the oil facility, the Fund introduced in September 1974 another longer-term lending facility designed to benefit developing countries in particular. This enables members "in certain special circumstances of balance-of-payments difficulty" to conclude stand-by arrangements with the Fund for up to three years instead of only one year; to increase their maximum use of the Fund's resources from 125 to 190 per cent. of their quotas; and to take up to eight years for the repayment of drawings. Coming on top of the existing special drawing facilities to finance major export shortfalls in primary producing countries and the holding of buffer stocks of primary commodities, the introduction of the oil facility and the extended Fund facility means that there are now five different categories of drawings possible on the Fund's General Account.

Turning to SDRs, no new allocations were made at the beginning of 1974 or 1975. Total gross transfers of SDRs in 1974 amounted to SDR 1,038 million. Transactions between countries under the designation procedure totalled SDR 449 million, while SDR 379 million was transferred by agreement among the members of the European "snake" in settlement of debts arising from exchange-market support operations. Transfers between countries and the Fund's General Account came to SDR 211 million, of which SDR 120 million was for the purpose of reconstituting countries' SDR holdings.

In the first quarter of 1975 total drawings on the Fund amounted to SDR 1,358 million. Of this, SDR 769 million represented drawings on the oil facility, the largest being those of Spain (296) and Turkey (113). Outside the oil facility the largest drawing was one of SDR 300 million by Italy. Net use of the Fund's resources during the quarter totalled SDR 1,116 million.

Reference has already been made (see page 30) to the conclusion of the Committee of Twenty's work on monetary reform and its continuation by the new Interim Committee of the Board of Governors, as well as to the valuation of the SDR as from 1st July 1974 in terms of a basket of sixteen currencies. In addition the General Arrangements to Borrow (GAB) were extended for a further five years in October 1974. In January 1975 broad agreement was reached on the sixth overall increase in Fund quotas. Total quotas are to be raised by 32½ per cent., rounded up to a figure of SDR 39 milliard. The share of OPEC Fund members in total quotas is to be doubled, from 5 to 10 per cent., and that of the group of non-oil developing countries to be at least maintained at the present figure of 23 per cent. Details of the new structure of quotas have not yet been agreed.

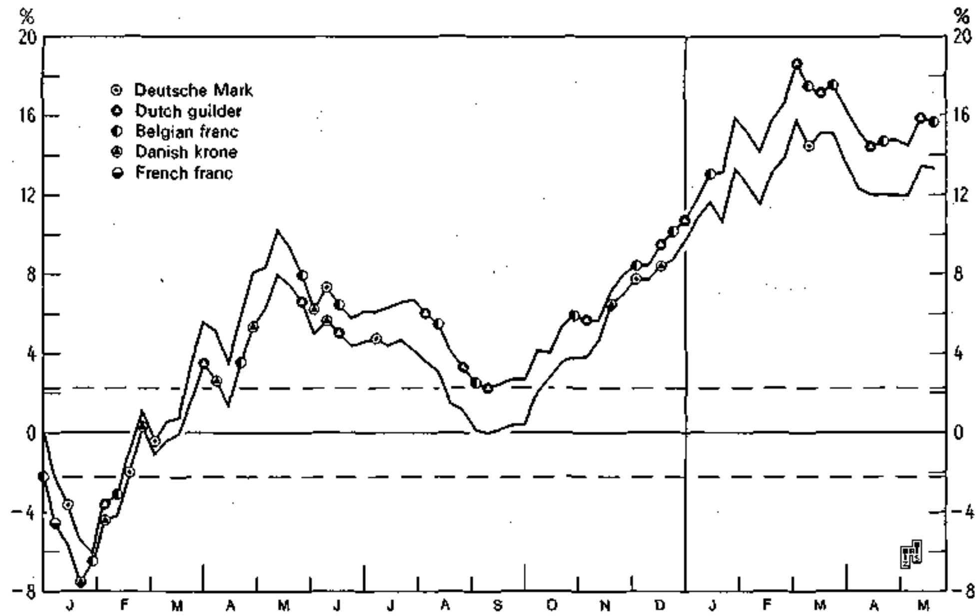
Following the agreement in principle reached at the meeting of the Interim Committee in January 1975, the enlargement of the Fund's oil facility was formally announced in April. On top of the unused SDR 540 million left over from the 1974 facility, up to a further SDR 5 milliard of resources is to be sought from oil-exporting countries and other Fund members in strong external positions. Access to the facility is to be made more conditional than before.

Joint float of certain European currencies.

The joint float of the currencies of Belgium, Denmark, Germany, the Netherlands, Norway and Sweden continued during the period under review on the basis established in March 1973, France having withdrawn from the group on 21st January 1974. The band of participant currencies continued to be repeatedly stretched to its maximum width, with particularly large-scale interventions being necessary during the spring of 1974, when the Deutsche Mark was the strongest currency in the group, and in the third quarter, when for much of the time it was the weakest. Moreover, on a number of occasions the authorities of participating countries chose to intervene in dollars in anticipation of reaching the limits vis-à-vis their partner currencies in the "snake". This was partly because pressure within the "snake" often arose as a result of excess market supply or demand for dollars against a particular member currency, such as the Deutsche Mark. In addition, to the extent that it lessens the need for intervention in the "snake", dollar intervention reduces the scale of settlements arising out of such interventions. For EEC members of the "snake" these settlements can give rise to difficulties since they have to be made in assets corresponding in composition to the debtor country's reserves.

During the period of renewed weakness of the US dollar between late January and mid-May 1974 the six currencies remaining in the "snake" rose to between 9 and 11 per cent. above their nominal central dollar rates. From early March onwards the Deutsche Mark was at the top of the "snake" with the Swedish krona, the Danish krone and subsequently the Belgian franc at the bottom. The German authorities

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



Note: The French franc was allowed to float independently beginning 21st January 1974.

supported these currencies to the extent of some $1.6 milliard between early March and mid-May. During the recovery of the dollar, from mid-May to early September, the "snake" moved down against it by about 8 per cent. In June, with the market relatively calm, outstanding claims and debts arising out of intervention in the "snake" fell almost to zero. Following the Herstatt failure the Deutsche Mark eased against the dollar more than the other currencies of the joint float and went to the bottom of the "snake". The Belgian franc, the Dutch guilder and the Norwegian krone were the strongest currencies in the group during this summer period and supported the Deutsche Mark to the extent of about $1.3 milliard in the third quarter.

From early September 1974 until the beginning of March 1975 the "snake" moved steadily upwards by altogether 17 per cent. vis-à-vis the dollar, but without strong pressures arising between the member currencies. In fact large-scale dollar purchases by Germany, particularly in January and February 1975, had the effect of keeping the Deutsche Mark from rising to the top of the group. By the beginning of March the currencies of the "snake" were in a band 16½–18¾ per cent. above their nominal central dollar rates. Subsequently they eased a little against the dollar, although by late May, when the dollar had weakened again, the band was only about 2½ per cent. lower than it had been at the March peak. During the course of March the Deutsche Mark fell to the bottom of the "snake" and in April it was given moderate support by some other members of the group. In addition there were substantial sales of dollars in the exchange market by the German authorities.

Following the very sharp rise of the Swiss franc against all other major currencies which started in late October 1974, the Swiss authorities began early in 1975 to explore with the participants in the joint float the possibility of the Swiss franc joining the group. No decision has yet been taken on this. On 9th May the French President indicated that, in view of the improvement in France's external situation, the French franc might be rejoining the group. Later in the month the franc was again within 2¼ per cent. of its cross parities with the "snake" currencies.

During the period under review the Austrian schilling continued to be informally linked to the "snake". In mid-May 1974, however, following strong upward pressure on the schilling its margins of fluctuation against "snake" currencies were widened from 2¼ per cent. to 4½ per cent., and the effective exchange rate vis-à-vis these currencies and the Swiss franc was raised by about 3 per cent.

Other exchange developments.

Apart from the exchange rate developments described in Chapter I and the preceding section of this chapter, the main industrial countries made further significant changes during the period under review in administrative controls over international movements of funds. To a large extent these consisted in the continuation of the removal of restrictions on inward movements of funds, together in some cases with measures to encourage inflows, which had been started early in 1974 following the oil price increases. (See 44th Annual Report, pages 150–155). In Switzerland, however, the removal of these restrictions was so rapidly followed by a major movement into the franc that they were soon reintroduced and extended in scope. Another feature of the period under review was the tightening-up by the authorities in a number of European countries, as well as in the United States, of their supervision and/or regulation of the banks' foreign exchange operations, following the banking disturbances that occurred in the spring and summer of 1974. Finally, in the rest of the world there were a number of exchange rate depreciations, as well as some changes in exchange rate policy away from maintaining the stability of currencies in terms of the US dollar to policies of stabilisation against a trade-weighted basket of foreign currencies.

Regulation and supervision of banks' foreign exchange operations. Following the heavy foreign exchange losses sustained by a small number of banks in the spring and summer of 1974, a number of countries moved to strengthen official control and supervision of that part of the activities of their banking system. The first to do so was *Germany,* in mid-July 1974, following the failure of the Herstatt bank towards the end of June. Banks were obliged to report at the end of each month their forward exchange positions, including some maturity and currency break-downs, as well as separate reporting of positions vis-à-vis residents and non-residents. Subsequently, limits on banks' open foreign exchange positions (spot plus forward) at the end of each working day were introduced in October. These limits were 30 per cent. of a bank's liable funds for the total of a bank's open position and 40 per cent. each for positions maturing within one calendar month and within one calendar half-year. From April 1975 onwards banks were only required to report their overall forward exchange positions with no further break-downs.

In *Switzerland* the reporting of banks' forward exchange transactions was put on a monthly basis in July 1974 and from end-October this was also applied to other financial institutions subject to the Banking Law. This was followed in April 1975 by a gentleman's agreement under which the banks (as well as non-bank institutions engaged in foreign currency business) report to the authorities at the end of each business day all exchange transactions, spot or forward, of $5 million or more. Exceptionally large transactions are reported before execution and the authorities may in certain circumstances intervene in such transactions.

In the *United Kingdom* the authorities tightened up their supervision of the banks in August 1974. In December 1974 banks were asked to report on the scope of the dealing authorities delegated to their overseas branches and a recommended code of conduct in that field, designed to lessen the risk of exchange losses, was circulated by the authorities.

In *Austria* reporting of the banks' gross forward exchange transactions, and related balance-of-payments items, was introduced in August 1974.

In the *United States* in mid-October 1974 the Treasury issued new regulations requiring major domestic banks, including their foreign branches and subsidiaries, to report their spot and forward assets and liabilities in each of nine major foreign currencies on both a weekly and monthly basis. As from February 1975 US non-bank corporations were required to report any spot and forward foreign currency positions in nine major currencies which were equivalent to $1 million or more.

In *Luxembourg* banks were asked in September 1974 to supply more detailed information on their forward exchange contracts and in November they were required to report monthly all open forward positions in a foreign currency exceeding the equivalent of L.fr. 25 million.

In *Belgium* daily reporting of forward positions in major foreign currencies was introduced in October 1974. Banks were also required to report monthly a maturity schedule of their net foreign exchange positions (spot, forward and combined) in leading currencies, as well as details of all individual forward exchange operations in excess of 10 per cent. of their own funds. In January 1975 surveillance of the banks' forward exchange operations was tightened.

Turning to *changes in controls over international movements of funds*, in *Germany* the Bardepot (cash deposit) scheme for limiting foreign borrowing by domestic non-bank corporations was suspended in September 1974 and the restrictions on non-resident purchases of bills of exchange and similar claims on German residents were removed. Following these measures, the minimum reserve ratios on the banks' foreign liabilities were lowered by 8 per cent. in October, with the new rates ranging from 32.2 per cent. for sight deposits to 23 per cent. for savings deposits. In January 1975 German banks and issuing houses were requested to limit non-resident Deutsche Mark bond issues and private placements to DM 300 and 150 million per month respectively. This arrangement was replaced in April 1975 by one under which the banks agreed to place outside the country all Deutsche Mark loans issued by foreign borrowers.

In *Japan* a variety of measures were taken during the second half of 1974 to encourage inflows of funds. In August restrictions were eased on the swapping of dollars into yen by foreign banks operating in Japan, on non-resident purchases of short-term government paper and unquoted fixed-interest securities, on prepayments for Japanese exports and on foreign borrowing by domestic industrial companies. In September reserve requirements and interest rate limits on non-residents' freely convertible yen accounts were removed and in October non-residents were freely allowed to purchase newly-issued domestic bonds and debentures.

On the other hand, prior to these measures Japanese banks were requested in June to limit their takings of Euro-dollar funds, which had increased very rapidly during the first part of the year. In July the banks were requested not to increase their dollar lending to non-residents beyond the end-June level. Towards the end of the year, however, this restriction was relaxed so far as lending to Japanese companies operating overseas was concerned.

In *Switzerland* the prohibition of the payment of interest on non-resident franc deposits was suspended in mid-October 1974, thus completing the removal of the various restrictions on short-term inflows of funds that had been imposed from 1971 onwards. When this move was swiftly followed by a movement into the franc, restrictions on inflows were reimposed on a more comprehensive scale than earlier. In late November the interest ban was reintroduced, together with a commission charge of 3 per cent. per quarter and reserve requirements, on all increases in non-resident franc deposits above the end-October level. To prevent these measures being circumvented through the forward exchange market, banks were instructed to keep forward sales of francs to non-residents at or below the end-October level. In January 1975 the interest ban was applied to the total stock of non-resident franc deposits, and the commission charge raised to 10 per cent. per quarter. At the same time banks were instructed to reduce their forward sales of francs to non-residents and were prohibited from taking up overall (spot plus forward) short positions in all foreign currencies taken together. This measure was extended in April to cover positions in each of nine major currencies separately, as well as positions in all other foreign currencies taken together.

The Swiss authorities also acted in November 1974 to ensure prompt export of funds borrowed in the Swiss market by non-residents by reintroducing immediate compulsory sale of the proceeds on the exchange market. In December this regulation was tightened up by requiring such conversions to be made at the National Bank. Earlier in the year, in order to ease the situation on the domestic capital market, the issue of franc-denominated loans and notes by non-residents had been temporarily prohibited in May. From August onwards private placements of notes, and from September onwards loan issues, by non-residents were again allowed and in May 1975 all limits on private placements of notes were removed.

In *Sweden* a number of measures have been taken since the spring of 1974 to encourage inflows of funds. In April 1974 banks were allowed to raise interest rates on loans to customers if this would lead domestic companies to seek more external finance. At the same time the minimum period for which firms could borrow abroad to finance industrial investment was reduced from ten to five years. In June 1974 payment of interest on any subsequent increase in residents' foreign currency deposits with Swedish banks was prohibited. This was followed in August by permission for borrowing abroad without reference to any particular purpose for which the funds were required.

In *Italy* a cash deposit scheme was introduced in early May 1974 under which importers were required to place on six-month non-interest-bearing deposit accounts at the Bank of Italy 50 per cent. of the c.i.f. value of a wide range of merchandise imports. In late July most agricultural imports were exempted from the deposit requirement, following an agreement between the EEC countries, and the whole scheme was abolished in March 1975. In July 1974 the Italian authorities prohibited any further increase in the commercial banks' net short-term foreign indebtedness.

In *Spain* the banks were allowed freely to open accounts in convertible foreign currencies for non-residents as from July 1974. No bank, however, may accept a total of such deposits for periods of up to three years in excess of twice its own funds. Funds received in this way may be lent at home or abroad, subject to a limit on loans to non-residents of 5 per cent. of a bank's total deposits or 20 per cent. of the borrower's resources.

In *Denmark* the limit on individual long-term foreign borrowing by domestic enterprises was raised in September 1974 from D.kr. 5 to 20 million a year. As from

December residents of other EEC countries have been allowed freely to purchase krone-denominated bonds quoted on the Copenhagen stock market.

In *Austria* the restrictions introduced in November 1972 on certain types of inward non-resident investment and on foreign borrowing by residents to finance imports and domestic investment have been extended until the end of 1975. In addition, the August 1971 arrangements under which the banks refrain from adding to domestic liquidity through increases in their foreign currency liabilities vis-à-vis non-residents have been extended until mid-1975. Since the end of 1974, however, the banks are no longer required to place on non-interest-bearing accounts at the National Bank 75 per cent. of any increase in their schilling liabilities to non-residents.

In the *United Kingdom* the sterling guarantee agreements, originally entered into in 1968 for a period of three years with individual overseas sterling countries, were discontinued at the end of 1974. By then the guarantees had lost much of their former importance as they had not applied to increases in those countries' balances since September 1973, some of which, following the oil-price increases, had been very substantial.

In the field of exchange control, restrictions on outward direct investment were slightly tightened in December 1974, while in January 1975 the banks were prohibited from converting foreign currency bills of exchange into sterling for rediscount in London, except those covering movements of goods into or out of the Scheduled Territories.

In *Finland* an import deposit scheme was introduced in March 1975 for a period of one year. Deposits, which vary between 5 and 30 per cent. of the dutiable value of a wide range of merchandise imports, have to be placed on non-interest-bearing accounts at the Bank of Finland for periods of six months.

In *Greece* the drachma was unpegged from the dollar in March 1975. Exchange rates are now related to changes in a trade-weighted average of foreign currency values so as to maintain the drachma's value against this average.

In *Iceland* the exchange rate of the króna against the dollar was lowered in several steps by altogether 38 per cent. between May 1974 and February 1975, from a central rate of I.kr. 92.80 to one of I.kr. 149.60. In addition an import deposit scheme was in effect from May to December 1974.

In *Yugoslavia* the exchange rate of the dinar against the US dollar and other major currencies was adjusted downwards several times during the period under review. In August 1974 allocations of foreign exchange for consumer goods imports were reduced by 15 per cent., and for imports of raw materials and semi-finished products by 10 per cent. At the same time imports of certain consumer goods were made subject to special licence. Shortly afterwards an import deposit scheme was introduced, under which importers must deposit for periods of between six and twelve months on non-interest-bearing accounts at the central bank amounts varying from 30 to 50 per cent. of the value of a wide range of goods.

In *Turkey* the pound had been slightly revalued against the dollar in May 1974, from T£ 14 to T£ 13.50 = US $1. Subsequently, however, by April 1975 the rate was lowered again to its former level, in two stages. In addition the Turkish pound was adjusted downwards against certain European currencies in November 1974, January 1975 and May 1975.

With regard to the rest of the world, in *Australia* the currency was devalued in late September by 12 per cent. against both the US dollar and gold. At the same time the direct link between the Australian dollar and the US dollar, introduced after the December 1971 currency realignment, was discontinued. Since then exchange rates for the Australian dollar against other currencies have been determined in such a way as to maintain the dollar's value against a trade-weighted average of foreign currency values. In addition restraints on inflows of private capital were eased from mid-1974 onwards. Between June and November the 33⅓ per cent. non-interest-bearing deposit requirement on foreign borrowing except for trade credit was phased out. The minimum period for foreign borrowing by Australian residents, as well as the minimum period to maturity of fixed-interest securities eligible for purchase by non-residents, was lowered from two years to six months in November 1974 and January 1975 respectively.

In *New Zealand,* which had unpegged from the dollar in July 1973 and based its exchange rate policy on the concept of the effective rate of exchange, exchange rate adjustments were made simultaneously with the September 1974 devaluation of the Australian dollar. The New Zealand dollar was adjusted upwards by 3 per cent. against the Australian dollar and downwards by 9 per cent. against all other currencies.

In *South Africa* the former practice of maintaining a fixed rate of exchange between the rand and the US dollar for lengthy periods was discontinued in June 1974. Since then a number of minor adjustments in both directions have resulted in a cumulative depreciation of the middle rate against the dollar by 2 per cent.

In *Hong Kong* the dollar was allowed to float as from late November 1974, thus terminating the fixed link with the dollar introduced following the floating of sterling in mid-1972.

In the *Middle East* a number of oil-exporting countries have recently unpegged their currencies from the dollar and fixed them against the SDR at rates corresponding to the relative gold contents of these currencies and the SDR. This was done by *Iran* in February and by *Saudi Arabia* and *Qatar* in March. Also in March, *Kuwait* unpegged from the dollar and fixed to a trade-weighted basket of currencies.

In *Israel* the pound was devalued by 30 per cent. against the dollar in November 1974, to a new rate of I £6 = US$1. At the same time taxes on certain imports were raised by between 10 and 20 per cent., and imports of certain consumer goods banned for six months.

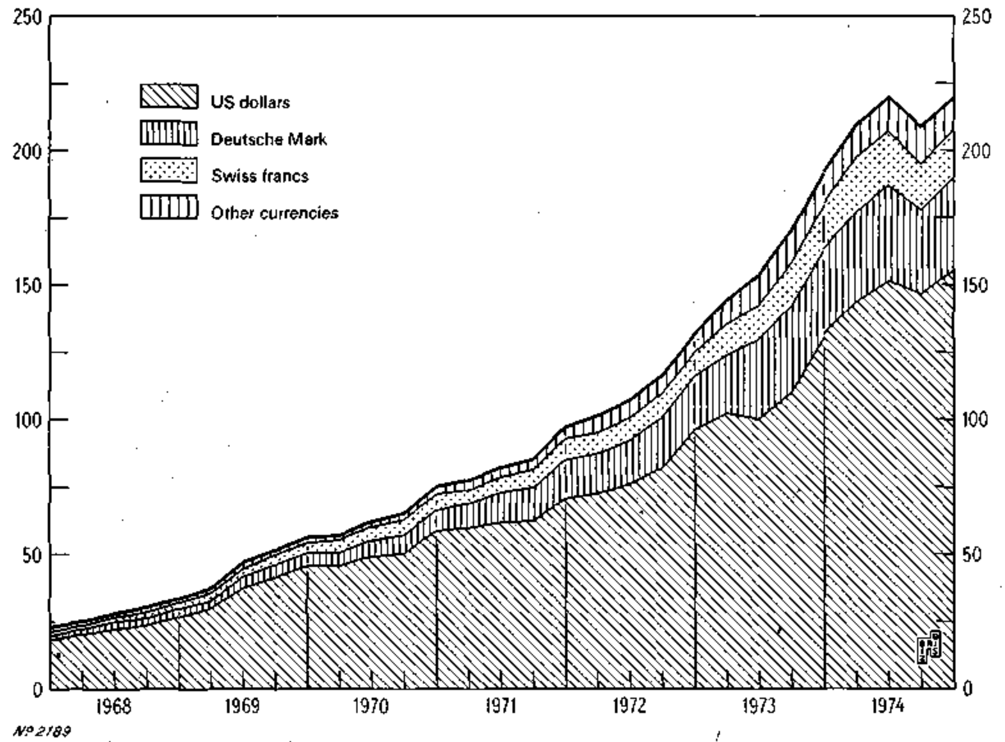
In Latin American countries a number of currencies depreciated substantially during the period under review. In *Argentina* the peso was devalued in early March 1975 by 50 per cent. against the dollar on the official exchange market from Pesos 5 to Pesos 10 = US$1, and by 34 per cent. on the financial market from Pesos 9.98 to Pesos 15.10 = US$1. In *Brazil* the cruzeiro was adjusted downwards against the dollar twelve times between May 1974 and May 1975, by 18 per cent. in all from Cruz. 6.6 to Cruz. 8.0 = US$1. In *Chile* the depreciation of the currency against the dollar during the year ending May 1975 was 85 per cent.; the main exchange rate now stands at Esc. 4,300 = US$1 and the tourist rate at Esc. 4,800 = US$1. In *Colombia* the peso depreciated nearly 15 per cent. against the dollar, from Pesos 25.6 = US$1 in May 1974 to Pesos 30 = US$1 in April 1975. In *Uruguay* the exchange rate for the peso on the commercial market was lowered by 54 per cent. between April 1974 and April 1975, from Pesos 1,084 to Pesos 2,330 = US$1.

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

The Euro-currency market.

For the Euro-currency market 1974 was a most eventful year. The gross external foreign currency liabilities of banks in eight reporting European countries expanded rapidly during the first half of the year, showed a considerable contraction during the third quarter and then rose again towards the end of the year. All in all, gross liabilities increased by $28 milliard, or 14 per cent., to $220 milliard, substantially less than the growth of $60 milliard, or 45 per cent., in 1973. Roughly $8 milliard of the 1974 expansion appears to have been the result of valuation changes, reflecting the increase in the dollar value of banks' liabilities in currencies

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



that have appreciated against the dollar. Excluding these exchange rate effects, the only actual increase was in the dollar component, which expanded by $24 milliard, whereas the non-dollar segment of the Euro-currency market appears to have contracted by $4–5 milliard. The moderate overall expansion occurred against the background of a rise of nearly 40 per cent. in world trade dollar prices and domestic rates of inflation that exceeded 10 per cent. in most countries.

The slow-down in growth was much less marked when one looks at the net size of the market. Net of double-counting due to interbank redepositing but including positions vis-à-vis non-bank residents, the amount of Euro-credit outstanding through the banks of the eight reporting European countries may be estimated to have gone up by $45 to 177 milliard, or by about one-third; this compares with an increase of $40 milliard, or nearly 45 per cent., in 1973. The dollar component rose by roughly $36 to 133 milliard. This was the first time that the market's net growth was not considerably smaller than its expansion in gross terms. The reason for this was that the contraction in the third quarter was confined to the interbank sector of the market, whereas credits to end-users continued to expand throughout the year. In particular, there was a fairly sharp increase in lending to domestic non-bank residents which is not reflected in the gross figures.

Including the foreign currency activities of banks in places outside the reporting European area, the net size of the Euro-currency market may be estimated to have grown by $55 milliard last year to a total of about $210 milliard, after expanding by some $50 milliard in 1973.

In the first quarter of 1975 the gross external positions of the banks of the eight reporting European countries seem to have gone up by about $10 milliard, or somewhat less than in the preceding quarter. But whereas the fourth-quarter figures were boosted by the building-up of end-year positions and by large valuation effects, the liquidation of these positions had the opposite effect on the figures for the first quarter, and valuation changes were of much smaller importance. In real terms, therefore, the expansion of gross external positions seems to have been considerably more pronounced than in the last three months of 1974. On the basis of still very incomplete evidence, the "net size" of the market at the end of March 1975 may be tentatively estimated at around $185 milliard for the reporting European area and at $220 milliard if foreign currency banking elsewhere is included.

According to OECD sources new syndicated medium and long-term Euro-currency loan facilities amounted to $30.2 milliard last year, up from $24.1 milliard in 1973. The monthly average of new facilities granted slowed down from $3.5 milliard in the first half of 1974 to about $1.5 milliard in the second half and showed a further slight decrease in the first quarter of 1975.

Main influences. Not surprisingly, the most important factor behind the growth of the Euro-currency market last year was the higher price of oil. This sharply boosted both the supply of and the demand for Euro-currency funds. On the sources side of the market, it gave rise to massive inflows from oil-exporting countries. In 1974 alone, the volume of new funds injected into the Euro-currency market from this source may be put at around $24 milliard. In addition, there seems to have been an increase of the order of several milliard dollars in deposits by oil companies. On the uses side, many oil-importing countries borrowed heavily from the market to finance their rising deficits. In the first half of 1974 new long and medium-term credit lines obtained by governments and public-sector institutions in the Euro-market amounted to about $16.5 milliard, with the United Kingdom, France and

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

End of month	Dollars: Total	Dollars: of which vis-à-vis non-banks	Other foreign currencies: Total	of which: vis-à-vis non-banks	of which: Deutsche Mark	of which: Swiss francs	of which: Sterling	of which: Guilders	of which: French francs
	in millions of US dollars								
Liabilities									
1970 Dec.. . .	58,700	11,240	16,590	2,450	8,080	5,720	940	550	420
1971 Dec.. . .	70,750	9,980	26,980	2,750	14,630	7,760	2,110	860	440
1972 Dec.. . .	96,730	11,810	35,200	3,620	19,540	8,810	2,210	1,360	1,080
1973 March . .	102,070	12,940	41,860	4,740	21,930	11,280	2,940	1,230	1,740
June . .	100,110	13,680	53,620	5,560	29,650	12,940	4,040	2,210	2,260
Sept. . .	109,740	14,480	60,060	5,810	32,480	15,980	4,050	2,510	2,570
Dec. I . .	130,470	16,370	60,960	5,610	32,140	17,060	4,790	2,260	2,160
Dec. II[1] .	131,380	17,470	60,720	5,630	32,020	17,160	4,560	2,260	2,130
1974 March . .	143,980	18,660	65,190	6,310	33,310	20,390	4,470	2,090	2,180
June . .	151,680	19,660	67,840	7,310	35,450	19,850	5,100	2,290	2,080
Sept. . .	146,930	18,930	60,180	7,410	30,740	17,090	4,300	2,370	2,440
Dec.. . .	155,690	23,110	63,990	8,050	34,220	18,250	3,560	2,760	2,270
Memorandum item *Position vis-à-vis residents*[2]									
1972 Dec.. . .		*3,260*		*1,720*					
1973 Dec. I . .		*5,020*		*2,560*					
Dec. II[1] *.*		*5,020*		*2,550*					
1974 Dec.. . .		*8,560*		*3,780*					
Assets									
1970 Dec.. . .	60,370	11,850	17,880	4,670	10,110	5,080	610	560	400
1971 Dec.. . .	71,500	14,360	28,630	6,750	16,220	8,180	1,620	700	490
1972 Dec.. . .	98,000	18,340	33,840	8,000	20,390	7,780	2,180	720	700
1973 March . .	98,100	19,450	43,100	9,230	27,030	8,910	2,420	1,090	1,190
June . .	101,270	20,290	51,330	10,710	32,460	10,180	3,050	1,320	1,470
Sept. . .	111,880	21,150	55,740	12,420	34,140	13,020	2,740	1,300	1,560
Dec. I . .	133,760	23,870	54,840	12,000	31,400	14,590	3,150	1,320	1,750
Dec. II[1] .	132,110	24,730	55,510	13,980	31,410	15,000	3,080	1,240	1,760
1974 March . .	146,100	28,710	58,530	14,090	32,950	15,800	3,090	1,220	1,700
June . .	154,170	31,300	59,670	14,790	33,730	16,110	3,130	1,320	1,290
Sept. . .	148,970	31,300	52,750	15,250	30,390	13,250	2,490	1,480	1,360
Dec.. . .	155,670	34,570	58,450	17,900	34,620	14,330	2,040	1,870	1,480
Memorandum item *Position vis-à-vis residents*[2]									
1972 Dec.. . .		*5,120*		*3,530*					
1973 Dec. I . .		*8,830*		*5,150*					
Dec. II[1] *.*		*8,820*		*5,120*					
1974 Dec.. . .		*16,430*		*6,330*					
Net position									
1970 Dec.. . .	1,670	610	1,290	2,220	2,030	− 640	− 330	10	− 20
1971 Dec.. . .	750	4,380	1,650	4,000	1,590	420	− 490	− 160	50
1972 Dec.. . .	1,270	6,530	−1,360	4,380	850	−1,030	− 30	− 640	− 380
1973 March . .	− 3,970	6,510	1,240	4,490	5,100	−2,370	− 520	− 140	− 550
June . .	1,160	6,610	−2,290	5,150	2,810	−2,760	− 990	− 890	− 790
Sept. . .	2,140	6,670	−4,320	6,610	1,660	−2,960	−1,310	−1,210	−1,010
Dec. I . .	3,290	7,500	−6,120	6,390	− 740	−2,470	−1,640	− 940	− 410
Dec. II[1] .	730	7,260	−5,210	8,350	− 610	−2,160	−1,480	−1,020	− 370
1974 March . .	2,120	10,050	−6,660	7,780	− 360	−4,590	−1,380	− 870	− 480
June . .	2,490	11,640	−8,170	7,480	−1,720	−3,740	−1,970	− 970	− 790
Sept. . .	2,040	11,370	−7,430	7,840	− 350	−3,840	−1,810	− 890	−1,080
Dec.. . .	− 20	11,460	−5,540	9,850	400	−3,920	−1,520	− 890	− 790
Memorandum item *Position vis-à-vis residents*[2]									
1972 Dec.. . .		*1,860*		*1,810*					
1973 Dec. I . .		*3,810*		*2,590*					
Dec. II[1] *.*		*3,800*		*2,570*					
1974 Dec.. . .		*7,870*		*2,550*					

[1] As from December 1973 (December II) the figures no longer include the Euro-currency positions of the BIS (previously reported under the figures for the Swiss banks) but do incorporate certain long-term positions not given for earlier periods. [2] Excluding Germany.

Italy alone accounting for well over half of this figure. In addition to borrowing themselves or inducing other public-sector entities to do so, governments in a number of countries encouraged commercial banks and other enterprises to have recourse to foreign credit. Japanese banks, for example, took up $9.4 milliard abroad in the first half of 1974, roughly two-thirds of it in the Euro-currency market, and in France private non-bank firms borrowed $3 milliard of foreign funds on a longer-term basis either via French banks or directly from banks abroad.

The rise in oil prices also exerted an indirect influence on the development of the Euro-currency market in a number of ways. Expectations that flows of oil funds to the United States would lead to a dramatic strengthening of the dollar were an important consideration behind the removal by the United States of its various barriers against capital outflows in January 1974, well ahead of the end-1974 deadline which had been announced earlier by the Administration. Likewise, the possibility that the higher oil prices would weaken the Deutsche Mark was one consideration in the easing last year of German measures against capital inflows. Similar moves were also made by a number of other countries.

In contrast to the easing of restrictions by the other countries, the net impact of the removal of US controls on the growth of the market is somewhat uncertain. On the one hand, it would tend to augment the supply of dollars from the United States to the Euro-currency market and, in particular, facilitate the rechannelling of funds abroad if the US attracted an overly large share of the oil surpluses. On the other hand, as far as the demand for Euro-currency funds is concerned, the US restraint programme had been a major factor in the market's growth. By cutting off the foreign subsidiaries of US firms and other borrowers from the US financial markets, it had diverted a large part of their credit demand to the Euro-market. Now that access to the US markets is open again, the Euro-market will be able to retain the bulk of this business in the long run only if the premium it has to pay for dollar funds is not too large. However, the market will clearly continue to benefit from its special expertise, its location and its wholesale character.

It may be of interest to note in this context that whereas foreign branches of US banks recorded a slow-down in the growth of their assets from 56 per cent. in 1973 to 24 per cent. in 1974, the rate of increase in foreign assets of US banks accelerated from 29 to 72 per cent. Moreover, one consequence of the lifting of the US restrictions on capital outflows was the direct participation of banks in the United States in Euro-loan syndicates.

In April 1975 the Federal Reserve reduced from 8 to 4 per cent. the reserve requirement on foreign borrowing by member banks. Although this move was motivated by different considerations, its effects on the Euro-market will to some extent be the same as those stemming from the abolition of the restraints on capital outflows. It will tie the Euro-market even closer to the US market and increase the ability of US-based banks to compete for international business.

Apart from the oil-price impact and related policy changes, the Euro-market continued to be influenced, especially during the first half of 1974, by factors broadly similar to those operative in 1973. The acceleration of inflation and tight monetary conditions continued to weaken the long-term capital markets. New Euro-bond issues, for example, showed a further sharp contraction. At the same time, the inflation of prices and wages together with declining profits heightened corporate financing needs. The combination of larger borrowing requirements and the inability of long-term capital markets to accommodate them increased dependence on bank credit. The Euro-market was in a favourable position to meet this demand for finance for two reasons: firstly, unlike the banks in national markets the Euro-banks were not hampered by credit ceilings or restrictive domestic money-supply targets; secondly, with the aid of floating rate loans (roll-over credits) these banks were able to provide fairly long-term finance while protecting themselves and their customers against adverse changes in interest rates. At over $9 milliard, the volume of new syndicated loans arranged in 1974 for private corporate borrowers was about 55 per cent. higher than the total for 1973. And despite the contraction of interbank business, the 1974 increase in the Euro-banks' direct claims on non-banks, though partly related to balance-of-payments financing, was the largest yet recorded.

Finally, the instability of exchange rates also provided the market with opportunities for growth. It tended, for example, to increase the demand for forward cover from non-bank firms. Since contracts, particularly those with longer-term maturities, could not always be matched in the forward markets, the banks could accommodate their customers' need for protection against exchange losses by covering themselves through a combination of spot exchange transactions plus Euro-currency lending or borrowing.

Against the background of an exceptionally rapid market expansion, apprehension began to arise in the spring of last year about the potential dangers for the Euro-currency market deriving from the huge balance-of-payments deficits, inflation and erratic exchange rates. Large foreign exchange losses were incurred by a few banks and, as some of the countries with the largest oil deficits had already been heavy borrowers of Euro-currency funds, there were fears that the Euro-banks' claims might become immobilised to some extent or that these banks might be shackled with exchange control regulations. In addition, it was felt that the syndicated loan business had grown too rapidly and that the market's maturity transformation was dangerous. Moreover, it appeared that rapid growth in balance sheets, together with narrow profit margins and the high cost of equity, had led to a considerable deterioration in the banks' capital/loan ratios. A further concern was the uncertainty as to whether central banks would act as lenders of last resort for the Euro-market. These misgivings led to some well-publicised shifts of deposits by some large banks out of the Euro-market to the United States.

It was in this climate of general unease that in late June the news about the failure of the Herstatt bank hit the market. The resultant shaking of confidence widened the premium which the Euro-banks had to pay over deposit rates in the United States, the pressure being heightened by the peaking of monetary tightness in the United States. The institutions to suffer most from the repercussions of the Herstatt incident were the smaller banks in the market and banks without the clear backing of a parent institution. These, together with the banks of some large deficit countries, now had considerable difficulty in obtaining refinancing in the interbank market. The premium they had to pay for funds went up as high as

2 percentage points above LIBOR (London interbank offered rate), i.e. substantially above the yield they were themselves earning on their syndicated loan portfolios. Despite the continued flow of oil funds into the market, interbank liabilities and assets declined sharply during July and August.

Following a statement on 10th September by the central-bank Governors of the Group of Ten countries confirming their responsibility for the international bank market and their willingness and ability to help in case of need, market sentiment slowly began to improve. Interbank business began to pick up again hesitantly, although at the end of 1974 the outstanding amount of interbank assets and liabilities was still well below the mid-year level.

In the first quarter of 1975 the recovery of confidence made further progress. The premium of Euro-rates over US rates contracted, the multi-tier interest rate structure became much narrower, and both non-bank and interbank assets and liabilities appear to have recorded substantial increases. This renewed expansion occurred despite a number of retarding influences, such as the downturn in world economic activity, the increasing amount of finance handled by the long-term capital markets and a slow-down in new supplies of oil funds.

Apart from the reassurances of the Group of Ten central-bank Governors, several factors contributed to the gradual improvement in market sentiment: the positive response from the parent institutions of consortium banks to a Bank of England request for commitments to support these banks should they run into difficulties; a statement by the Federal Reserve that it would be willing to act as lender of last resort to any soundly-managed member bank with temporary liquidity problems caused by abrupt withdrawals of petro-dollars or other deposits; the increased official emphasis on bank supervision and regulation; the general relaxation of monetary restraint, the downturn in interest rates and the recovery of the longer-term capital markets; the fact that despite precarious conditions in the Euro-markets during the summer virtually all Euro-banks had managed to survive; and the realisation that the financial consequences of the oil-price increases had proved to be more manageable than originally feared.

Despite the temporary threat to the stability of the system, the events of last summer seem to have had on the whole a salutary effect on the development of the market. Banks have become more risk-conscious and selective in their new loan business. The size of individual syndicated loans and, partly as a result of the difficulties of the smaller banks, the number of participants in these loans have been reduced, while average maturities have become considerably shorter. The margins over interbank rates and other fees charged by Euro-banks on new floating rate loans have increased sharply and should therefore enable them to build up adequate provisions against losses; owing to the multi-tier interest rate structure, it is mainly the big banks that have benefited from this trend and, since these banks also received most of the petro-funds, their market position has been considerably strengthened. The emphasis of new lending has shifted away from the outright financing of balance-of-payments deficits towards project-related loans, such as those for the development of new energy sources. And last but not least, with the guidance of central banks and new regulations the banks have become more prudent in their foreign exchange activities and are now paying more attention to the soundness of their balance-sheet structure, particularly as regards their capital leverage. All this would suggest that despite the renewal of confidence the market will henceforth tend to expand at more moderate rates than in recent years.

Composition of the market. Whereas in 1974 the reporting banks' gross external positions in domestic currencies continued to expand at about the same pace as in 1973, the growth of their dollar liabilities slowed down from 35 per cent. to 18 per cent. and that of their liabilities in other foreign currencies from 73 per cent. to 5 per cent.

Assets and liabilities in dollars rose by $23.6 and 24.3 milliard respectively and the dollar's share in total outstanding positions went up by 2.5 percentage points to 72 per cent. The $0.7 milliard decline in the banks' net external position in dollars was very much smaller than the estimated $4–4.5 milliard increase in their net dollar claims on domestic residents. This would indicate that despite the dollar's downward movement on the exchanges the Euro-banks themselves built up their spot positions in that currency.

Assets and liabilities in foreign currencies other than the dollar expanded by $2.9 and 3.3 milliard respectively. The Deutsche Mark alone accounted for the whole of the increase in assets and for two-thirds of that in liabilities. In the absence of the valuation effects resulting from the appreciation of these currencies against the dollar there would have been, as already indicated, a contraction of roughly $5 milliard. There are two main factors which account for this sluggish performance of the non-dollar component. Firstly, the oil-exporting countries receive none of their payments in Deutsche Mark or Swiss francs and have been making the great bulk of their Euro-currency placements in the form of dollars. Secondly, owing perhaps to the Herstatt incident, the weakness of the Euro-currency market in the second half of 1974 seems to have affected in particular the non-dollar segment. Whereas at year-end dollar positions stood above the mid-year level, the banks' non-dollar liabilities and assets were still below it, even if valuation changes are included. The contraction was, however, limited to the interbank market.

A second feature was the relatively strong expansion in direct claims on non-banks, which was partly due to the substantial volume of lending to governments and public-sector institutions. Claims on foreign non-banks went up by $13.8 milliard and those on domestic non-banks by $8.8 milliard, compared with increases of $9.5 and 5.3 milliard respectively in 1973. Liabilities to non-banks also expanded more than in 1973, partly as a result of the build-up of deposits by oil companies. On the other hand, the growth of interbank positions slowed down sharply. Interbank assets, for example, expanded by $18.8 milliard in the first half of 1974 but declined by $12.6 milliard during the summer before again recording an increase of $6.5 milliard in the fourth quarter. The overall expansion of $12.7 milliard for the year as a whole compares with one of $47.2 milliard in 1973.

With regard to the contribution of the banks of individual countries to the overall growth of the market, the $27.6 milliard increase in external liabilities was in fact the net result of a $10.3 milliard contraction in the liabilities of the Italian

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

Countries	End of month	Liabilities: Domestic currency	Liabilities: Foreign currencies	Assets: Domestic currency	Assets: Foreign currencies	Net position: Domestic currency	Net position: Foreign currencies	Net position: Total
		in millions of US dollars						
Belgium-Luxembourg	1973 December	1,800	23,840	1,160	24,450	– 640	610	– 30
	1974 March	2,060	27,140	1,410	28,280	– 650	1,140	490
	June	2,280	28,380	1,650	29,810	– 630	1,430	800
	September	2,160	28,080	1,510	29,420	– 550	1,340	790
	December	2,500	31,280	1,650	32,210	– 850	930	80
France . . .	1973 December	4,510	27,360	1,850	27,630	– 2,660	270	– 2,390
	1974 March	..	..	..	..	..	..	..
	June	3,890	32,600	1,530	32,300	– 2,360	– 300	– 2,660
	September	3,440	31,250	1,160	30,190	– 2,280	– 1,060	– 3,340
	December	3,680	32,510	1,080	31,820	– 2,600	– 690	– 3,290
Germany . .	1973 December	9,080	6,660	8,130	6,700	– 950	40	– 910
	1974 March	9,480	7,120	8,660	7,300	– 820	180	– 640
	June	10,360	7,690	10,210	7,750	– 150	60	– 90
	September	9,540	6,860	10,510	7,030	970	170	1,140
	December	11,250	7,680	14,210	8,360	2,960	680	3,640
Italy	1973 December	1,820	23,870	790	23,810	– 1,030	– 60	– 1,090
	1974 March	1,590	23,510	870	22,670	– 720	– 840	– 1,560
	June	1,890	21,300	850	19,570	– 1,040	– 1,730	– 2,770
	September	1,480	13,660	600	12,610	– 880	– 1,050	– 1,930
	December	1,330	13,610	600	12,510	– 730	– 1,100	– 1,830
Netherlands .	1973 December	1,180	9,620	910	9,410	– 270	– 210	– 480
	1974 March	1,260	10,880	1,020	11,050	– 240	170	– 70
	June	1,450	10,920	980	11,580	– 470	660	190
	September	1,180	11,140	940	10,920	– 240	– 220	– 460
	December	1,360	11,890	1,040	12,040	– 320	150	– 170
Sweden . .	1973 December	460	900	220	1,710	– 240	810	570
	1974 March	460	1,120	360	2,090	– 100	970	870
	June	490	1,150	350	2,310	– 140	1,160	1,020
	September	540	1,100	380	2,200	– 160	1,100	940
	December	510	1,040	430	2,060	– 80	1,020	940
Switzerland .	1973 December	6,560	9,200	7,320	9,630	760	430	1,190
	1974 March	7,240	8,780	8,510	9,460	1,270	680	1,950
	June	7,490	9,370	8,680	10,290	1,190	920	2,110
	September	7,250	8,820	8,410	10,280	1,160	1,460	2,620
	December	8,510	10,570	9,160	12,300	650	1,730	2,380
United Kingdom .	*1973 December*	*6,150*	*90,650*	*1,440*	*84,280*	*– 4,710*	*– 6,370*	*– 11,080*
	1974 March	6,060	103,260	1,440	96,150	– 4,620	– 7,110	– 11,730
	June	6,960	108,110	1,350	100,230	– 5,610	– 7,880	– 13,490
	September	7,790	106,200	1,410	99,070	– 6,380	– 7,130	– 13,510
	December	7,730	111,100	1,870	102,820	– 5,860	– 8,280	– 14,140
Total . .	1973 December	31,560	192,100	21,820	187,620	– 9,740	– 4,480	– 14,220
	1974 March*	32,660	209,170	24,120	204,630	– 8,540	– 4,540	– 13,080
	June	34,810	219,520	25,600	213,840	– 9,210	– 5,680	– 14,890
	September	33,380	207,110	25,020	201,720	– 8,360	– 5,390	– 13,750
	December	36,870	219,680	30,040	214,120	– 6,830	– 5,560	– 12,390
Canada . . .	1973 December	1,090	11,530	400	11,940	– 690	410	– 280
	1974 March	1,120	11,640	390	12,430	– 730	790	60
	June	1,260	11,380	420	12,500	– 840	1,120	280
	September	1,230	11,150	380	12,560	– 850	1,410	560
	December	1,610	11,730	410	13,540	– 1,200	1,810	610
Japan . . .	1973 December	690	12,930	810	16,300	120	3,370	3,490
	1974 March	750	17,960	970	17,190	220	– 770	– 550
	June	770	22,260	1,230	17,070	460	– 5,190	– 4,730
	September	970	23,880	1,280	18,430	310	– 5,450	– 5,140
	December	870	24,080	1,370	19,240	500	– 4,840	– 4,340

* Including end-December 1973 figures for France.

banks and a $37.9 milliard growth in those of the banks of the other reporting European countries. The picture was broadly similar on the assets side.

The contraction in the positions of the Italian banks — in the period from the end of April to the end of November the decrease in their liabilities amounted to over 50 per cent. — did not give rise to any major difficulties because assets and liabilities were well matched. The Euro-currency borrowing of the Italian public sector had been conducted through banks located outside Italy, whereas the Italian banks themselves had been active mainly in the interbank market. When, owing to the market's concern about Italy's external payments position, the Italian banks were compelled to pay increasingly high premiums over LIBOR, this interbank jobbing was no longer profitable for them and they allowed their positions to run off. On a net basis the Italian banks' external liabilities in foreign currencies went up from $0.1 to 1.7 milliard in the first half of 1974 and were reduced by $0.7 milliard in the third quarter.

Over half of the expansion in the gross external positions of the banks of the other seven reporting European countries was accounted for by banks in the United Kingdom alone. Nevertheless, the rate of growth of the UK banks' gross liabilities slowed down from 52 per cent. in 1973 to 23 per cent. Their net external takings went up from $6.4 to 8.3 milliard, which was fully explained by an increase from $6.4 to 8.9 milliard in their net claims on UK non-bank residents. The major part of the inflow occurred during the fourth quarter, when the UK Treasury made a first $1.5 milliard drawing on its $2.5 milliard Euro-loan facility. The French banks were the only other net takers of foreign currency funds. Here again the shift from $0.3 milliard of net assets to $0.7 milliard of liabilities was more than accounted for by an expansion from $0.7 to 2.5 milliard in net claims on non-bank residents. At over 30 per cent., the Belgium-Luxembourg banks again recorded the most rapid increase in gross positions, but their net position showed little change.

The German and Swiss banks were the largest net exporters of funds. In view of the important rôle of the Deutsche Mark and the Swiss franc in the Euro-market, it is relevant in the case of these two countries also to take into account movements in their external positions in domestic currency. The German banks' total net external position shifted from $0.9 milliard of liabilities to $3.6 milliard of assets. Of this $4.5 milliard outflow, $2.5 milliard took place in the fourth quarter when there was a pronounced easing of German domestic monetary conditions. The Swiss banks' net foreign assets in domestic and foreign currency expanded by $1.2 milliard; this figure does not, however, include trustee funds, i.e. money placed by Swiss banks for the account and at the risk of their customers.

In the first quarter of 1975 the growth of Euro-currency positions seems to have differed in two respects from that recorded in 1974. Firstly, a large part — probably over two-thirds — of the estimated $10 milliard expansion in external assets and liabilities occurred in foreign currencies other than dollars, a development which was almost certainly related to the weakness of the dollar on the exchanges. Secondly, there appears to have been a substantial recovery in interbank business; on the liabilities side in particular, a very large part of the growth in foreign currency positions seems to have been vis-à-vis banks.

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

Countries	End of month		US dollars: Liabilities	US dollars: Assets	US dollars: Net	All other foreign currencies: Liabilities	All other foreign currencies: Assets	All other foreign currencies: Net
			in millions of US dollars					
Belgium-Luxembourg	1973	December	10,500	11,000	500	13,340	13,450	110
	1974	March	11,850	13,230	1,380	15,290	15,050	− 240
		June	12,010	14,100	2,090	16,370	15,710	− 660
		September	12,430	14,640	2,210	15,650	14,780	− 870
		December	13,350	15,210	1,860	17,930	17,000	− 930
France	1973	December	18,220	20,320	2,100	9,140	7,310	−1,830
	1974	March	..	..	..	..	..	..
		June	21,150	23,840	2,690	11,450	8,460	−2,990
		September	21,300	23,130	1,830	9,950	7,060	−2,890
		December	22,650	24,210	1,560	9,860	7,610	−2,250
Germany	1973	December	5,550	5,050	− 500	1,110	1,650	540
	1974	March	5,870	5,360	− 510	1,250	1,940	690
		June	6,260	5,630	− 630	1,430	2,120	690
		September	5,720	5,110	− 610	1,140	1,920	780
		December	6,160	6,140	− 20	1,520	2,220	700
Italy	1973	December	16,280	16,570	290	7,590	7,240	− 350
	1974	March	15,410	14,860	− 550	8,100	7,810	− 290
		June	14,160	12,840	−1,320	7,140	6,730	− 410
		September	9,970	9,130	− 840	3,690	3,480	− 210
		December	10,440	9,770	− 670	3,170	2,740	− 430
Netherlands	1973	December	4,690	5,710	1,020	4,930	3,700	−1,230
	1974	March	4,950	7,240	2,290	5,930	3,810	−2,120
		June	5,140	7,350	2,210	5,780	4,230	−1,550
		September	5,360	6,440	1,080	5,780	4,480	−1,300
		December	5,900	7,180	1,280	5,990	4,860	−1,130
Sweden	1973	December	500	1,090	590	400	620	220
	1974	March	680	1,410	730	440	680	240
		June	680	1,530	850	470	780	310
		September	610	1,460	850	490	740	250
		December	560	1,320	760	480	740	260
Switzerland	1973	December	6,470	6,910	440	2,730	2,720	− 10
	1974	March	6,310	6,820	510	2,470	2,640	170
		June	6,760	7,570	810	2,610	2,720	110
		September	6,570	7,610	1,040	2,250	2,670	420
		December	9,150	8,930	780	2,420	3,370	950
United Kingdom . .	1973	December	69,170	65,460	−3,710	21,480	18,820	−2,660
	1974	March	80,690	76,860	−3,830	22,570	19,290	−3,280
		June	85,520	81,310	−4,210	22,590	18,920	−3,670
		September	84,970	81,450	−3,520	21,230	17,620	−3,610
		December	88,480	82,910	−5,570	22,620	19,910	−2,710
Total	1973	December	131,380	132,110	730	60,720	55,510	−5,210
	1974	March*	143,980	146,100	2,120	65,190	58,530	−6,660
		June	151,680	154,170	2,490	67,840	59,670	−8,170
		September	146,930	148,970	2,040	60,180	52,750	−7,430
		December	155,690	155,670	− 20	63,990	58,450	−5,540
Canada	1973	December	10,840	11,170	330	690	770	80
	1974	March	10,930	11,550	620	710	880	170
		June	10,700	11,660	960	680	840	160
		September	10,560	11,770	1,210	590	790	200
		December	11,090	12,700	1,610	640	840	200
Japan	1973	December	12,350	14,770	2,420	580	1,530	950
	1974	March	17,250	15,550	−1,700	710	1,640	930
		June	21,590	15,310	−6,280	670	1,760	1,090
		September	23,080	16,530	−6,550	800	1,900	1,100
		December	22,960	17,150	−5,810	1,120	2,090	970

* Including end-December 1973 figures for France.

Sources and uses. As regards the sources and destination of Euro-funds, the main feature of 1974 was a large net flow of funds from the oil-exporting countries through the reporting banks to countries outside the reporting European area. The available statistics do not give separate figures for the oil-exporting countries, but they do show the "Middle East" (which includes also Iran and Libya). The reporting banks' liabilities to this area rose by $19.6 milliard, or nearly 200 per cent., last year. To ascertain the total intake of petro-funds it would be necessary to add to this figure an estimate for the increase in liabilities to other oil exporters such as Venezuela and Algeria, and also to take into account petro-funds that entered the market via trustee accounts in Switzerland and through the BIS and banks outside the reporting European area. In aggregate the inflow of petro-funds might well have amounted to $24 milliard. Claims on oil-exporting countries may be estimated to have risen by about $1 milliard, so that the total net inflow from these countries might be put in very broad terms at around $23 milliard.

The development of the reporting banks' foreign positions vis-à-vis outside-area countries other than the oil exporters also reflected very strongly the financial consequences of the oil-price increases. As already indicated, net claims on Japan went up by $7.0 milliard. Similarly, the deterioration in the balance-of-payments position of Latin American countries was reflected in a $3.2 milliard improvement in the reporting banks' net position vis-à-vis that area. Liabilities towards Latin America, after expanding by over 50 per cent. in 1973, showed very little increase. Excluding Venezuela, they would have recorded a substantial decline and the improvement in the net position might have amounted to nearly $5 milliard. Net assets vis-à-vis Australia, New Zealand and South Africa rose by $1.5 milliard. The net position of the Euro-banks towards western European countries outside the reporting area improved by $3.4 milliard; the growth in liabilities towards these countries slowed down from 37 per cent. in 1973 to 6 per cent., whereas credits to them continued to expand rapidly. Claims on eastern Europe also registered quite a sharp rise of $2.4 milliard, but this was partly offset by a $1.3 milliard increase in funds received.

There was a substantial rise of an aggregate $2.8 milliard in net claims on Singapore and the international banking centres in the Caribbean area; however, the available statistics do not give any insight into the ultimate uses of these funds. Similarly, a $2.2 milliard expansion in net claims on the United States must be viewed against the background of the large volume of foreign lending by banks in the United States. In fact, gross lending to the United States went up by $5.2 milliard in the first half of the year when the US banks built up their foreign assets very appreciably. Reflecting the US lead in the downward movement of interest rates and the related weakening of the dollar, net claims on the United States declined by $1.1 milliard in the last three months of the year and seem to have recorded an even larger contraction during the first quarter of 1975.

All in all the Euro-banks seem to have lent more to oil-importing countries outside their own area than they themselves received in the form of direct deposits from the oil-exporting countries, with the gap being filled by funds from within the reporting European area. As follows from the table on page 141, the Euro-banks'

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

Positions vis-à-vis	December 1973			June 1974			December 1974		
	Dollars	All other currencies	Total	Dollars	All other currencies	Total	Dollars	All other currencies	Total
	in millions of US dollars								
	Liabilities								
Inside area									
Belgium-Luxembourg . .	6,590	4,070	10,660	7,110	5,150	12,260	6,530	4,070	10,600
France	11,240	5,140	16,380	11,610	4,730	16,340	11,410	3,920	15,330
Germany	3,600	4,320	7,920	3,360	5,490	8,850	3,770	6,800	10,570
Italy	11,270	5,080	16,350	8,780	5,090	13,870	6,440	1,930	8,370
Netherlands . . .	4,880	3,060	7,940	5,570	3,400	8,970	5,400	3,740	9,140
Sweden	740	370	1,110	1,160	450	1,610	980	380	1,360
Switzerland . . .	16,430	11,640	28,070	17,230	13,780	31,010	20,580	14,740	35,320
United Kingdom .	15,130	6,230	21,360	15,620	6,910	22,530	13,970	5,410	19,380
Total	69,880	39,910	109,790	70,440	45,000	115,440	69,080	40,990	110,070
Outside area									
Other western Europe	9,820	7,260	17,080	11,040	7,270	18,310	11,080	6,950	18,030
Eastern Europe .	1,820	1,900	3,720	2,730	2,040	4,770	3,310	1,750	5,060
Canada	5,700	540	6,240	5,010	530	5,540	4,460	430	4,890
Japan	3,440	140	3,580	4,170	150	4,320	3,530	190	3,720
Caribbean area .	6,120	1,380	7,500	8,690	1,820	10,510	8,510	1,980	10,490
Latin America . .	8,190	800	8,990	8,770	960	9,730	8,140	910	9,050
Middle East . . .	6,210	4,050	10,260	15,440	5,020	20,460	23,960	5,870	29,830
Singapore	730	260	990	1,200	210	1,410	1,030	250	1,280
Others	6,720	3,240	9,960	9,470	3,370	12,840	9,660	3,250	12,910
Total	48,750	19,570	68,320	66,520	21,370	87,890	73,680	21,580	95,260
United States . .	10,140	460	10,600	11,970	520	12,490	12,600	440	13,040
Total	58,890	20,030	78,920	78,490	21,890	100,380	86,280	22,020	108,300
Unallocated . . .	2,610	780	3,390	2,750	950	3,700	330	980	1,310
Grand total . .	131,380	60,720	192,100	151,680	67,840	219,520	155,690	63,990	219,680
	Assets								
Inside area									
Belgium-Luxembourg . .	5,580	5,090	10,670	6,230	5,780	12,010	7,060	5,570	12,630
France	10,630	4,790	15,420	9,320	4,410	13,730	9,000	3,450	12,450
Germany	3,210	10,970	14,180	3,120	12,410	15,530	2,970	12,220	15,190
Italy	14,280	4,560	18,840	13,830	4,430	18,260	11,240	1,760	13,000
Netherlands . . .	3,740	2,680	6,420	3,490	2,830	6,320	4,160	2,560	6,720
Sweden	520	690	1,210	620	730	1,350	830	800	1,630
Switzerland . . .	4,550	2,980	7,530	4,550	2,920	7,470	5,070	3,000	8,070
United Kingdom .	21,650	7,390	29,040	23,510	8,620	32,130	20,770	7,210	27,980
Total	64,160	39,150	103,310	64,670	42,130	106,800	61,100	36,570	97,670
Outside area									
Other western Europe	7,350	5,090	12,440	9,400	5,470	14,870	10,450	6,320	16,770
Eastern Europe .	4,660	2,740	7,400	5,460	3,390	8,850	5,890	3,900	9,790
Canada	3,900	730	4,630	2,850	720	3,570	2,390	520	2,910
Japan	7,510	590	8,100	13,690	350	14,040	14,450	790	15,240
Caribbean area .	12,060	1,860	13,920	16,300	1,890	18,190	15,430	3,170	18,600
Latin America . .	7,010	620	7,630	8,660	530	9,190	10,330	550	10,880
Middle East . . .	2,060	490	2,550	2,090	530	2,620	2,870	700	3,570
Singapore	1,650	110	1,760	2,180	140	2,320	2,990	170	3,160
Others	7,130	2,200	9,330	9,000	2,150	11,150	10,360	3,360	13,720
Total	53,330	14,430	67,760	69,630	15,170	84,800	75,160	19,480	94,640
United States . .	14,130	690	14,820	19,190	830	20,020	18,670	830	19,500
Total	67,460	15,120	82,580	88,820	16,000	104,820	93,830	20,310	114,140
Unallocated . . .	490	1,240	1,730	680	1,540	2,220	740	1,570	2,310
Grand total . .	132,110	55,510	187,620	154,170	59,670	213,840	155,670	58,450	214,120

net claims on the outside area went up by about $2 milliard while $5 milliard was obtained from the inside area (the difference between the two figures is explained by the $3 milliard change in the unallocated item). The rôle of the reporting European area in 1974 as a net supplier of Euro-currency funds is certainly somewhat surprising given the large volume of Euro-currency borrowing by some countries within that area. There are, however, a number of factors which go some way towards explaining how this occurred. Firstly, part of the Euro-currency funds borrowed by the public sectors of these countries for balance-of-payments reasons were redeposited by them in the Euro-currency market. Secondly, oil companies which figure in the statistics as residents of the reporting European area built up their Euro-dollar deposits in anticipation of royalty payments. And thirdly, the market received a large supply of new funds from inside-area countries such as Switzerland and Germany. For example, the net liabilities of the banks in the other reporting countries vis-à-vis Switzerland (including the BIS) showed an increase of $6.7 milliard. It needs to be stressed, however, that a large part of the funds which appear in the statistics as being supplied by Switzerland entered that country from outside the

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

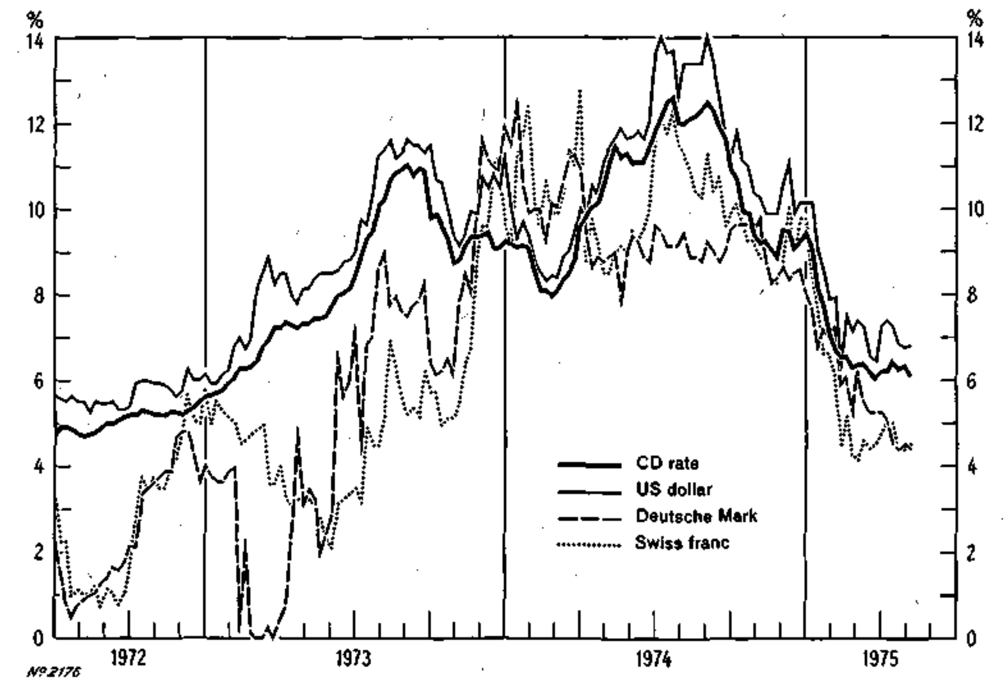
End of period	Reporting European area: Total	of which: Banks[1]	of which: Non-banks	United States	Rest of the world	Un-allocated	Total
	in milliards of US dollars						
Uses							
1969	15.0	7.0	8.0	16.8	12.0	0.2	44.0
1970	24.0	9.0	15.0	13.1	19.0	0.9	57.0
1971	32.8	13.7	19.1	8.3	28.9	1.0	71.0
1972	38.9	18.1	20.8	9.6	43.1	0.4	92.0
1973 I	51.3	21.8	29.5	13.2	66.8	0.7	132.0
1973 II	49.0	19.5	29.5	13.5	67.8	1.7	132.0
1974	61.9	20.9	41.0	18.2	94.6	2.3	177.0
Sources							
1969	21.7	9.5	12.2[2]	4.1	17.6	0.6	44.0
1970	27.7	13.5	14.2[2]	4.5	24.0	0.8	57.0
1971	32.4	16.4	16.0[2]	6.1	31.4	1.1	71.0
1972	35.2	17.4	17.8[2]	6.9	47.9	2.0	92.0
1973 I	51.5	24.0	27.5[2]	9.5	68.0	3.0	132.0
1973 II	50.8	23.3	27.5[2]	9.5	68.3	3.4	132.0
1974	68.5	31.6	36.9[2]	11.9	95.3	1.3	177.0
Net position[3]							
1969	− 6.7	− 2.5	− 4.2	+12.7	− 5.6	− 0.4	−
1970	− 3.7	− 4.5	+ 0.8	+ 8.6	− 5.0	+ 0.1	−
1971	+ 0.4	− 2.7	+ 3.1	+ 2.2	− 2.5	− 0.1	−
1972	+ 3.7	+ 0.7	+ 3.0	+ 2.7	− 4.8	− 1.6	−
1973 I	− 0.2	− 2.2	+ 2.0	+ 3.7	− 1.2	− 2.3	−
1973 II	− 1.8	− 3.8	+ 2.0	+ 4.0	− 0.5	− 1.7	−
1974	− 6.6	−10.7	+ 4.1	+ 6.3	− 0.7	+ 1.0	−

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

reporting European area through trustee accounts or in some other way. In that sense, therefore, the net-supplier rôle of the reporting European countries was more a statistical than a genuine one and the real position might not have been far short of balance.

An overall view of developments within the reporting European area can be obtained from the table on page 141. On the sources side of the market, the supply of new funds from within that area may be estimated at nearly $18 milliard. About $9.5 milliard of this represented non-bank funds, with the trustee funds and deposits by oil companies referred to above forming the largest components. The $8.5 milliard of new funds supplied by banks included switching into foreign currency by the reporting banks themselves, Deutsche Mark funds placed on the market by German banks, and deposits by official monetary institutions, a substantial part of the latter coming indirectly from oil-exporting countries. On the uses side of the market, the identified offtake by the reporting European area may be estimated at about $13 milliard. Most of this went to private non-bank corporations and to public-sector institutions and agencies, some of which figure as banks in the statistics. Other interbank positions within the reporting European area, which are largely netted out when computing the size of the Euro-currency market, showed on balance a substantial decline during 1974. This development is partly reflected in the table on page 140, where it can be seen that inside-area claims, after a $3.5 milliard expansion in the first half of the year, contracted by $9.1 milliard in the second half.

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



Interest rates. In 1974 the combination of a sharp rise in US money-market rates and a widening of the premium which Euro-banks had to pay for dollar funds compared with banks in the United States pushed Euro-dollar rates to new historical peaks.

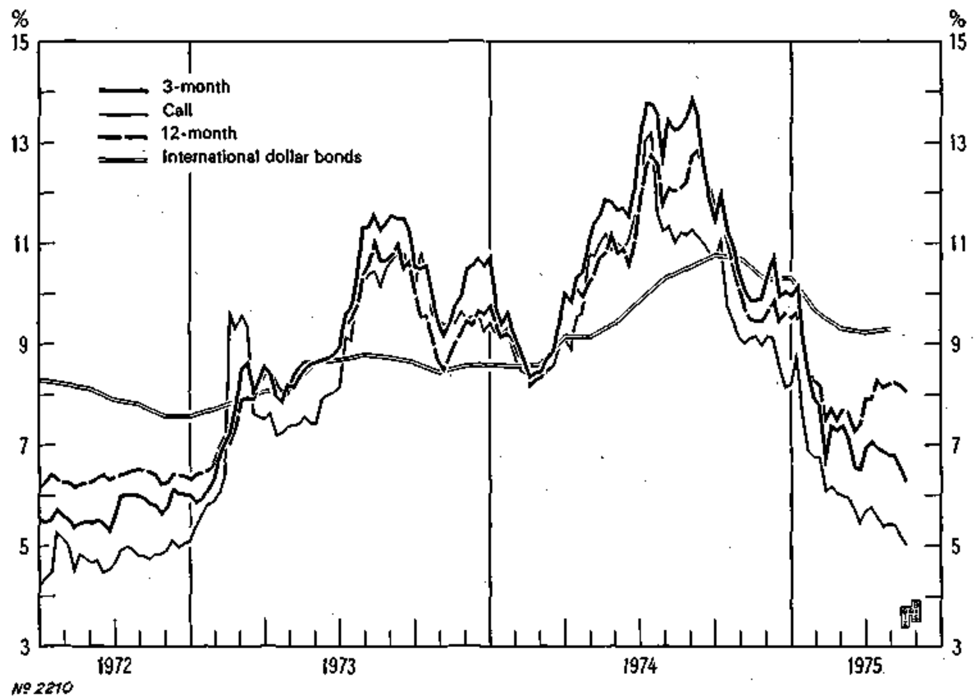
The year opened with market conditions fairly easy. The unwinding of positions built up over the year-end, the downward movement of US money-market rates, inflows of funds from US residents following the removal by the United States of restrictions on capital exports, and increased supplies of funds from the oil-exporting countries pushed the three-month London interbank rate down from 10½ per cent. in December 1973 to below 8½ per cent. in the second half of February 1974. The tightening of monetary conditions in the United States subsequently initiated a renewed rise in Euro-dollar rates, but their premium over US certificate of deposit rates remained very low and for the first time for several years came close to zero in the course of April. This suggests that at the interest levels conditioned by US rate developments new supplies of Euro-currency funds tended to exceed demand. It is true that new loan commitments entered into by the Euro-banks in the first four months of 1974 reached record levels, but a substantial part of these facilities, particularly those extended to governments, was not actually drawn upon.

In May, however, the situation began to change; confidence weakened and the flow of oil moneys into the market seems to have been partly offset by withdrawals of other funds. As a result the market became progressively tighter; the three-month rate premium over the United States widened to well over ½ percentage point by mid-May and under the impact of the Herstatt incident was pushed to about 1¾ percentage points at the end of June. With US interest rates also rising steeply — the three-month US certificate of deposit rate itself went up by 4 per cent. from its February low — the Euro-dollar interbank rate reached a peak of over 14 per cent. around the middle of July, its highest level ever. Even that rate did not fully reflect market pressures, since as a result of the development of a multi-tier interest rate structure certain groups of banks had to pay as much as 16 per cent., or 3½ percentage points more than the yield on US certificates of deposit.

From September onwards the easing of monetary conditions in the United States initiated a long and steep fall in Euro-dollar rates which was only temporarily broken in late 1974 by the usual year-end factors. After reaching a low of 6½ per cent. in the second half of March 1975, the three-month Euro-dollar rate firmed again, under the influence of interest rate developments in the United States, to above 7½ per cent. in early April, but subsequently declined to below 6 per cent. in the second half of May. The premium of three-month Euro-dollars over certificate of deposit rates remained quite high throughout the autumn of 1974 but then narrowed to ⁵/₈ per cent. in the early months of 1975.

A significant feature of rate developments in the period under review was the changes that occurred in the term structure of interest rates. Whereas in early 1974 one-month, three-month and one-year rates had been almost identical, in May 1975 there was, for example, an exceptionally wide spread of over 2½ per cent. between one-year and one-month rates. In part this simply reflected the market's view about

Euro-dollar deposit rates and Euro-dollar bond yields.
End-of-month rate and weekly averages.



the future course of inflation and interest rates. But since this spread was much greater than in the case of interest rates in the United States, it may also have mirrored the market's effort to achieve a better matching of maturities.

Rates for Euro-deposits in non-dollar currencies behaved in some cases quite differently from Euro-dollar rates. The Euro-Deutsche Mark rate, for example, reached its highest level — $12^5/_8$ per cent. on three-month money — as early as January 1974 despite a simultaneous decline in money-market rates in Germany. The reason for its strength was the exchange market's more optimistic view about the dollar which was reflected in the emergence of a forward discount of the Mark of over 3.0 per cent. In early spring, when the exchange market's confidence regarding the dollar began to wane and when, moreover, German interest rates were falling rapidly, the quotations eased to about 9 per cent. Despite the sharp swings that occurred in Euro-dollar rates they then remained close to this level, until in November they began to move downwards again parallel to the decline in German domestic interest rates.

The Euro-bond market.

The world-wide weakness of long-term capital markets in 1974 did not spare the Euro-bond market. On the contrary, it was more seriously affected than most national bond markets, partly because it could not count on a fairly steady flow of

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

Borrowing countries or areas	Years or quarters	International issues, by currencies: US dollars	Other currencies: Total	of which Deutsche Mark[2]	of which Guilders	of which Others	Total	of which Convertible bonds[3]	Foreign issues in national markets[2]
		in millions of US dollars							
Western Europe	1972	1,310	1,310	510	250	550	2,620	130	590
	1973	1,090	960	550	160	250	2,050	180	960
	1974	420	1,000	380	370	250	1,420	—	1,310
	1975 1st q.	*250*	*1,180*	*820*	*190*	*170*	*1,430*	—	*600*
Canada	1972	20	340	270	—	70	360	—	1,140
	1973	30	170	170	—	—	200	—	1,010
	1974	380	60	—	—	60	440	—	1,960
	1975 1st q.	*130*	—	—	—	—	*130*	—	*570*
United States .	1972	1,770	260	90	80	90	2,030	1,070	240
	1973	710	110	50	10	50	820	360	500
	1974	110	—	—	—	—	110	—	80
	1975 1st q.	—	*30*	—	*30*	—	*30*	—	—
Other developed countries[4] . .	1972	100	380	260	70	50	480	—	60
	1973	60	140	140	—	—	200	—	50
	1974	220	120	120	—	—	340	40	150
	1975 1st q.	*140*	*330*	*290*	*30*	*10*	*470*	*10*	*170*
Rest of the world[5] .	1972	430	120	90	—	30	550	20	340
	1973	350	90	70	20	—	440	80	750
	1974	120	20	—	—	20	140	50	790
	1975 1st q.	*20*	—	—	—	—	*20*	—	*120*
International institutions .	1972	680	210	10	80	120	890	—	2,020
	1973	650	240	20	—	220	890	—	2,040
	1974	680	190	100	20	70	870	—	3,280
	1975 1st q.	*300*	*170*	*140*	*30*	—	*470*	—	*550*
Total issues placed	1972	4,310	2,620	1,230	480	910	6,930	1,220	4,390
	1973	2,890	1,710	1,000	190	520	4,600	620	5,310
	1974	1,930	1,390	600	390	400	3,320	90	7,570
	1975 1st q.	*840*	*1,710*	*1,250*	*280*	*180*	*2,550*	*10*	*2,010*

[1] Based on IBRD and OECD sources. [2] Includes non-negotiable "Schuldscheindarlehen" (loans secured by certificates of indebtedness) placed privately. [3] Includes bonds with detachable warrants entitling holders to subscribe for shares. [4] Australia, Japan, New Zealand, South Africa. [5] Including eastern European countries.

funds from institutional investors, partly because of its exposure to exchange rate uncertainty and partly because of the competition to which it was subject from the Euro-currency market. The total volume of new issues, which had already contracted sharply in 1973, declined by another 28 per cent. to $3,320 million and amounted to only 48 per cent. of the peak level recorded in 1972.

The basic causes of the further drop in issues were largely the same as in 1973. Faster rates of inflation and the associated tightening of monetary policy not only led to a fall in Euro-bond prices but at the same time pushed short-term interest rates up far above bond yields. The fear of capital losses and the attraction of the much higher Euro-currency deposit rates at times virtually dried up the supply of new funds to the Euro-bond market; and borrowers were reluctant to incur long-term debts at high fixed interest rates at a time when world economic prospects were beginning to look rather uncertain. Moreover, the lack of buying interest, combined with the high interest cost at which dealers had to finance their inventories of bonds, impaired the operation of the secondary markets still further. As was to be expected, these negative influences bore most heavily on public issues, the volume of which fell by over 50 per cent. to $1,560 million — only 30 per cent. of the 1972 level. In addition, a sharp drop occurred in the average maturity of the bonds offered. Private placements increased by 24 per cent. to $1,760 million.

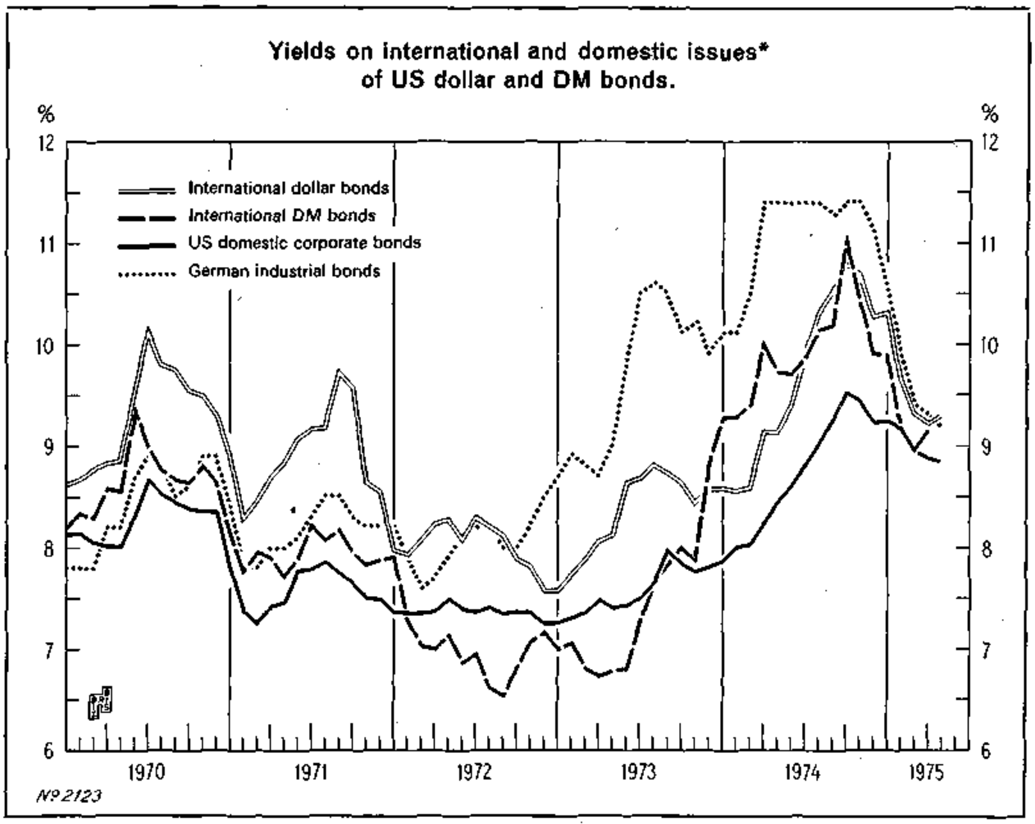
Despite the bleak picture for 1974 as a whole, the general easing of monetary conditions led to clear signs of improvement towards the end of the year, and in the first quarter of 1975 the Euro-bond market staged a remarkable recovery. With the return to a more normal term structure of interest rates, the volume of public offerings went up from a monthly average of $80 million in the six-month period from March to September 1974 to about $150 million in the fourth quarter and then jumped to $460 million in the first quarter of 1975. In fact, the figure of $1,370 million for public offerings in the first quarter of 1975 was not much short of the total for 1974; private placements amounted to $1,180 million.

Two other developments affected the Euro-bond market in the period under review. The first was the removal of US controls on capital outflows. This was reflected in the virtual disappearance of issues by US firms, which up to 1972 had been the largest single group of borrowers on the Euro-bond market. On the other hand, in view of the very strict regulatory requirements the opening-up of the US capital market did not reduce to any great extent the dependence of most groups of non-US borrowers on the Euro-bond market. In fact, apart from Canadian, Israeli and IBRD issues, there were only two public offerings in the US market by foreign borrowers in 1974.

Owing to the weak state of the Euro-bond market, international bond issues by western European borrowers declined from $2,050 to 1,420 million but their share in the total remained approximately unchanged. Developing countries were nearly squeezed out of the Euro-bond market with a fall in their takings from $440 to 100 million, while international institutions succeeded in keeping their offtake at nearly the same level as in 1973.

The second development was the oil-price increases, which were reflected most clearly on the supply side of the market. Increasing purchases by oil-exporting countries provided support to the market during 1974 and were an important factor behind the remarkable revival of issuing activity in the first quarter of 1975. Arab banks have become more important in issuing syndicates and some loans have been tied to Arab currencies.

With regard to the currency denomination of new issues in 1974, the share accounted for by the dollar fell back from 63 to 58 per cent. and that by the Deutsche Mark from 22 to 18 per cent. However, owing to the weakness of the dollar in the exchange markets and the relatively favourable outlook for domestic long-term interest rates in Germany, the share taken by the Deutsche Mark began to go up strongly in the closing months of 1974 and amounted to 49 per cent. in the first quarter of 1975, whereas the dollar's share dropped to 33 per cent. Given the depressed



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

state of the share markets, nearly all international issues in 1974 were in the form of straight bonds.

The yield on international dollar bonds rose from 8½ per cent. at the beginning of 1974 to a peak of 10¾ per cent. in late summer, but subsequently eased to about 9¼ per cent. by the spring of 1975. The discount of Euro-bond yields compared with short-term (i.e. three-month) Euro-dollar rates had run off in the course of the first two months of 1974, but with the skyrocketing of Euro-dollar rates it widened sharply during the spring and exceeded 3 percentage points in the summer. However, following the world-wide easing of monetary conditions, Euro-dollar rates again plunged below Euro-bond yields in the course of the autumn and by May 1975 international dollar bond yields were about 3 percentage points higher than three-month Euro-dollar rates.

In contrast to international issues, foreign issues in national markets (including private placements) expanded sharply in 1974, going up by 43 per cent. to $7,570 million. The largest shares in this total were: $3,080 million issued by the IBRD, $2,150 million of which was raised in oil-exporting countries; $1,960 million issued by Canada, nearly all of which was placed in the United States; and $560 million issued by Israel, the whole of it in the United States. In the first quarter of 1975 the volume of foreign issues in national markets reached the record level of $2,010 million.

VI. ACTIVITIES OF THE BANK.

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

Last year the Bank was again very active in performing functions which facilitated co-operation among central banks. In addition to the regular meetings of the Governors of the central banks of the Group of Ten countries and Switzerland and to those of the Board of Directors, it organised periodic meetings of central-bank officials to examine matters such as the development of the gold and foreign exchange markets and the Euro-currency market and to study and exchange information on other economic, monetary, technical and legal questions of interest to central banks.

The Bank continued to participate as an observer in the work of the Committee of the Board of Governors of the International Monetary Fund on Reform of the International Monetary System and Related Issues, usually known as the Committee of Twenty, until its termination in June 1974. Subsequently it took part as an observer in the first meetings of the Interim Committee of the Board of Governors of the International Monetary Fund on the International Monetary System which was established in October 1974.

The Bank also continued to provide the Secretariat for the Committee of Governors of the central banks of the member states of the European Economic Community and for the Board of Governors of the European Monetary Co-operation Fund, as well as for their sub-committees and groups of experts. The latter are normally entrusted with preparatory studies for discussion among the central-bank Governors; they include in particular the Committee of Governors' Alternates, a group specialising in the technical problems raised by monetary integration, a group commissioned to carry out periodic examinations of the development of the money supply in the member countries and of the problems raised by the co-ordination of national monetary policies, a group whose object is to promote the harmonisation of monetary policy instruments applied by member countries (this group is responsible to both the Monetary Committee and the Committee of Governors), and a group entrusted with drawing up regulations for the future staff of the European Monetary Co-operation Fund.

These committees and groups held a large number of meetings at regular intervals during 1974-75, usually in Basle. Their work led in a number of cases to the adoption of decisions by the Governors or the preparation of opinions for the attention of the Ministers of Finance of the EEC countries; among the subjects studied were the Community exchange system (its operation and adaptation and the possible association of other countries), the recycling of capital (Community loans), the European unit of account, the question of gold and the operation of the Euro-currency markets.

The Bank also provided the Secretariat for the Committee on Banking Regulations and Supervisory Practices established by the Governors of the Group of Ten countries in December 1974. In the light of last year's international banking disturbances, the Committee has been asked by the Governors to give particular attention to the need for an international early-warning system.

Furthermore, the Bank continued to perform the functions entrusted to it in August 1964 by the Ministers of the Group of Ten of collecting and distributing to all the participants of the Group and to Working Party No. 3 of the Organisation for Economic Co-operation and Development statistical data concerning the financing of external surpluses and deficits of the Group of Ten countries. It also continued to assemble, survey and distribute statistical data on the Euro-currency market and to be associated with other work of the Group of Ten and of the OECD. In particular, it participated in the Working Group that negotiated the Agreement, signed in Paris on 9th April 1975, establishing a Financial Support Fund of the OECD. The aim of the Fund is to provide a supplementary source of credit in exceptional circumstances for countries experiencing serious economic difficulties. The Bank has expressed its willingness to assist the operations of the Fund, both as Agent and by helping to finance, in particular through credits to their central banks, member countries' contributions to loans made by the Fund.

Finally, the Bank has continued to act as Secretariat for the computer experts of the central banks of the Group of Ten countries with a view to furthering the exchange of information between central banks on computer hardware and software and assisting them in a wide range of related subjects. During the meetings of these experts close attention has been paid, inter alia, to technical aspects of the standards concerning banking procedures that are being worked out within the International Standards Organisation and to developments in the rapidly changing areas of message switching and electronic systems for international payments, as well as to the policy implications of these developments. A study has been prepared by these experts on security and reliability in electronic systems for international payments. It has also been decided to set up an experimental data bank at the BIS for the storage of macro monetary and economic information of value to the central banks. In addition, other meetings have been held in Basle and at various central banks to examine a number of technical questions, including message authentication, codes for payment operations and related internal accounting procedures, and standards for the exchange of information between central banks.

2. Operations of the Banking Department.

The Balance Sheet of the Bank and the Profit and Loss Account at 31st March 1975, certified by the auditors, are reproduced at the end of this Report; both are expressed in gold francs.*

* * *

* In this chapter the term "francs" (abbreviated to F) signifies *gold* francs, except where otherwise indicated. The conversion into gold francs (units of 0.290 322 58... grammes of fine gold—Article 4 of the Statutes) of the various currencies included in the Balance Sheet has been made on the following bases: in the case of the US dollar, the official parity, i.e. US \$1 = 0.736 662 grammes of fine gold; in the case of those currencies floating jointly, the central rate; for all other currencies, the middle market rate against the US dollar on 26th March 1975.

The balance-sheet total at 31st March 1975 again amounted to a record end-year figure, standing at F 41,940,402,173
against, on 31st March 1974, F 31,615,466,191

It thus registered an increase of F 10,324,935,982
or 33 per cent., quite considerably more in both absolute and relative terms than that recorded in the previous financial year (6,365 million and 25 per cent.).

It should be noted, however, that almost one-tenth of the increase in question reflected the effective appreciation of certain currencies, most particularly the Swiss franc.

BIS: Development of the balance-sheet total over the past ten financial years.

Financial years ended 31st March	Total of Balance Sheet	Movement over the year	
	in millions of francs		in percentages
1966	7,882	+ 32	—
1967	8,232	+ 350	+ 4
1968	12,041	+ 3,809	+ 46
1969	14,643	+ 2,602	+ 22
1970	20,699	+ 6,056	+ 41
1971	23,856	+ 3,157	+ 15
1972	29,362	+ 5,506	+ 23
1973	25,250	− 4,112	− 14
1974	31,615	+ 6,365	+ 25
1975	41,940	+10,325	+ 33

The following items are not included in the Balance Sheet:

(i) bills and other securities held in custody for the account of central banks and other depositors;

(ii) the assets (bank balances, bills and other securities) held by the Bank as Depositary under the Act of Pledge concluded with the European Coal and Steel Community and as Trustee for international government loans;

(iii) gold under earmark held by the BIS; this item amounted to 1,091 million francs on 31st March 1975, against 1,014 million on 31st March 1974.

LIABILITIES (COMPOSITION OF RESOURCES).

BIS: Development of the composition of resources over the past ten financial years.

Financial years ended 31st March	Paid-up capital and reserves	Borrowed funds	Sundry liabilities	Balance-sheet total
	in millions of francs			
1966	151	7,449	282	7,882
1967	151	7,764	317	8,232
1968	170	11,548	323	12,041
1969	200	14,133	310	14,643
1970	463	20,060	176	20,699
1971	539	23,086	231	23,856
1972*	754	28,401	207	29,362
1973*	849	24,179	222	25,250
1974*	967	30,378	270	31,615
1975*	1,122	40,435	383	41,940

*After allocation of the net profit for the year.

A. Capital, reserves, provisions and miscellaneous liabilities.

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

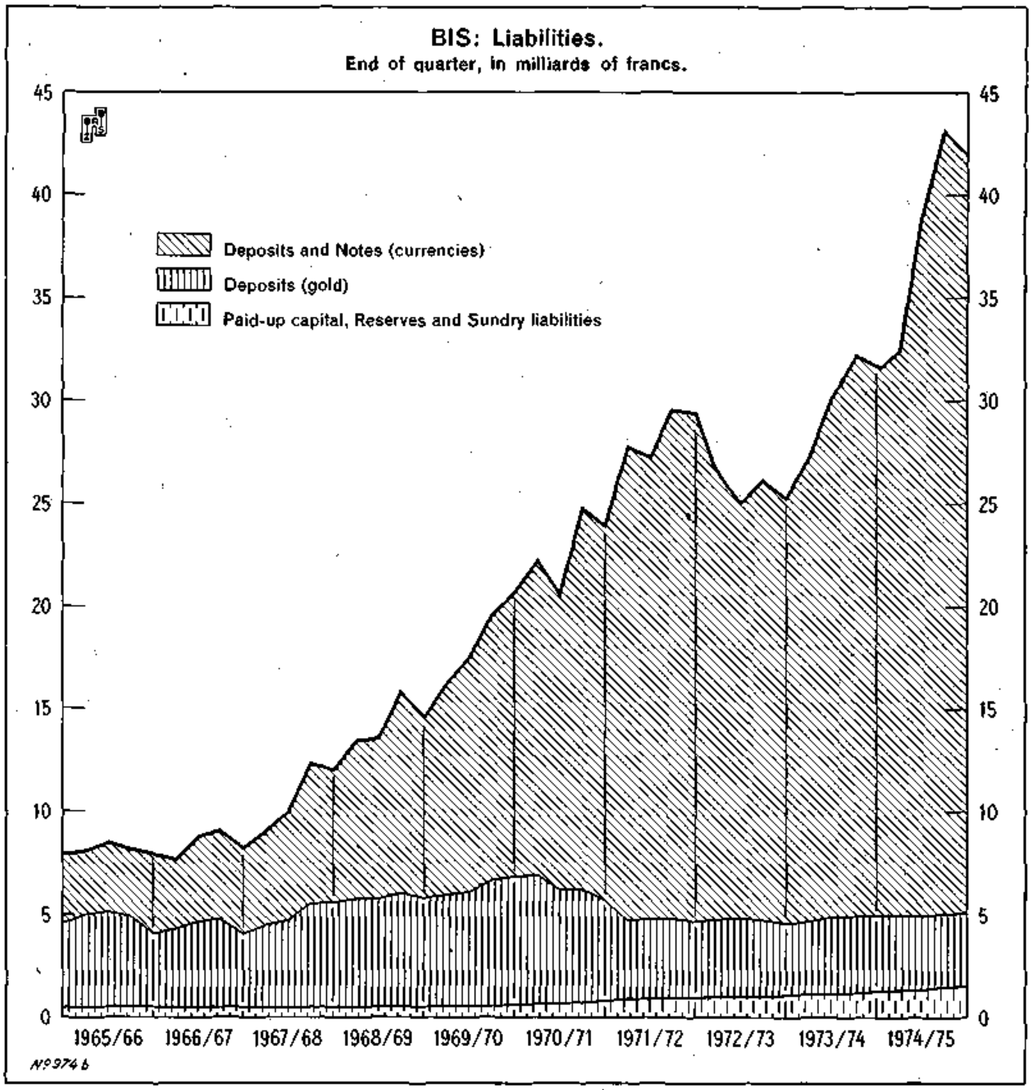
The Bank's authorised capital remained unchanged; so also did the issued capital, which is made up of 481,125 shares paid up to the extent of 25 per cent.

(b) Reserves

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

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

(2) *General Reserve Fund*
after allocation of the net profit for 1974–75 F 371,447,193



This compares with 309.4 million francs on 31st March 1974, the difference of 62 million francs representing the amount it is proposed to transfer to the Fund from the net profit; the proposed increase in this Fund is in conformity with the provisions of Article 51(4) of the Statutes.

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

This Reserve Fund remained unchanged, having in 1973 already reached one-quarter of the paid-up capital, which is the maximum laid down in Article 51(5) of the Statutes.

(4) *Free Reserve Fund*
after allocation of the net profit for 1974–75 F 344,518,200

This compares with 251.5 million francs on 31st March 1974, the amount it is proposed to transfer to the Fund from the net profit being 93 million francs.

The Bank's overall reserves after allocation of the net profit for 1974–75 thus stand at F 821,211,487

This compares with 666.2 million francs at the beginning of the financial year, giving an increase of 155 million; in the preceding financial year the increase in the overall reserves had amounted to 118 million.

(c) The item "Miscellaneous" rose to F 265,671,759

This compares with 140.5 million francs, giving an increase of 125.2 million.

(d) Provision for Building Purposes F 90,548,730

This compares with 103.2 million francs; the decrease of 12.7 million francs is the result of incurred expenditure of 28.8 million francs, partly offset by an exchange gain of 16.1 million francs.

(e) Profit and Loss Account, before allocation F 182,063,281

This figure represents the net profit for the financial year 1974–75; it has thus reached a record level, showing an increase of 37 million francs compared with the figure for the preceding financial year of 145.1 million francs. Details of the proposed allocation of the profit for 1974–75 are given in Section 7 below; these proposals, to which a number of references have already been made in connection with the development of the reserves, provide in particular for a sum of 27,063,281 francs — the same amount as in the preceding financial year — to be set aside in respect of the dividend to be paid on 1st July 1975.

B. Borrowed funds.

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

BIS: Borrowed funds, by origin.

Origin	Financial years ended 31st March 1974	Financial years ended 31st March 1975	Movement
	in millions of francs		
Deposits of central banks	28,809	38,861	+ 10,052
Deposits of other depositors	1,017	909	− 108
Notes	552	665	+ 113
Total	30,378	40,435	+ 10,057

The increase in "Deposits of central banks" was very marked and accounted for practically the whole of the rise in borrowed funds (+ 33 per cent.); it involved mainly deposits in US dollars, which were thus responsible for the major part of the increase in the balance-sheet total.

The two other items recorded small movements which virtually offset one another:

(i) a contraction in "Deposits of other depositors", mainly as a result of the repayment of deposits held by commercial banks; and

(ii) an increase in "Notes" — all denominated in Swiss francs — which was entirely attributable to the appreciation of that currency in terms of gold francs during the course of the financial year.

Among these three categories of borrowed funds, the preponderant share in the total of the first — "Deposits of central banks" — continued to increase (rising to 96 per cent.).

BIS: Borrowed funds, by nature and term.

Term	Deposits in gold			Deposits in currencies			Notes		
	Financial years ended 31st March		Movement	Financial years ended 31st March		Movement	Financial years ended 31st March		Movement
	1974	1975		1974	1975		1974	1975	
	in millions of francs								
Sight	2,851	3,079	+ 228	147	365	+ 218	—	—	—
Not exceeding 3 months	244	481	+ 237	22,691	29,197	+ 6,506	—	665	+ 665
Over 3 months	614	9	− 605	3,279	6,639	+ 3,360	552	—	− 552
Total	3,709	3,569	− 140	26,117	36,201	+ 10,084	552	665	+ 113

During the course of the financial year the proportion of deposits in gold in relation to the total of borrowed resources fell from 12 to 9 per cent., while that of deposits in currencies rose from 86 to 89 per cent.

(a) Deposits in gold F 3,568,515,858

This figure compares with that of 3,709 million francs at 31st March 1974. The reduction of 140 million, or 4 per cent., was attributable to withdrawals by central banks and largely offset the increase of 183 million recorded during the previous financial year. The withdrawals in question involved deposits at over three months. The remainder of the decrease in this category of deposit was accounted for by reconversions into sight deposits and transfers to deposits at not exceeding three months.

(b) Deposits in currencies F 36,201,238,861

This figure compares with that of 26,117 million francs at 31st March 1974, representing an increase of 10,084 million, or 39 per cent. Nearly two-thirds of this very sharp expansion — almost double that recorded in the previous financial year — was accounted for by funds at not exceeding three months and one-third by funds at over three months. Mention may also be made of an increase in sight deposits, especially large in relative terms.

(c) Notes F 665,449,072

This figure compares with that of 552 million francs at 31st March 1974, the increase of 113 million being due exclusively — as already mentioned above — to the rise in the value of the Swiss franc.

ASSETS (EMPLOYMENT OF RESOURCES).

The following table gives a break-down of the main items of the assets according to their *nature*.

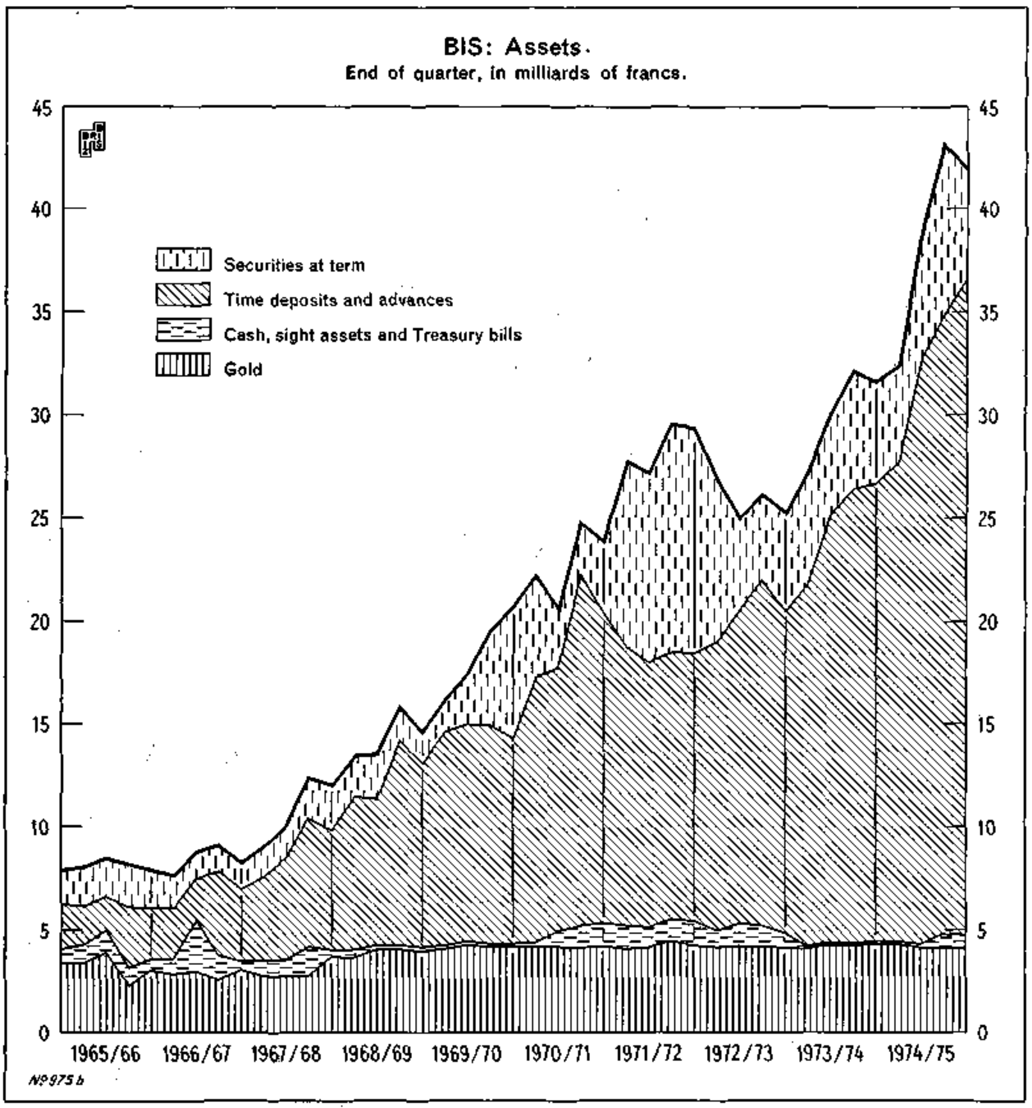
BIS: Distribution, by nature, of sight assets and other investments.

Nature	Financial years ended 31st March 1974		1975		Movement	
	In millions of francs					
Sight assets						
Gold	4,332		4,122		− 210	
Currencies	47	4,379	87	4,209	+ 40	− 170
Treasury bills						
Currencies		8		515		+ 507
Time deposits and advances						
Gold	71		104		+ 33	
Currencies	22,242	22,313	31,782	31,886	+ 9,540	+ 9,573
Securities at term						
Currencies		4,889		5,143		+ 254
Total						
Gold	4,403		4,226		− 177	
Currencies	27,186	31,589	37,527	41,753	+ 10,341	+ 10,164

The distribution of these assets calls for the following comments:

(a) Gold F 4,121,836,539

This item, consisting entirely of gold in bars, amounted to 4,332 million francs on 31st March 1974. The contraction of 210 million during the last financial year was due to the withdrawals of deposits in gold already mentioned, and to the use



of gold in swap operations concluded against currencies as well as for investments in gold. On the other hand, it should be noted that, as indicated in note 3 to the Balance Sheet, the portion of the gold holdings that was pledged declined from 761 million to 334 million during the financial year.

(b) Cash on hand and on sight account with banks F 86,656,247

This figure compares with 47 million francs at 31st March 1974, representing an increase of 40 million.

(c) Treasury bills F 515,658,921

This figure compares with that of 8 million francs at 31st March 1974. The increase of 507 million reflects the resumption of purchases of Treasury bills by the Bank as from October 1974.

It should be noted that the total increase recorded by the two items that have just been commented upon substantially exceeds that in sight deposits received in currencies.

(d) Time deposits and advances F 31,885,841,821

This figure compares with one of 22,313 million francs at 31st March 1974, representing an increase of 9,573 million, or 93 per cent. of the rise in total assets.

The gold component of this item went up from 71 million to 104 million, the Bank having utilised part of its gold holdings for investment in the form of time deposits as already mentioned above.

Time deposits and advances in currencies rose from 22,242 million to 31,782 million, thus recording a very marked increase of 9,540 million, or almost one-half. The rise represents additional investments — chiefly in US dollars — made in a fairly large number of markets, as well as facilities extended to central banks.

(e) Securities at term F 5,143,319,658

This figure compares with one of 4,889 million at 31st March 1974. The moderate rise of 254 million in this item resulted mainly from purchases of paper issued on one particular market.

(f) Miscellaneous F 187,088,986

This figure compares with 26 million francs at 31st March 1974. The sharp expansion of 161 million was largely attributable to accounting adjustments, rendered necessary by the fact that certain swaps against gold had been concluded at market-related prices.

The table below shows the distribution of time deposits and advances and securities at term by *maturity*.

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

Term	Financial years ended 31st March 1974	1975	Movement
	in millions of francs		
Not exceeding 3 months	21,967	27,546	+ 5,579
Over 3 months	5,235	9,483	+ 4,248
Total	27,202	37,029	+ 9,827

As this table shows, the increases recorded in the totals of these two items were broadly comparable in absolute terms.

Forward gold operations.

These operations, which appear under note 2 to the Balance Sheet, resulted in a positive net balance (gold receivable) of F 39,521,613 compared with one of 3 million francs at the end of March 1974, which represents an increase of 37 million during the course of the financial year. This movement was attributable to the conclusion of swaps of gold (repurchased forward) against currencies already mentioned above in connection with assets in gold (item a).

* * *

In the financial year 1974–75 the volume of operations continued to follow a parallel development to that of the Balance Sheet and the profits, and consequently reached a particularly high level.

3. The Bank as Trustee for international government loans.

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

The financial year 1974–75 for the Young Loan ended on 1st June 1975. The interest in respect of the financial year amounted to the equivalent of about 27.7 million francs and was duly paid to the Bank and distributed by the latter among the Paying Agents. Redemption of conversion bonds in respect of the financial year 1974–75 was fully effected by purchases of bonds on the market. All the outstanding

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

Issue	Currency	Redemption value*			
		Bonds issued	Bonds purchased or drawn for redemption in respect of the financial years: 1958–59 to 1973–74	Bonds purchased or drawn for redemption in respect of the financial years: 1974–75	Balance after redemption
American . . .	$	67,019,000	16,239,000	1,662,000	49,118,000
Belgian	B.fr.	202,869,000	47,447,000	4,527,000	150,895,000
British	£	20,665,500	4,799,400	486,900	15,379,200
Dutch	Fl.	52,578,000	12,065,000	1,185,000	39,328,000
French	Fr.fr.	501,834,000	117,812,000	11,857,000	372,165,000
German	DM	14,509,000	3,308,000	295,000	10,906,000
Swedish . . .	S.kr.	92,780,000	21,763,000	2,293,000	68,724,000
Swiss	Sw.fr.	58,393,000	13,463,000	1,264,000	43,666,000

* Redemption value on 1st May 1975 established in accordance with the provisions of the London Agreement on German External Debts of 27th February 1953 but without taking into account the revaluations of the Deutsche Mark in 1961 and 1969, the floating of exchange rates and the introduction—and in certain cases the subsequent alteration—of central rates for various currencies of issue.

funding bonds were redeemed on 1st December 1972, whereas the final maturity date for the conversion bonds is fixed at 1st June 1980.

The question whether the exchange guarantee attached to the Young Loan under the terms of the London Agreement was applicable in the case of the revaluations of the Deutsche Mark in 1961 and in 1969 was submitted in May 1971 to the court of arbitration provided for in the Agreement; the arbitral proceedings are in progress. As regards the more recent question whether the exchange guarantee is applicable when currencies of issue of the Young Loan undergo material changes in exchange value — whether as a result of the adoption of floating exchange rates or of central rates — without a formal change in their respective par values being involved, the Trustee has drawn this matter to the attention of the governments of the countries in which issues of the Loan were made and has requested them to take the matter up and do everything to ensure that an appropriate solution is reached.

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

The following table shows the position with regard to this Loan:

Austrian Government International Loan 1930.

Issue	Currency	Nominal value			
		Bonds assented	Bonds purchased or drawn for redemption in respect of the financial years		Balance after redemption
			1959 to 1973	1974	
American . . .	$	1,667,000	1,192,000	101,000	374,000
Anglo-Dutch .	£	856,600	591,400	49,300	215,900
Swiss	Sw.fr.	7,102,000	4,319,000	404,000	2,379,000

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

The following table shows the amounts outstanding on the secured loans issued by the European Coal and Steel Community between 1954 and 1961 for which the Bank performs the functions of Depositary in accordance with the provisions of the Act of Pledge concluded between itself and the Community on 28th November 1954.

During the financial year 1974–75 the amounts received by the Bank for the service of the secured loans came to the equivalent of about 10 million francs in respect of interest and about 41 million francs in respect of redemption. By the end of the financial year the total amount outstanding had been reduced to the equivalent of approximately 178 million francs.

Secured loans of the European Coal and Steel Community.

Series of Secured Notes	Dates of issue	Countries of issue	Lenders	Original amounts of loans		Amounts unredeemed on 1st April 1975	Rates of interest %	Year of final maturity or redemption
1st	1954	United States	US Government	$	100,000,000	30,700,000	3⅞	1979
2nd	1955	Belgium	Caisse Générale d'Epargne et de Retraite, Brussels	B.fr.	200,000,000	84,800,000	3½	1982
3rd	1955	Germany	Westdeutsche Landesbank Girozentrale, Düsseldorf[1]	DM	50,000,000	14,989,800	3¾	1981
4th	1955	Luxembourg	Caisse d'Epargne de l'Etat, Luxembourg	B.fr. L.fr.	20,000,000 5,000,000	9,480,000 —	3½ 3½	1982 1961
5th	1956	Saar	Landesbank und Girozentrale Saar, Saarbrücken	DM	2,977,450[2]	598,467	4¼	1977
6th	1956	Switzerland	Public issue	Sw.fr.	50,000,000	—	4¼	1974
7th	1957	United States	Public issue	$	25,000,000	—	5½	1975
8th	1957	United States	Public issue	$	7,000,000	—	5	1962
9th	1957	United States	Bank loans	$	3,000,000	—	5	1962
10th	1957	Luxembourg	Etablissement d'Assurance contre la Vieillesse et l'Invalidité, Luxembourg	L.fr.	100,000,000	51,307,036	5⅜	1982
11th	1958	United States	Public issue	$	35,000,000	9,700,000	5	1978
12th	1958	United States	Public issue	$	15,000,000	—	4½	1963
13th	1960	United States	Public issue	$	25,000,000	10,150,000	5⅜	1980
14th	1960	United States	Public issue	$ $ $	3,300,000 3,300,000 3,400,000	— — —	4¾ 4⅞ 5	1963 1964 1965
15th	1961	Luxembourg	Etablissement d'Assurance contre la Vieillesse et l'Invalidité, Luxembourg	L.fr.	100,000,000	65,359,012	5¼	1986
16th	1961	Netherlands	Public issue	Fl.	50,000,000	23,200,000	4½	1981

[1] The original lenders, Rheinische Girozentrale und Provinzialbank and Landesbank für Westfalen Girozentrale, were merged as from 1st January 1969 under the name Westdeutsche Landesbank Girozentrale. [2] This loan, which was contracted in French francs, was converted into Deutsche Mark in 1959. The original amount was 350,000,000 old French francs.

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

The Bank continued to perform the functions of Agent for the European Monetary Co-operation Fund which it has been executing since 1st June 1973. This new Community institution, which was set up on 6th April 1973 by the member states of the European Economic Community, is still only in the initial stage of its operation. The Bank's functions as its technical agent have consequently continued to be confined to book-keeping operations, consisting principally in recording in the Fund's accounts:

- the debts and claims vis-à-vis the Fund of the EEC central banks participating in the "snake" arrangement which arise from interventions carried out by those banks in member countries' currencies in order to maintain the fixed margin of 2.25 per cent.;

- the periodic settlement of these debts and claims, this generally taking place at the end of the month following the intervention;
- operations carried out in connection with the short-term monetary support arrangements.

Over the past financial year, as in the year 1973–74, the central banks concerned — the number of which was reduced to four on 20th January 1974 — have alternated in being debtors and creditors. These movements in opposite directions were not, however, all on the same scale and their effect for each country varied considerably according to the size of the economy concerned and the country's external reserve position.

In aggregate, the amounts recorded by the Fund in respect of interventions were appreciably lower than in 1973–74; this was due primarily to the smaller number of currencies participating in the "snake" and to the fact that the central banks intervened on a greater scale than before in dollars, and such operations are not entered in the Fund's books. As a result, there was some reduction in the volume of accounting operations carried out by the Agent of the Fund.

6. Amendment of Articles 51 and 52 of the Bank's Statutes.

The Board of Directors decided at its meeting on 13th May 1975 to convene an Extraordinary General Meeting for 8th July 1975 with a view to amending Articles 51 and 52 of the Statutes. The action of the Board in proposing this amendment has been prompted by international monetary developments over the past few years.

Under Article 4 of the Statutes the Bank's capital is expressed in terms of gold francs,* which are defined as a weight of gold, and Article 51 of the Statutes fixes the amount of the dividend as a percentage of the paid-up capital. As the annual dividend may not exceed 9 per cent. of the paid-up capital, consisting of a 6 per cent. dividend having priority over all other appropriations of the net profits plus a maximum further dividend of 3 per cent., the most which can be distributed in a given financial year is 56.25 gold francs per share.

It is this gold franc amount which has to be converted into the currency of payment — traditionally Swiss francs — for distribution to the shareholders.

This method of determining the dividend, although not one commonly applied by companies, which generally fix their dividends on the basis of the net profits for the financial year, did not give rise to any major problem up till 1970. Since then, although the dividend declared in gold francs has always been the maximum authorised under the Statutes, the amount paid to the shareholders has varied

* For the sake of clarity, the term "francs" has not been used as an abbreviation for gold francs in this section.

appreciably owing to alterations in exchange rates and, in particular, the successive changes in the official gold price in the United States. Furthermore, it has become increasingly difficult to ensure that shareholders receive a fair return on their share in the capital: but for the limits set by Article 51, clauses (2) and (3), of the Statutes, the growth in the Bank's profits would have made it possible for a larger dividend to be paid.

The problem would quite clearly take on a new aspect if the official price of gold were either to be raised or abolished, but the difficulties would still not be resolved. As the Bank's profits accrue almost entirely in currencies, in terms of gold francs they would be reduced in inverse proportion to any increase in the price of gold. Given the preferential status of the 6 per cent. dividend under Article 51 (2) of the Statutes, the balance available for allocation to the reserves could be insufficient, or even non-existent. This could jeopardise the development of the Bank's activities.

The Board has decided that this unsatisfactory situation should be brought to an end by amending Article 51 and, in conjunction therewith, Article 52 of the Statutes, so as to remove the concept of a dividend related by Statute to the amount of the paid-up capital and to enlarge the scope for transfers to and withdrawals from the Special Dividend Reserve Fund. As a result of these changes, it would be left to the discretion of the Board to decide the level of the annual dividend which it recommends for approval by the General Meeting, thereby making it possible for shareholders to receive a share of the profits more in line with prevailing circumstances. In addition, the present limit on the amount which can be set aside in the Special Dividend Reserve Fund by transfers from the net profits would be abolished and the Board would also have greater freedom, in connection with its dividend recommendation, to have recourse to the Special Dividend Reserve Fund if necessary.

These measures should enable the Bank to ensure a fair and reasonably consistent return for shareholders, even if the financial results of the Bank were to fluctuate, while ensuring that appropriate transfers are made to its reserves in view of the growth in its activity and the development of its balance sheet.

The proposed changes, if approved by the Extraordinary General Meeting on 8th July 1975, cannot enter into force until the Swiss Government, acting with the agreement of the other governments which are bound by the 1930 Convention respecting the Bank, has given its approval.

In view of the importance of the proposed reform it is considered that private shareholders — i.e. members of the general public who, not being central banks, have no right of representation at General Meetings pursuant to Article 14 of the Statutes — should be provided with the opportunity, if they so wish, to dispose of their shares on fair terms. A repurchase offer will therefore be submitted to these shareholders by the Bank, acting on behalf of a consortium of central banks, as soon as the above-mentioned amendments to the Bank's Statutes have been approved by the Extraordinary General Meeting to be held on 8th July 1975. The offer will remain open for acceptance for three months as from that date. The offer price, which has been fixed at Sw.fr. 3,100 per share (ex dividend), will be the same for all shares held by the general public, irrespective of the issue of which they form part.

7. Net profits and their distribution.

The accounts for the forty-fifth financial year ended 31st March 1975 show a net operating surplus of 187,622,476 francs, as compared with 168,212,066 francs for the preceding financial year and 136,048,276 francs for the financial year 1972–73. The main reasons for this considerable increase are the very much larger volume of funds handled by the Bank during the year and the higher proportion of the Bank's own funds held in currencies.

The Board of Directors has decided to transfer to the Provision for Exceptional Costs of Administration an amount of 5,559,195 francs; no allocation is being made this year to the Provision for Building Purposes. As a result of the afore-mentioned transfer the net profit amounts to 182,063,281 francs, against 145,063,281 francs for the previous financial year and 122,063,281 francs for the financial year 1972–73. The allocation of this amount is governed by Article 51 of the Statutes.

On the basis of this provision, the Board of Directors recommends that the net profit of 182,063,281 francs be applied by the General Meeting in the following manner:

(i) an amount of 18,042,187 francs in payment of the preferential dividend of 6 per cent. per annum, this dividend being fixed at 37.50 francs per share;

(ii) an amount of 9,021,094 francs — a sum falling within the statutory limit of 20 per cent. of the remainder of the net profit — to be appropriated in payment of the maximum further dividend of 3 per cent. per annum, this dividend being fixed at 18.75 francs per share;

(iii) an amount of 62,000,000 francs to be transferred to the General Reserve Fund; and finally

(iv) an amount of 93,000,000 francs, representing the remainder of the available net profit, to be transferred to the Free Reserve Fund. This Fund can be used by the Board of Directors for any purpose which is in conformity with the Statutes.

If these proposals are accepted, the total dividend will amount to 56.25 francs per share and will be paid in Swiss francs on 1st July 1975 to the shareholders whose names are entered in the Bank's share register on 20th June 1975.

In the interest of the shareholders the Board of Directors decided at its meeting on 11th March 1975 that, in view of the continuing wide difference between the official gold parity and the market rate of the Swiss franc, the dividend should once again be converted into Swiss francs on the basis of the official gold parity of the Swiss franc at the end of the financial year, namely Sw.fr. 1 = 0.217 592 5926 grammes of fine gold. The dividend will therefore be paid in the amount of 75.05 Swiss francs per share as last year. Because of the exchange loss for the Bank which arises from this method of conversion of the dividend into Swiss francs, an amount of 9,222,082 francs was charged against the Bank's earnings for the financial year 1974–75 to cover the additional cost of the dividend over and above the amount of 27,063,281 francs shown in respect of the dividend in the Balance Sheet and in the Profit and Loss Account at 31st March 1975.

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

In June 1974 M. Bernard Clappier succeeded M. Olivier Wormser as Governor of the Bank of France and became an ex-officio member of the Board in place of M. Wormser. At the meeting of the Board held on 9th July 1974 the Chairman expressed the appreciation and gratitude of all members of the Board for M. Wormser's outstanding services to the BIS during his term of office of more than five years.

The Chairman informed the Board at its meeting held on 9th July 1974 that Mr. Gordon W.H. Richardson, Governor of the Bank of England, had appointed Lord O'Brien of Lothbury under Articles 27(2) and 28 of the Statutes to fill the vacancy on the Board caused by the resignation of Mr. Michael J. Babington Smith, for the unexpired period of the latter's term of office ending on 6th May 1975. Lord O'Brien was re-appointed a Director under Article 27(2) of the Statutes by Mr. Richardson in April 1975.

At the meeting of the Board held on 12th November 1974 the Chairman announced that M. Clappier had appointed as his Alternates M. Marcel Théron in place of M. André de Lattre, who had assumed the appointment of President and General Manager of the Crédit National, and M. Gabriel Lefort in place of M. Henri Koch. The Chairman thanked M. de Lattre and M. Koch for the valuable services they had rendered to the Bank.

At its meeting on 20th January 1975 the Board received with very great regret the Chairman's announcement that Dr. Donato Menichella had decided to relinquish his seat on the Board as from 31st December 1974. The Chairman paid tribute to the outstanding services which Dr. Menichella had rendered to the Bank and to central-bank co-operation during his exceptionally long period of office of nearly thirty years.

At the same meeting the Chairman announced that Dr. Guido Carli, Governor of the Bank of Italy, had appointed Dr. Paolo Baffi as a member of the Board to fill the vacancy caused by the resignation of Dr. Menichella. This appointment was made under Articles 27(2) and 28 of the Statutes for the unexpired period of Dr. Menichella's term of office ending on 7th November 1975. The Chairman also reported that Dr. Carli had appointed Dr. Rinaldo Ossola to act as his Alternate in place of Dr. Baffi. He expressed the Bank's gratitude to Dr. Baffi for his valuable services as an Alternate during a period of more than fourteen years.

At the end of February 1975 M. Cecil de Strycker succeeded M. Robert Vandeputte as Governor of the National Bank of Belgium and became an ex-officio member of the Board in place of M. Vandeputte. At the Board's meeting on 11th February 1975 the Chairman thanked M. Vandeputte on behalf of all members of the Board for the eminent services which he had rendered to the Bank during his term of office of more than four years.

The mandate of Mr. Krister Wickman as a member of the Board being due to expire on 31st March 1975, he was re-elected under Article 27(3) of the Statutes at the meeting of the Board held on 11th March 1975 for a further period of three years ending on 31st March 1978.

Dr. Henri Guisan, who had joined the BIS in 1941 and had been the Bank's Legal Adviser since 1955, relinquished his appointment at the end of September 1974. At the Board's meeting on 10th September 1974 the Chairman thanked Dr. Guisan on behalf of all members of the Board for the great skill and professional competence which he had always displayed in carrying out his important and most valuable work for the Bank. At the same meeting the Board appointed Prof. Dr. F.E. Klein Legal Adviser and Manager as from 1st October 1974; Prof. Klein had been the Bank's Deputy Legal Adviser since 1968.

At the Board's meeting in September 1974 Dr. Antonio d'Aroma, who had been the Bank's Secretary General since 1962, was appointed Assistant General Manager and Dr. Günther Schleiminger of the Deutsche Bundesbank was appointed Secretary General. Both of these appointments took effect as from 1st January 1975.

On 31st March 1975 Dr. Karl Schmid, Assistant Manager, who had been successively in charge of the Bank's EPU Section, EMA Section and Accounting Section, retired after more than eighteen years' valuable and devoted service.

* * *

The Bank learned with deep regret of the death of M. Roger Auboin on 16th October 1974 and of Dr. Raffaele Pilotti on 30th August 1974. M. Auboin had been General Manager of the Bank from 1938 until his retirement in 1958 and Dr. Pilotti had been Secretary General from the foundation of the Bank in 1930 until his retirement in 1951.

CONCLUSION.

At the present time the industrial countries are undergoing the sharpest and most widespread of post-war recessions. The downturn began abruptly at the start of last year with the shock to demand in the automotive and related industries of the sudden outbreak of the oil crisis. The United States, Japan, Germany and the United Kingdom were the first countries to be affected. Up to the middle of 1974 the recession was moderate and selective, but after that it became more general and more rapid. Italy and France, as well as many of the smaller countries, saw the output curve tilt downwards, and the production decline in the four largest countries accelerated sharply as hesitancy and weakness seized most categories of final demand.

The key analytical question about the present slump is why it has been so much more severe than the previous post-war recessions. Four main causal factors may be cited:

1) The huge increase in the price of oil. This has had the effect, firstly, of depressing demand in the automotive industry much more than in past recessions, as many potential buyers dropped out because of higher operating costs of motor vehicles and uncertainties about future supplies. Other oil-related demand, such as that for air transportation, was similarly affected. And, secondly, since demand for oil is rather inelastic, the much higher price pre-empted buying power from other categories of the spending stream.

2) The intensity of inflation. The rate of increase in prices and wages in both 1973 and 1974 was exceptionally high. It was set off at first by the boom in commodity prices which developed because of supply difficulties in the face of high levels of demand, with speculative forces engendered by the breakdown of the exchange rate system adding to the upward push. And as commodity pressures waned, the rise in oil prices, the jump in wage demands and a spurt in the prices of industrial products worsened the inflationary situation — despite a faltering of total final demand. This virulent inflation deepened the recession since it cut into real demand in several ways. In most countries the volume of business investment outlays and real spending of various segments of the public sector were more adversely affected than in previous recessions. In some countries even real consumer expenditure was curtailed, despite the rise in nominal wages.

3) The coincidence of the downturn. To a greater extent than usual, the timing of the recession was similar for most industrial countries. Hence, there were very few countries in which continued expansionary conditions tended to cushion a more general sagging of demand. In fact, the coincidence of the downturn added to the contraction by its adverse effect on the volume of world trade.

4) The severe restraint of stabilisation policy. Faced with inflation rates that had risen two or threefold, the monetary authorities imposed measures of tight restraint. The expansion of the money supply in key cases was held to a lower rate than that

of nominal gross national product and interest rates soared to record levels in both domestic and international markets. The high cost of money put a sharper brake on postponable expenditures than usual and the cut-back in housing construction has been drastic, although the availability and cost of mortgage funds were not the only factors.

The depth of the recession has offered a target to the armchair strategists of stabilisation policy and the tightness of monetary measures in particular has been subjected to criticism. Of course, the restraining measures restrained, and it is too simple to imagine that the recession just suddenly became worse than expected.

But what was there to do? Inflation was at a clearly dangerous rate, and still rising despite the levelling-off or even decline of total demand. The few attempts at incomes policy were not a serious deterrent. And where price controls were made stringent, without the government being able to impose the same stringency on wages, the company sector was severely squeezed — as in Britain and the Netherlands. The situation did not simply reflect mechanistic quantity-of-money relationships. In fact, rather than the inflationary outburst being fully explained by an expanding money supply, prices first of basic commodities and then of oil were taking the lead. And early in 1974 the fever transmitted itself to industrial prices and wages. An inflationary psychology had taken hold and the belief in an ever greater depreciation of money became widespread, with no group prepared to exercise self-restraint for the common good. In these circumstances the dampening of inflation was given full priority in monetary policy. The authorities had a clear duty to do so; to rely on possible self-correction would have been to ignore too much past experience to the contrary.

Was the effort successful? Certainly, in most countries the rate of inflation has come down considerably and the feverish atmosphere has abated. Of course, it may be argued that the commodity boom was bound to taper off and that the jump in oil prices was a once-for-all phenomenon. But it was not evident that it would have been once-for-all without the help of much easier demand conditions or that the reversal in basic commodity prices would have continued without a change in the economic climate. The positive gains also are that wholesale prices have been stable or declining in many countries, that an atmosphere of price competition has been restored in industry and that the rate of consumer price increase has generally slowed down. Less success has been attained with negotiated wages, although the size of increases has also moderated. Germany is the most striking case, and even there forceful leadership was a key factor in confining the new wage round earlier this year to about 6.5 per cent. None the less, wage push continues in the midst of recession and nearly every week in one country or another there are strikes in industries that are quite depressed.

In the United Kingdom there have been few signs of a let-up; wage demands have been exceeding 30 per cent., with the price index lagging behind. It seems an article of faith in labour circles that wage increases must at least match the rise in the consumer price index, even though price increases have partly come from abroad, money demand has been spilling over into a balance-of-payments deficit, and the cost pinch on profits has been drying up new investment. But, sure as fate, real consumption is going to have to be curtailed and the mass of labour will be obliged to shoulder its share of the cut. The only questions are the extent to which the cut will come by unemployment and the amount of financial stress the enterprise sector will be forced to bear.

As the situation in the industrial countries still has inflationary aspects and as some structural adjustments in the use of real resources will be necessary, the outlook at this time is not clearly an optimistic one. The United States and Germany have shifted to an expansionist course and, while US activity is likely to pick up soon, the turn may be more delayed in Germany. Other countries have also taken stimulative measures, but more cautiously; and a few, like the United Kingdom, are still applying restraint. Hence, it does not seem that a rapid and vigorous recovery is in prospect or, indeed, that it could be safely managed.

In international payments, the fourfold rise in the price of oil led to unprecedented imbalances for most countries. The current-account surplus of the oil-exporting countries increased from about $5 milliard in 1973 to $70 milliard last year, with their cash surplus reaching $55 milliard. The current-account position of the OECD countries ended up with a deficit of $33 milliard, while that of non-oil developing countries was about $25 milliard, as against $8 milliard the year before.

The unbalanced positions, however, have not been static: imports of the OPEC countries have risen quite rapidly, while the demand for oil has been reduced by its high price, by the very mild winter and by the deepening of the recession. From a peak quarterly level of about $17.5 milliard last year, the OPEC surplus is estimated to have fallen by about one-third in the first quarter of 1975. Some industrial countries improved their trade position sharply between the first and second halves of last year, and by the first quarter of this year the position was substantially better for almost all of them, though non-oil surpluses and deficits among them remained significant. On the other hand, the deficit of the non-oil developing countries widened as they were less able to curtail oil use and their industrial goods imports increased.

Hence, the situation remains unstable. The developing countries will be under pressure to reduce their swollen trade deficits, while in the industrial countries the consumption of oil will rise when a cyclical upturn comes. It is recognised that basic adjustments in payments and in energy sources and uses are still pressing, but the wide ramifications of the problem and conflicts of interests have been obstacles to agreement on an effective line of policy at both the national and the international level.

While financing difficulties arose for quite a number of countries over the past year, the problem as a whole was managed without great strains. This was because deficits were in the main financed by credits taken in the Euro-market and from the US banking system, with the large flow of oil funds into sterling and dollars helping the process. Of the industrial countries, only Italy was obliged to seek assistance from official sources.

The developing countries managed through a variety of sources, the largest being credits taken in the New York and Euro-markets. Besides that, the IMF's prompt initiative in setting up a special oil facility was very helpful, as were the drawings it made available from its general quotas. The oil countries themselves also provided direct grants and loans of about $2.5 milliard to other developing countries.

For the present year the IMF has set up a further special oil facility of SDR 5 milliard, largely for the help of developing countries. Also, in the OECD a facility to be available as a safety net for its member countries has been agreed upon, with total quotas amounting to $25 milliard. Co-operation on financing has again been more feasible than on basic adjustment.

In the face of the oil countries' surpluses, it was agreed from the start that the oil deficits could not be managed by allowing a free downward float of exchange rates; the result would have been a self-reinforcing contraction in economic activity. Hence, with the help of huge intervention by deficit countries, the pressure in the exchange markets was held down and the movement of rates in general was limited. But, since the dollar was still the main transaction and reserve currency, the system remained essentially a dollar system, and the disparity between the dollar deficit and the surpluses in several European currencies came out in a depreciation of the dollar against those currencies. The rise of the Swiss franc was particularly strong and the Deutsche Mark also appreciated markedly.

The weakness of the dollar started after January 1974, as soon as the US controls on capital exports were lifted. With a fierce demand for dollar funds, there was a rush of foreign lending by US financial institutions, partly for direct foreign investment. This outflow was not so much in response to interest rate differentials as to sheer availability — as could be seen also in the Euro-dollar market. The depreciation of the dollar was reversed for a few months when the Federal Reserve's grip on the money supply was at its tightest; but it was renewed again from September on when money once more flowed out in large volume.

There was, however, also a demand side to the exchange rate movements. Had the recipients of dollar surpluses been prepared on balance to hold their liquid funds fully in dollars, the huge borrowing and on-payments in dollars would have left the exchange markets neutral. But for several reasons part of the flow was placed in other currencies — particularly Deutsche Mark and Swiss francs. The aim has been in part to cover future payments obligations in currencies other than dollars. But more important has been a desire for some diversification of liquid currency holdings, a desire which became stronger when international political tensions were considered more acute. An insight into investors' motives is given by the fact that the demand for Euro-deposits in Deutsche Mark and Swiss francs increased at times when yields on dollars were 1½–2 per cent. higher. And as the dollar weakened, the rates were further affected by adverse changes in the terms of payments.

It was once thought that the development of additional reserve currencies might strengthen the monetary system, as the burden on the dollar would be lessened. As it has worked out, however, reserve diversification has been a destabilising force. The two islands of exchange stability in the system have been the countries in and around the European snake, on the one hand, and the sizable group of countries that have remained pegged to the dollar, on the other. Between the two, the central banks of Germany, Switzerland and the United States have intervened at times to steady their cross rates, but the degree of success achieved has not been outstanding. Hence, there are complaints that prevailing rates do not reflect the "fundamentals" — meaning the basic balance-of-payments situation. But, without full central-bank commitment on intervention, movements of money have become a "fundamental" too.

In these circumstances the reform to a new system of stable par values has remained stalled. One constantly hears that present conditions preclude such a solution; however, it is equally true that the authorities in key cases have been wary of the discipline of par values and that other objectives, such as avoiding controls or keeping freedom in monetary policy, have had priority. The conception of a stable rate system in which the SDR would take over the reserve functions of dollars and gold always seemed rather theoretical. The real heart of the problem was an operational understanding between the dollar and snake countries. The United States would have to assume its share of maintaining the dollar in the market, while other countries would have to avoid excess reserve accumulation. A reasonable co-ordination of monetary policy would be a requisite for both sides. Moving along these lines would show a will towards co-operation and lay a base for a new international monetary order.

René Larre

General Manager

BALANCE SHEET AND PROFIT AND LOSS ACCOUNT

AT 31st MARCH 1975

BALANCE SHEET

ASSETS

(Before and after

		Gold francs
Gold		4,121,836,539
Cash on hand and on sight account with banks		86,656,247
Treasury bills		515,658,921
Time deposits and advances		
Gold		
Not exceeding 3 months	34,456,320	
Over 3 months	69,255,234	
Currencies		
Not exceeding 3 months	23,669,505,224	
Over 3 months	8,112,625,043	
		31,885,841,821
Securities at term		
Not exceeding 3 months	3,841,940,986	
Over 3 months	1,301,378,672	
		5,143,319,658
Miscellaneous		187,088,986
Land, buildings and equipment		1
		41,940,402,173

Note 1: The gold franc is the equivalent of 0.290 322 58... grammes fine gold — Art. 4 of the Statutes. Currencies are converted as follows: the US dollar at the official gold parity, i. e. US $ 1 = 0.736 662 grammes fine gold; all other currencies at central or market rates against the US dollar.

Note 2: At 31st March 1975, gold receivable against currencies on forward contracts amounted to 39,521,613 gold francs.

Note 3: The equivalent of 334,005,808 gold francs' worth of gold was pledged at 31st March 1975 in connection with deposits received.

AT 31st MARCH 1975

allocation of the year's Net Profit)

LIABILITIES

		Before allocation	After allocation
		Gold francs	Gold francs
Capital			
Authorised: 600,000 shares, each of 2,500 gold francs ...	1,500,000,000		
Issued: 481,125 shares	1,202,812,500		
of which 25% paid up		300,703,125	*300,703,125*
Reserves			
Legal Reserve Fund	30,070,313		*30,070,313*
General Reserve Fund	309,447,193		*371,447,193*
Special Dividend Reserve Fund	75,175,781		*75,175,781*
Free Reserve Fund	251,518,200		*344,518,200*
		666,211,487	*821,211,487*
Deposits (gold)			
Central banks			
Sight	3,046,058,516		
Not exceeding 3 months...	480,323,189		
Over 3 months	9,048,872		
Other depositors			
Sight	33,085,281		
		3,568,515,858	*3,568,515,858*
Deposits (currencies)			
Central banks			
Sight	338,421,163		
Not exceeding 3 months...	28,455,185,639		
Over 3 months	6,531,911,995		
Other depositors			
Sight	26,584,638		
Not exceeding 3 months...	742,010,714		
Over 3 months	107,124,712		
		36,201,238,861	*36,201,238,861*
Notes			
Not exceeding 3 months...		665,449,072	*665,449,072*
Miscellaneous		265,671,759	*265,671,759*
Provision for Building Purposes		90,548,730	*90,548,730*
Profit and Loss Account		182,063,281	—
Dividend payable on 1st July 1975		—	*27,063,281*
		41,940,402,173	*41,940,402,173*

REPORT OF THE AUDITORS TO THE BOARD OF DIRECTORS AND TO THE GENERAL MEETING OF THE BANK FOR INTERNATIONAL SETTLEMENTS, BASLE

In our opinion the Balance Sheet and the Profit and Loss Account give a true and fair view of the state of the Bank's affairs at 31st March 1975 and of its profit for the year ended on that date. We have obtained all the information and explanations which we have required. The Bank has kept proper books, and the Balance Sheet and the Profit and Loss Account are in agreement with them and with the information and explanations given us.

Zurich, 25th April 1975

PRICE WATERHOUSE & CO.

PROFIT AND LOSS ACCOUNT

for the financial year ended 31st March 1975

		Gold francs
Net interest and other income ...		216,576,673
Less: Costs of administration:		
Board of Directors ...	419,402	
Management and Staff ...	22,188,943	
Office and other expenses ...	6,345,852	28,954,197
Net operating surplus ...		187,622,476
Less: Amount transferred to Provision for Exceptional Costs of Administration ...		5,559,195
Net Profit for the financial year ended 31st March 1975 ...		182,063,281
The Board of Directors recommends to the Annual General Meeting that the Net Profit should be allocated in accordance with Article 51 of the Statutes as follows:		
Dividend of 6% p.a. on paid-up capital 37.50 gold francs per share ...		18,042,187
		164,021,094
Additional dividend (statutory maximum) of 3% p.a. on paid-up capital 18.75 gold francs per share ...		9,021,094
		155,000,000
Transfer to General Reserve Fund ...		62,000,000
		93,000,000
Transfer to Free Reserve Fund ...		93,000,000
		—

Movement on the Provision for Building Purposes during the financial year ended 31st March 1975

	Gold francs
Balance at 1st April 1974 ...	103,251,698
Add: Exchange difference ...	16,113,357
	119,365,055
Less: Amortisation of expenditure incurred ...	28,816,325
Balance at 31st March 1975 per Balance Sheet ...	90,548,730

BOARD OF DIRECTORS

Dr. J. Zijlstra, Amsterdam	Chairman of the Board of Directors, President of the Bank
Henri Deroy, Paris	Vice-Chairman

Baron Ansiaux, Brussels
Dr. Paolo Baffi, Rome
Dr. Guido Carli, Rome
Bernard Clappier, Paris
Dr. Leonhard Gleske, Bremen
Dr. Karl Klasen, Frankfurt a/M.
Dr. Fritz Leutwiler, Zurich
The Rt. Hon. Lord O'Brien of Lothbury, London
Gordon W. H. Richardson, London
Cecil de Strycker, Brussels
Krister Wickman, Stockholm

Alternates

Dr. Otmar Emminger, Frankfurt a/M., or
Johannes Tüngeler, Frankfurt a/M.
Georges Janson, Brussels
Christopher W. McMahon, London, or
M. J. Balfour, London
Dr. Rinaldo Ossola, Rome, or
Prof. Francesco Masera, Rome
Marcel Théron, Paris, or
Gabriel Lefort, Paris

MANAGEMENT

René Larre	General Manager
Dr. Antonio d'Aroma	Assistant General Manager
Dr. Milton Gilbert	Economic Adviser, Head of the Monetary and Economic Department
R. T. P. Hall	Head of the Banking Department
Dr. Günther Schleiminger	Secretary General, Head of Department
Dr. Antonio Rainoni	Manager
Maurice Toussaint	Manager
Prof. Dr. F. E. Klein	Legal Adviser

D. H. Stapleton	Deputy Secretary General
Robert Chaptinel	Deputy Manager
Dr. Warren D. McClam	Assistant Manager
M. G. Dealtry	Assistant Manager
R. G. Stevenson	Assistant Manager
Rémi Gros	Assistant Manager