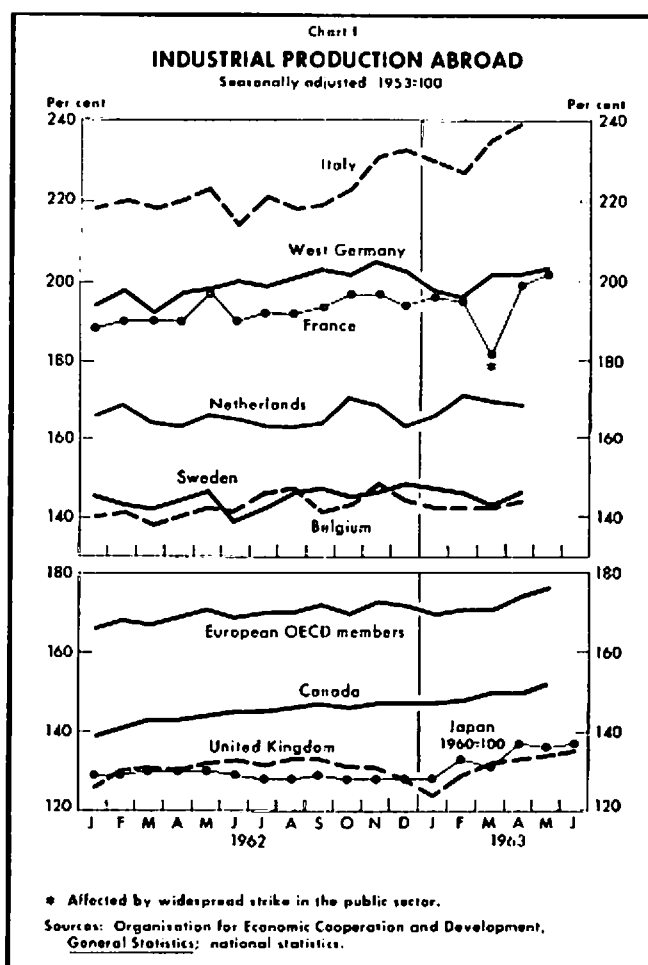
Recent Financial Policy Measures Abroad

New and significant financial policy measures have been adopted by many of the major foreign industrial countries since the beginning of the year.[1] These moves have occurred against the background of further, albeit in some cases slackened, growth in economic activity and of continued strength in the international position of most of these countries.

In an era of increased interdependence between national money markets and of further gradual liberalization of international capital movements, national financial policies have implications reaching beyond a country's own boundaries. Consequently, such national measures are now generally undertaken only after thorough consideration of their bearing on the national balance of payments and the international payments system. In the case of the United States, for example, balance-of-payments considerations were the main influence in the July decision to raise the Federal Reserve Banks' discount rate and the permissible maximum rates on commercial banks' time deposits of ninety days' to one year's maturity. Several foreign countries, on the other hand, have had to face the dilemma that a tightening of monetary policy to deal with incipient or actual inflationary pressures might accentuate existing balance-of-payments surpluses by inducing capital inflows. It has therefore become increasingly important that the leading countries consult on their national financial policies and attempt to achieve a measure of cooperation in such policies.

GENERAL ECONOMIC BACKGROUND

In Western Europe, the pickup in activity from the lag occasioned by the unusually severe winter has showed somewhat divergent patterns. In the United Kingdom, strength in the construction and automobile industries and a good recovery of exports have led to a rapid growth in production (see Chart I). By June industrial production had reached a new peak, with unemployment declining



* Affected by widespread strike in the public sector.
Sources: Organisation for Economic Cooperation and Development, General Statistics; national statistics.

[1] For developments in the latter part of 1962, see "Recent Monetary Policy Measures Abroad", this *Review*, January 1963, pp. 7-9.

through July from earlier record levels.[2] According to the National Institute of Economic and Social Research, over-all output in the United Kingdom has been growing this year at an annual rate of 4 to 5 per cent, compared with an average rate of 1.5 per cent in 1961-62, and is expected to continue at the same pace during the remainder of 1963.

In the European Economic Community (Common Market), on the other hand, the spring recovery suggests that this year's rate of over-all economic expansion may be somewhat slower than in the past few years. In fact, the Community's Commission has already reduced from 4.4 to 4 per cent its forecast for the growth in total output of the Common Market countries this year. This composite rate subsumes estimated annual growth rates of 4.5 per cent in France, 5 per cent in Italy, close to 3 per cent in Benelux, and 3.5 per cent in Germany. As far as generalizations can be made, this expected slowing-down in the pace of economic activity on the Continent reflects primarily a reduced rate of business investment. In some countries and industries, the heavy investments of earlier years have raised capacity to the point where the prospective growth of demand over the near future can be met with existing facilities. Also, widespread scarcities of skilled labor have contributed to a tendency for wage increases to outstrip productivity gains. The attendant rise in unit costs of production has posed for many European firms the alternatives of reduced profit margins or attempts to raise prices in competitive markets. Thus, investment incentives in the Common Market countries as a group appear to have declined somewhat. In addition, official restraint measures have in some countries contributed to the current slackening of the rate of growth. The relative roles played by these factors have, of course, varied greatly among the various countries and industries.

In Canada, economic activity advanced during the first half of this year and unemployment has fallen considerably below the seasonal highs of last winter. In Japan, industrial production rose steadily in the early part of the year and then leveled off somewhat in May and June as the demand for capital goods slackened.

There have been only limited changes so far this year in the external payments position of the major trading countries. The Common Market as a whole is generally judged likely to record somewhat smaller official reserve gains than in previous years, with continued strength in the balance of payments of France and renewed strength in that of Germany partially offset by the recent weakening in Italy's external position. The British balance of payments, on the other hand, has been buoyed by the recovery of exports during the first half of 1963. British reserves fell in February-March, after the rejection of Britain's bid to join the Common Market, but were partially sustained by central bank cooperation; they recovered during the spring and, by the end of July, after repayment of central bank credits, were only moderately below their January level. Although Canada and Japan continued to record deficits on current account, both countries were able to add to their international reserves during January-June as a result of capital inflows.

Against this varying background, monetary policy and other financial measures abroad followed diverse patterns. A number of countries took steps to sustain the further expansion of their economies, while others moved toward monetary restraint in order to counter potential or actual upward pressures on prices. In addition to dealing with immediate problems some countries adopted broader reforms, primarily in an effort to channel available savings from short-term investments into the capital market.

RELAXATION OF MONETARY POLICY

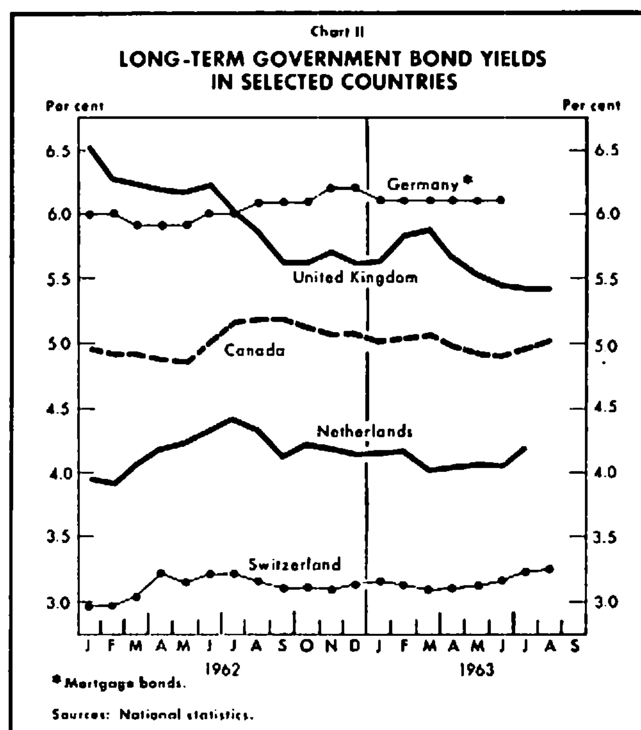
In the United Kingdom, Canada, the Netherlands, Austria, Denmark, and Japan, the monetary authorities reduced discount rates (see table) or relaxed other monetary restraints. (As discussed below, Canada subsequently raised its rate again.) Like the numerous discount rate reductions of 1962, this year's moves often reflected improved reserve positions. But to an important extent they also aimed at maintaining sufficient monetary ease to permit continued growth in domestic economic activity.

At the beginning of the year the Bank of England lowered its discount rate to 4 per cent from 4½. Simultaneously, however, the bank announced that it would on occasion charge the discount houses at a rate above the bank rate. This measure was designed to reduce the spread between that rate and the rates for Treasury bills and related short-term paper in order to discourage outflows of short-term capital. The technique was used on only one day, during March, when the discount market was charged 4½ per cent. Since then the spread between the bank rate and the average bill rate at tender has remained within ⅜ per cent, instead of the more usual ½ to ¾ per cent. During March-May and again in August, the Bank of England allowed one or more of the commercial banks to let their liquidity ratios dip temporarily below the 30 per cent minimum, thus helping to keep bank credit available and domestic interest rates attractive to borrowers. In addition, recent moves in British debt management have been de-

[2] Both series seasonally adjusted.

signed to impart strength to the longer term government securities market. Issuance of new long-term debt so far this year has been limited to a £400 million 5 per cent Exchequer cash loan (maturing in 1976-78 and yielding 5.21 per cent) offered in April. Since then, the Treasury has relied on the shorter end of the market to meet its cash requirements, while long-term yields have eased steadily since early March (see Chart II).

The Bank of Canada on May 6 reduced its discount rate for the chartered banks to 3½ per cent from 4, the latest in a series of reductions from the 6 per cent rate set in mid-1962 in the course of a stabilization program designed to defend the par value of the Canadian dollar. The rise of Canada's international reserves to record levels and a desire to provide a spur to domestic activity were important factors in these moves. Interest rates in Canadian financial markets eased gradually but steadily in the wake of the May discount rate cut. On August 12, however, the Canadian authorities raised the rate once more to 4 per cent in a move prompted by July reserve losses and by uncertainty over the effects on Canada's balance of payments of the proposed United States tax on purchases of foreign securities.[3] The Governor of the Bank of Canada emphasized that the rate increase did not signal a change in the bank's basic monetary policy, which is still aimed at promoting credit conditions conducive to economic expansion. Also with a view toward Canada's longer term growth, the Canadian Government's 1963-64 budget, submitted on June 13, proposed the creation of two new financial institutions: a National Development Corporation that would channel funds into new Canadian industries or purchase foreign-owned Canadian securities, and a Municipal Development and Loan Board that would be authorized to purchase municipal bonds.



CHANGES IN FOREIGN CENTRAL BANK DISCOUNT RATES, 1962-63
In per cent

Country	Date		New rate	Change
Austria	1963:	June 27	4½	−½
Belgium	1962:	January 18	4¼	−¼
		March 22	4	−¼
		August 9	3¾	−¼
		December 6	3½	−¼
	1963:	July 18	4	+½
Canada	1962:	June 24	6	*
		September 7	5½	−½
		October 12	5	−½
		November 13	4	−1
	1963:	May 6	3½	−½
		August 12	4	+½
Denmark	1963:	August 19	6	−½
Finland	1962:	March 30	8	+1¼
		April 28	7	−1
Greece	1963:	January 17	5½	−½
Japan	1962:	October 27	6.93	−0.365
		November 27	6.57	−0.365
	1963:	March 20	6.205	−0.365
		April 20	5.84	−0.365
Netherlands	1962:	April 25	4	+½
	1963:	January 8	3½	−½
Sweden	1962:	April 6	4½	−½
		June 8	4	−½
	1963:	January 18	3½	−½
		June 14	4	+½
United Kingdom	1962:	March 8	5½	−½
		March 22	5	−½
		April 26	4½	−½
	1963:	January 3	4	−½

* From November 1956 through June 21, 1962, the discount rate of the Bank of Canada was set at ¼ per cent above the latest average tender rate for Treasury bills. The discount rate stood at 5.17 per cent on June 21, 1962.

[3] However, an understanding was reached with the Canadian Government under which the United States Treasury included in the draft legislation a provision permitting the President to exempt new issues "if the application of the tax . . . will have such consequences for a foreign country as to imperil, or threaten to imperil, the stability of the international monetary system". The Canadian authorities, on their part, have stated that it was not their intention to increase Canada's official international reserves through the proceeds of borrowings in the United States.

Dutch monetary policy this year has also tended toward greater ease against the background of a satisfactory international reserve position and a lack of marked inflationary pressures. On January 8, the Netherlands Bank lowered its discount rate to 3½ per cent from the 4 per cent rate in force since April 1962. As a further measure of relaxation, the bank suspended the gentleman's agreement of mid-1961 under which a ceiling had been placed on commercial bank credit expansion. Breaking through that ceiling had carried the obligation to place with the central bank "special deposits" equal to 100 per cent of the excess granted. After taking these measures, the central bank acted repeatedly to keep the money and credit markets on an even keel. The banks' cash reserve ratio, which had been lowered to 4 per cent in order to help them weather the year-end liquidity drain, was raised to 5 per cent in late January, to offset sizable transfers of government funds to the municipalities. However, the flotation of large government loans in February and May prompted reductions in the ratio to 4 per cent and 3 per cent, respectively. The 3 per cent ratio will continue in force at least through late September, partly to offset seasonal drains on bank liquidity.

In a move primarily aimed at aligning Austrian interest rates and exchange control practices more closely with those of other European countries, the Austrian National Bank lowered its discount rate on June 27 from 5 per cent to 4½ and simultaneously relaxed its controls over international capital movements. The discount rate had last been changed in March 1960, when it was raised to 5 per cent from 4½. It should be noted that the June reduction was not accompanied by a relaxation of any of the stringent credit controls that had been imposed during 1962 to absorb some of the domestic liquidity engendered by the substantial payments surplus, although that surplus was running at a lower rate during the first quarter of 1963. The commercial banks are still subject to reserve ratios of 10 and 8 per cent against sight and savings deposits—ratios that are high for Austria by historical standards. Moreover, the banks still have to observe a minimum liquidity ratio of 60 per cent for deposit increases after August 1, 1962. The international ramifications of the discount rate change were reinforced by measures designed to forge closer bonds between the Austrian and other European capital markets. These measures will be implemented in stages. Austrian banks will immediately enjoy greater freedom in placing and borrowing short- and medium-term funds abroad and in accepting foreign time deposits. As of this fall, present restrictions on longer term credits to, and borrowing from, nonresidents also are to be eased.

The National Bank of Denmark on August 19 lowered its discount rate to 6 per cent from 6½, the rate in effect since May 1961. The move reflected gains in the battle against previously severe inflationary pressures, which had been fought with comprehensive fiscal measures (including a 9 per cent sales tax) adopted in July 1962 and a freeze on prices and dividends enacted last February. Foreign exchange reserves rose during the first half of 1963, after falling for three years, and the trade deficit has been sharply reduced.

The Japanese monetary authorities have this year continued their efforts to lower the country's comparatively high interest rates. The discount rate reductions of last October and November were followed by a further cut in March, to 6.205 per cent from 6.57 per cent. The latest reduction, to 5.84 per cent in April, brought the rate to its lowest level since 1954. The general level of interest rates has, in fact, been declining with the discount rate, and credit has been expanding at a faster rate than a year ago. As of July, the Bank of Japan eliminated the 0.365 per cent penalty rate (over and above the discount rate) that it had been charging the banks for discounts in excess of 80 per cent of the discount ceilings established last October. It retained, however, the 3.65 per cent penalty rate for borrowings from the central bank in excess of these ceilings.[4]

MONETARY RESTRAINT

In France, Belgium, Sweden, Switzerland, and West Germany, the monetary authorities overtly turned to restraint or permitted a tightening of credit conditions in response to market forces.

France has this year experienced the persistence of a large over-all payments surplus and considerable inflationary pressures, induced in part by substantial wage increases. In an initial countermove, the French monetary authorities at the end of March raised from 32 to 35 per cent the proportion of deposits that banks must hold in the form of cash, Treasury bills, export bills, and medium-term paper. Subsequently, the Bank of France obtained discretionary power to raise this liquidity ratio to a new maximum of 38 per cent and, in fact, moved it up to 36 per cent at the end of May. In order to mop up additional liquidity, the French Treasury in May successfully floated a fifteen-year 4¼ per cent 1 billion franc issue—its first

[4] For Japanese moves in the foreign exchange field, see "Foreign Exchange Markets, January-June 1963", this *Review*, July 1963, p. 107.

long-term borrowing in five years.[5] The authorities also requested that the banks limit their loan expansion (except for medium-term export and industrial credits) to an annual rate of 12 per cent, as against an average expansion of 16 per cent in 1961-62. Finally, early in September, it was announced that a tightening of consumer credit regulations was imminent.

The French authorities also took steps to discourage any inflow of funds from abroad that might add to France's balance-of-payments surplus and weaken the domestic effects of these restrictive measures. Beginning in April, French banks were forbidden to pay interest on deposits owned by nonresidents outside the French franc zone (but excluding deposits of foreign central banks and international organizations).[6] Additional steps were taken in August to limit the availability of foreign funds to French residents in general, in addition to the banks. French borrowers now must obtain specific approval from the authorities for foreign credits that cost more than 4 per cent or exceed 1 million francs or have a maturity of over two years. (The previous limits had been 5 per cent, 2 million francs, and five years.) In addition, borrowings of whatever amount by French residents that would raise their total indebtedness to foreigners above 1 million francs now require prior authorization.

In Belgium, official moves this year have partly reflected, and partly contributed to, a general hardening of market rates that followed a rapid growth in bank credit through 1962 and some capital outflows this year. In March, the Finance Ministry announced a coupon rate of 5 per cent for the first tranche of the 1963 Treasury loan. In April, the government's Telephone and Telegraph loan was issued (at par) with a 5.5 per cent coupon rate, while the June tranche of the Treasury loan featured the same coupon and an issue price of 99. Also in June, the Ministry approved an increase in savings deposit rates to 3 per cent from 2.75. Subsequently, the rate on three-month Treasury "tap" bills, which had been 3 per cent since October 1962, was raised in three steps during July to 3.4 per cent, while the National Bank's discount rate was boosted from 3½ to 4 per cent on July 18.

Through the early months of 1963, as in most of 1962, Swedish monetary measures were still aimed at bolstering economic activity, which was being damped by sluggish industrial investment. On January 18, the Bank of Sweden lowered its discount rate to 3½ per cent from 4. This third ½ per cent reduction within nine months brought the rate to its lowest level since the beginning of 1955. By the end of the first quarter, however, a sharp rise in bank lending and an improving outlook for Swedish industry signaled an end to the need for official stimuli. Toward midyear, a continuing strong demand for credit began to cause a tightening in the financial markets. As a result, the commercial banks' new issue activity came to a virtual standstill and underwriters' bond inventories were proving difficult to move. These problems were accentuated by the large advance commitments of the government's General Pension Fund, which rendered inactive the most important single supplier of long-term funds in the market. On June 14, the Bank of Sweden raised its discount rate to 4 per cent in a move pointing to the desirability of a more modest rate of credit expansion. The next day, all deposit and lending rates at commercial banks, savings banks, and the post office were raised, as were the rates on local authority and mortgage loans.

In Switzerland, the credit situation began to tighten in the second quarter. Domestic loan demand—primarily to finance construction and imports—increased substantially, while private French and German interests began to borrow heavily in Switzerland. Some pressure in the money and credit markets persisted even beyond the midyear statement period. Thus, there was only weak response to the Zurich and Geneva municipal bond issues in late June and early July, and long-term yields had already tended upward. In addition, the Swiss commercial banks encountered difficulties in selling three- to five-year deposit certificates at the 3½ per cent rate in effect since mid-1962. In August, the Swiss National Bank approved an increase of ¼ percentage point in the rate that commercial banks may pay on such certificates, and also in the rate on new first mortgages, with a similar increase on existing mortgages to follow next year. Despite reduced liquidity, the Swiss commercial banks agreed to extend until the end of this year their gentleman's agreement with the Swiss National Bank to discourage the inflow of foreign funds. The banks will continue to pay no interest on foreign deposits of whatever type and to refrain from purchases of Swiss securities, real estate, and mortgages for foreign account. However, the previous provision subjecting deposits with less than six months' maturity to an annual charge of 1 per cent has now been eliminated.

Faced with mixed developments in the German economy, the monetary authorities have abstained from major policy changes thus far in 1963. The German

[5] Unlike the government issues of the 1950's, this loan does not carry an index clause linking principal or interest to some price or other index. However, interest is exempt from personal income tax, and the issue features a repayment premium of 2½ per cent after five years and 5 per cent after ten years.

[6] This measure is similar to those taken by Germany and Switzerland in 1960 (and still in force in modified form) in order to discourage the inflow of short-term funds.

Federal Bank has noted that the principal sources of such inflationary pressures as existed were government expenditures and the construction sector, which could be influenced more effectively by fiscal measures. The bank has also noted that any rapid tightening of monetary policy might produce a large influx of funds, such as occurred in 1960. Thus the authorities have kept unchanged the main indicators of monetary policy, including the discount rate and reserve requirements. In the face of rising credit demand, however, this neutral attitude led to a considerable rise of short-term rates through midyear, and there has been some capital flow into Germany.

FINANCIAL REFORMS

Since the beginning of 1963, France and Italy have adopted broader structural reforms of their money and capital markets. Generally, the major aims of these reforms are to reduce short- and medium-term rates, as a means of orienting savings toward long-term investments, and to encourage the flow of funds to business through the capital market rather than through bank loans.

The French Treasury discontinued selling bills on tap to the commercial banks in April, and substituted a quarterly auction system. This shift was made to insure that commercial bank investments in Treasury bills, over and above those held as part of the liquidity ratio, would be better attuned to the Treasury's cash requirements and to prevailing money market conditions.[7] Also in April the National Credit Council lowered the rates that banks may pay on time deposits and deposit certificates, and the Treasury reduced by 25 basis points the rates it pays on one- to five-year paper offered for public subscription. These securities constitute a highly popular investment medium for the general public's savings and now yield 2.50 to 4.05 per cent, depending on maturity.

Efforts to channel funds into the French capital market were reinforced in July with the official announcement that France would soon have two new types of financial institutions. Under legislation effective this month, the first of these (sociétés immobilières d'investissement) will be active in real estate financing and will bid for personal savings to help finance new private rental housing, an undertaking that lost popular appeal with the imposition of rent controls after World War I. Substantial tax advantages will be granted, including exemption from estate taxes on shares bequeathed by the original holder. The second new type of financial institution will be mutual funds (sociétés d'investissement à capital variable). These will be licensed by the Treasury, and may be required to hold at least 30 per cent of their assets in cash, listed bonds, and Treasury bills. The announcement of these innovations closely followed the issue of a comprehensive study of possible reforms of the French capital market, submitted to the government by a committee of experts. The establishment of mutual funds was one of the committee's recommendations.

The Italian authorities have continued their efforts, begun in the autumn of 1962, to create a flexible money market, foster capital market activity, and integrate these markets more closely with those abroad. This year's measures have aimed in particular at separating more sharply the short-, medium-, and long-term markets: banks are forbidden to accept deposits with more than eighteen months' maturity, while medium- and long-term credit institutions may no longer accept deposits with less than that maturity; an interest ceiling of 5 per cent is imposed on medium-term deposits (eighteen to sixty months); institutions that accept medium-term deposits are required to match these with medium- and long-term assets; and issues of medium-term securities are made subject to official approval. In a complementary move, Italian residents were authorized in April to invest in foreign bonds and shares that are quoted on stock exchanges abroad; the foreign securities purchased must be deposited, however, with an Italian bank or with foreign banks for the account of an Italian bank.

[7] The current liquidity ratio of 36 per cent includes a 15 percentage point requirement in Treasury bills. Bids for these bills continue to be filled at fixed rates of interest; these rates were lowered last February by 12½ basis points and now range from 2⅜ to 3⅛ per cent on 75-day to 725-day paper.