International Monetary and Financial Developments

THE TOKYO MEETING OF THE INTERNATIONAL MONETARY FUND

The question of international liquidity and of future world liquidity needs again dominated the annual meeting of the International Monetary Fund (IMF), which this year was held in Tokyo during the week of September 7.[1] In order to expand the Fund's resources and thus strengthen its ability to meet any contingencies that might arise, the Fund's governors agreed in principle on an increase of members' quotas. Several speakers suggested a 25 per cent increase in most quotas, and there were also suggestions that the quotas of Canada, Germany, and Japan might be raised somewhat more than proportionately, in recognition of the growing share of these three countries in international trade and payments. Individual quotas—which were last raised in 1959 and currently total \$15.6 billion—determine the limitations on the use of the Fund's resources, as well as the voting power, of each member country.

This year's discussions were held against the background of two studies of the international monetary system and international liquidity needs that were prepared by the IMF and the Group of Ten as a result of resolutions taken at the Washington meeting of the IMF last year.[2] The discussions, which produced a thorough analysis of the past performance and the likely evolution of the international monetary system, showed a large measure of agreement on the basic issues. It was generally felt that the present gold exchange standard has served past needs well and has contributed to an orderly expansion of international trade and finance. The several speak-

[1] For a discussion of the 1963 meeting, see "The Question of International Liquidity at the Fund Meeting", this *Review*, November 1963, pp. 167-69.

[2] International Monetary Fund, *Annual Report of the Executive Directors for the Fiscal Year Ended April 30, 1964*, Part II, and *Ministerial Statement of the Group of Ten*, August 10, 1964. The group consists of Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, United Kingdom, and the United States, with Switzerland an unofficial member.

ers endorsed the conclusions of the study by the Group of Ten, including those on the need for increases in IMF quotas, multilateral surveillance of the present bilateral liquidity arrangements, and coordination of monetary and fiscal policies by the major Western nations. There also was unanimity that the question of international liquidity is closely related to the need for balance-of-payments discipline. Domestic inflationary pressures must be checked by each country, and the provision of ample credit resources should not be viewed as a substitute for national action to correct payments imbalances.

Nevertheless, the delegates were aware of the possible future liquidity requirements of an ever-expanding world economy. In following up the studies of the past year, therefore, both the IMF and the Group of Ten will examine various proposals for the creation of additional reserve facilities. It is clear that the problem is both extremely important and difficult to resolve; there is a wide range of proposed solutions, several of which may have considerable merit. Hence, it is not surprising that there should be some divergence of opinion on the appropriate future course.

In his speech to the Governors of the Fund, Secretary of the Treasury Dillon emphasized the need for continuity and gradual evolution:

> It is highly significant that both studies concluded that the present system is functioning well and that any changes should be designed, in the words of the Fund report, "to supplement and improve the system where changes are indicated, rather than to look for a replacement of the system by a totally different one".

On the other hand, French Minister of Finance and Economic Affairs Giscard d'Estaing criticized the prominent position of the key currencies in the present system and favored a system in which gold would constitute the core of international liquidity, supplemented if necessary by "deliberate and concerted creation of either reserve assets or credit facilities". British Chancellor of the Exchequer Maudling rose to the defense of the gold exchange standard and suggested that the future course of action should evolve from it:

> I prefer to build on what has stood the test of time and experience, and has brought great benefits to the world. I know that some people question this, but I would not myself accept the views of those who think that the imbalance in world payments with which we have been faced has been aggravated by the workings of the gold exchange standard. I do not believe that the sources of that imbalance lie solely in conditions of inflation in the deficit countries. Nor do I believe that adjustments in domestic economic conditions leading to improved international balance would come about quickly and smoothly if only the role of gold were strengthened, and if the only fresh supply of owned reserves allowed in the principal industrial countries in addition to gold was a strictly limited amount of some new form of reserve asset distributed to that restricted group of countries on some uniform basis without regard to their present payments position.

The fact that present provisions for world liquidity—including the various cooperative arrangements among the central banks and treasuries of major industrial countries —are deemed sufficient to meet foreseeable needs allows time for careful and deliberate study of the various possible alternatives. Meanwhile, abrupt and radical changes in the institutional arrangements or the operating mechanism of the international monetary system are clearly unnecessary.

RECENT ECONOMIC POLICY MEASURES ABROAD

During the second and third quarters of this year, inflationary pressures continued to be the prime concern in a number of industrial countries abroad.[3] There were increasing signs that several countries which had initiated anti-inflationary programs earlier were meeting with success in controlling the upward movement of prices. Nevertheless, in many cases it was considered necessary to adopt further restraint measures during the period under review. In some countries, the lessening of inflationary pressures was apparently accompanied by a slackening in what previously had been very rapid advances of industrial activity. National economic and monetary developments and their interrelationships through the exchange markets and balances of payments were the subject of continual international consultation through the established channels of cooperation.

GENERAL ECONOMIC BACKGROUND. The over-all pace of economic activity remained vigorous in Continental Europe during the first half of the year. In the Common

[3] For a discussion of foreign economic and financial developments during September 1963-March 1964, see "Recent Economic Policy Measures Abroad", this *Review*, April 1964, pp. 74-78.

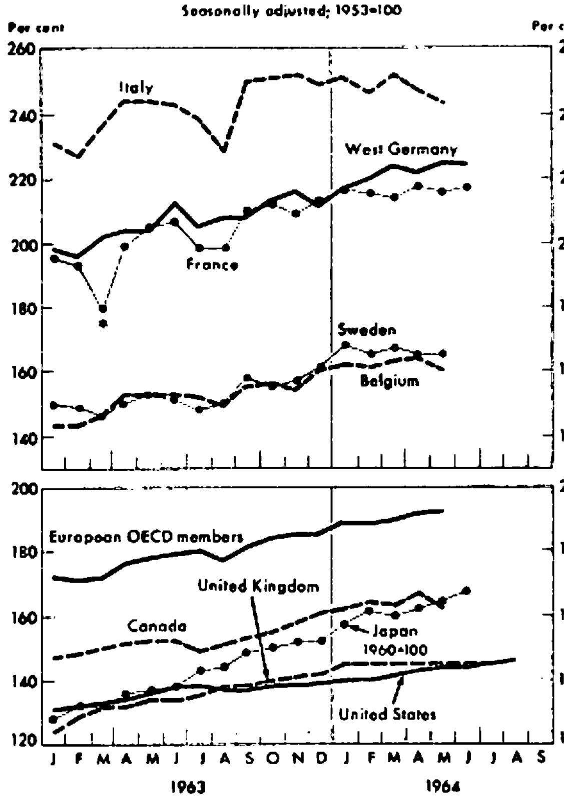
Market countries, further economic expansion reflected both a continued high level of consumer demand and a higher rate of industrial investment and construction activity than a year earlier. In January-May, industrial production advanced steadily—at an annual rate of 7 per cent as against 11 per cent in 1963—and labor scarcities became more acute in most member countries. Consumer prices continued to rise, but at a somewhat less rapid pace than in 1963.

Individual countries within the Common Market experienced somewhat divergent developments. In Belgium and France, the rate of increase in industrial output during January-May was less than during the same period a year earlier, while in Italy industrial production actually decreased on a seasonally adjusted basis (see Chart I). In Germany and the Netherlands, on the other hand, large increases in consumer and investment demand led to further substantial advances in industrial output. France and Italy succeeded in containing the increases in consumer prices during January-May to less than those registered a year earlier. In the Netherlands, on the other hand, large increases in wages and consumer purchasing power resulted in an accelerated increase in consumer prices (see Chart II).

Chart I

INDUSTRIAL PRODUCTION IN MAJOR COUNTRIES

Seasonally adjusted; 1953=100



* Affected by widespread strike in the public sector.

Sources: Organization for Economic Cooperation and Development, monthly statistical bulletins; national statistics.

Among the major industrial countries outside the European Continent, economic expansion continued at a vigorous pace. In the United Kingdom, to be sure, the growth rate of gross national product (GNP) fell from the exceptionally high levels reached at the end of last year; nevertheless, it was sufficiently high to draw into the productive stream substantial amounts of remaining unused resources of labor and equipment. Public and private fixed capital formation—especially in housing and private manufacturing investment—made important contributions to the increase in total output. Industrial production, on the other hand, has remained steady since January, reflecting a relatively small rise in consumer expenditures and sluggish exports. The Canadian economy, bolstered by large outlays on plant and equipment and booming exports, is expected to grow this year by about 7 per cent in terms of GNP. Japan's growth continued to exceed that of all other industrial countries, with July industrial production 16 per cent above a year earlier.

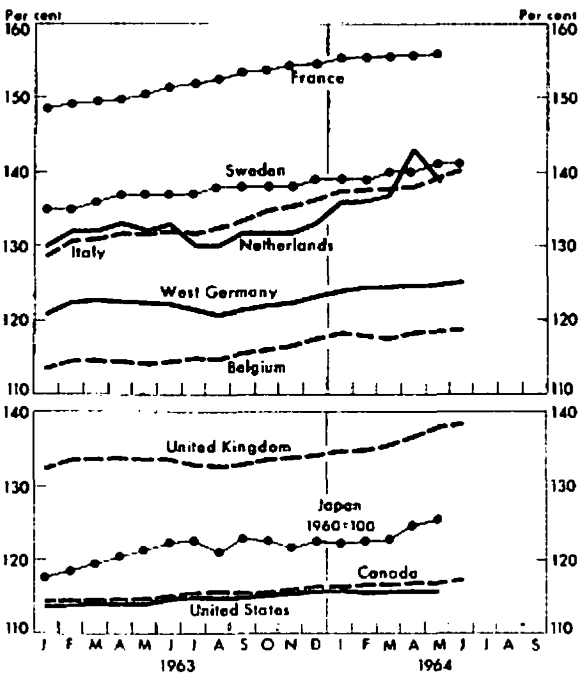
As in 1963, rising economic activity this year again led to high levels of imports, which contributed to the weak current-account positions in the balances of payments of some European countries. In contrast to last year, however, the surpluses and deficits of some individual countries tended to narrow. Italy's trade deficit declined noticeably during the first half of the year, a development which contributed to the over-all improvement in the Italian balance of payments. Germany's trade surplus was less in the second quarter than in either of the two preceding quarters and continued to diminish further in July and August. In the United Kingdom, the Netherlands, and Denmark, however, a rise in imports, combined in the case of the United Kingdom with sluggish exports, made for the emergence of current-account deficits in the first quarter.

In recognition of the mutual benefits to be gained from coordinated efforts to achieve economic stability, the Council of Ministers of the European Economic Community (EEC) in April drew up a common anti-inflationary program aimed at the stabilization of prices and costs in the EEC by the end of 1964. The program called for a continuation of restrictive credit policies, but also emphasized the need to complement credit policy with appropriate fiscal measures. Thus, the program envisaged that the rise in public expenditures be limited to 5 per cent per annum and that, if necessary, taxes be raised to balance

Chart II

CONSUMER PRICES IN MAJOR COUNTRIES

1953=100



Sources: Organization for Economic Cooperation and Development, monthly statistical bulletin; national statistics.

budgets. In the event that a budget deficit should prove unavoidable, it was recommended that the deficit be covered by long-term borrowing. During the period under review, the Common Market countries (as well as some others) acted along the general lines of the EEC program.

ITALY, FRANCE, AND THE NETHERLANDS. In both Italy and France, the principal aim of policy was to reinforce previous restraint measures that were beginning to show favorable results. The effects of the Italian anti-inflationary program initiated last year were most apparent in an improved trade balance. In the second quarter, Italian imports were 1 per cent above a year earlier while exports had increased by 18 per cent. The resulting strengthening of Italy's current account, combined with a net inflow on capital account, reversed the previous decline in official reserves and enabled the authorities to repay in August $65 million of the $225 million drawn from the International Monetary Fund in March. This repayment liquidated Italy's obligation to the Fund by reducing the IMF's holdings of lire to 75 per cent of the Italian quota. During the first half of this year, consumer prices increased somewhat less than a year earlier, and bank loans and deposits decreased noticeably. To be sure, economic expansion has also slowed down considerably, with GNP advancing during the first quarter at an annual rate of only 2.4 per cent in real terms.

Against this background, the Italian authorities moved to reduce further Italy's trade deficit and to dampen private consumption and public expenditures, while at the same time promoting industrial investment. In April, payment terms for imports of a number of durable goods were tightened, and measures to encourage exports were taken. These included a cut in the stamp tax on export bills, accelerated reimbursement to exporters of the sales tax, and a reduction in the premiums on export risk insurance. Supplementary measures introduced at the end of August were aimed at permitting increased manufacturing profits, which had been squeezed by the rapid advance in wages. A part of social security costs is henceforth to be financed by general fiscal revenues rather than by direct employer contributions. The general turnover tax is to be increased from 3.3 per cent to 4 per cent on most goods to finance the increased budgetary outlay. In other measures to encourage investment, a 100 billion lire ($160 million) investment fund is to be established to aid small and medium-sized industries, and legislation is to be introduced to allow the establishment of investment trusts. The August measures also provide for increases in taxes on middle and high incomes, and the Government stated its intention to limit the annual increase in Government expenditures to 5 per cent.

French anti-inflationary measures likewise have shown results. In January-August the French cost of living increased by about 1 per cent as against 3 per cent a year earlier, while the money supply declined by 0.5 per cent during the first five months, compared with a 2.5 per cent increase a year earlier. Although the rate of increase in over-all economic activity this year is expected to match last year's satisfactory results, private industrial investment has fallen off and activity in some key industrial sectors weakened more than seasonally during the summer months. The official over-all growth target for 1965, moreover, has been reduced below the 6 per cent originally envisaged.

The French authorities took a number of steps to constrain further public and private demand and to reinforce credit restraint. Fiscal policy has been an important ingredient in the French stabilization program. This year's budget deficit—planned from the start to be lower than last year's—is now believed likely to end up considerably less than originally estimated, and plans for a balanced budget in 1965 were announced in September.

This goal is to be achieved by limiting the increase in expenditures to 7 per cent. As regards monetary policy, the 10 per cent ceiling on permissible annual increases in bank credit was extended for another twelve months (to September 1965). In a temporary move designed to ease the midyear seasonal tightness in the money market and thus to curb inflows of funds from abroad, the commercial banks' required reserves in the form of cash, Treasury bills, and medium-term paper were reduced in early summer from 36 per cent to 33 per cent—a move that was reversed by September. Within this over-all ratio, the portion to be held in the form of Treasury bills was reduced from 13 per cent to 10 per cent, thereby enabling the banks to use a larger part of their resources to grant medium-term credit. To emphasize the point that there was to be no relaxation in over-all credit restraint, the authorities raised from 6 per cent to 7½ per cent the penalty rate on bank borrowing from the Bank of France exceeding 110 per cent of rediscount quotas. Furthermore, the Bank of France reiterated its warning to the commercial banks that increases in their lending by a rate greater than 10 per cent a year might be penalized by a reduction in their rediscount quotas at the central bank. In an additional move toward tightening, the authorities in June required consumer finance institutions to limit their lending to eight times their own capital, as against nine times previously.

In the Netherlands, the authorities also continued to reinforce previously taken anti-inflationary measures. Buoyant consumer demand and a continuing labor shortage were reflected in substantial price and wage increases during the first five months of 1964 as well as in a deterioration in the Dutch current account during the first quarter. In January-June, imports rose 23 per cent and exports 15 per cent over a year earlier. During the same period, bank credit increased by more than 10 per cent and persistently exceeded the ceilings set by the authorities. Therefore, in accordance with the gentleman's agreement currently in force, the banks were obliged to make noninterest-bearing deposits at the central bank equal to the amounts by which they had exceeded the ceilings. In the face of these developments, the Netherlands Bank on June 4 increased its discount rate by ½ point to 4½ per cent, the second such increase this year (see table); and, to prevent banks from obtaining additional liquidity from abroad, the Netherlands Bank ruled that after July 31 the foreign liabilities of a bank must not exceed its foreign assets by more than 5 million guilders ($1.4 million), unless prior approval has been obtained from the authorities. To achieve a steady degree of restraint, bank credit ceilings have been adjusted flexibly to changing seasonal

CHANGES IN FOREIGN CENTRAL BANK DISCOUNT RATES, 1964
In per cent

Country	Date	New rate	Change
Belgium	July 3	4¾	+½
Denmark	June 11	6½	+1
Japan	March 18	6.57	+0.73
Netherlands	January 6	4	+½
	June 4	4½	+½
Sweden	January 31	4½	+½
South Africa	July 15	4	+½
Switzerland	July 3	2½	+½
United Kingdom	February 27	5	+1

demands for credit. During May-August, when the demand for credit is seasonally slack, bank lending was limited to the average amount of credit outstanding in the first half of 1963, while from September to the end of the year an increase of 5 per cent above that level is permitted. In order to reduce consumer purchasing power, taxes on cigarettes and gasoline were raised, and officially controlled rents were increased by 10-12.5 per cent.

ANTI-INFLATIONARY MEASURES IN OTHER COUNTRIES. In Switzerland, a high level of consumer and investment demand, particularly in the building sector, sharply boosted the demand for credit. Under an April agreement between the Swiss National Bank and the commercial banks, the growth of bank advances to domestic borrowers this year is to be equal to only 79 per cent of the absolute increase in 1961 or 1960 (whichever was higher), as against last year's permissible increase of 82 per cent of the base period. The allowable increase in mortgage loans, on the other hand, remained unchanged at 108 per cent of the increase in the base year. Priority is to be given to loans for residential building, agriculture, and imports. Switzerland also created a capital issues commission to program the permissible total of new issues on a quarterly basis. As of May 1, all new stock and bond issues exceeding 5 million francs became subject to authorization by the commission. The buoyant demand for bank credit—combined with previous measures to discourage the inflow of foreign funds, which had been an important source of liquidity—caused a tightening in the money and capital markets during the first half of the year. By midyear, both short- and long-term rates stood about ¾ of a percentage point above a year earlier, and in July the Swiss National Bank raised its discount rate to 2½ per cent from 2 per cent and its lending rate against security collateral to 3½ per cent from 3 per cent. Furthermore, in order to absorb bank liquidity by providing a domestic short-term investment instrument, the National Bank in August sold a special issue of two-month Treasury securities to the commercial banks. The Swiss authorities also tightened consumer credit by increasing required downpayments to 30 per cent from 20 per cent and shortening the maximum repayment period to 2 years from 2½ years.

In Belgium, Germany, and Denmark the authorities also acted to restrain credit expansion. This year's vigorous business expansion in Belgium was accompanied by a 6 per cent increase in bank credit during January-May and by a continued increase in prices. To counter these developments, the Belgian National Bank in July raised its basic discount rate from 4¼ per cent to 4¾ per cent while tightening the eligibility requirements on the commercial paper it accepts for rediscounting. Also, the authorities used for the first time the powers granted under the 1961 banking reform law to require commercial banks to hold cash reserves with the central bank. Required reserves were initially set at 1 per cent of the banks' total deposit liabilities. In Germany, commercial bank reserve requirements on all types of deposits were increased by 10 per cent as of August 1. (The demand deposit ratio for large city banks, for example, rose from 13 per cent to 14.3 per cent.) At the same time, in order to discourage the banks from meeting any increased liquidity needs by borrowing abroad, the authorities announced that the banks' rediscount ceilings at the German Federal Bank would be reduced by an amount equal to any increase in their borrowings abroad. In an additional move to reduce domestic liquidity, the German Federal Bank on July 13 improved the terms on which it provides forward cover to commercial banks for investment in United States Treasury bills. In Denmark, vigorous economic expansion led to a renewal of upward price movements and a deterioration in the current account during the first quarter; and domestic liquidity—fed to a certain extent by large public and private borrowing abroad—increased rapidly, while bank credit expanded sharply. Against this background, the National Bank of Denmark on June 11 raised its discount rate from 5½ per cent to 6½ per cent. At about the same time the government banned further long-term foreign borrowing by local authorities and public enterprises. As of October 1, the National Bank imposed a penalty rate of 6 per cent, over and above the 6½ per cent discount rate, on commercial bank discounts from the central bank which are outstanding for more than twenty days in each quarter (thirty days in the fourth quarter) and which exceed on the average 25 per cent of the borrowing bank's combined capital and reserves.

In the United Kingdom, the authorities acted to restrain consumer spending somewhat. The 1964-65 budget, presented by the Chancellor of the Exchequer in April, called for a 10 per cent increase in taxes on tobacco and alcoholic beverages, which is designed to yield an additional £100 million. At the same time, nonnegotiable savings instruments were made more attractive. In this way, the authorities sought to curb the expected budgetary deficit and to improve the prospects for its noninflationary financing.

In Japan, further measures were taken to control the commercial banks' foreign indebtedness and thus buttress the tighter credit policy in force since late 1963. In July, the Bank of Japan placed limits on the amounts of foreign short-term funds Japanese banks are permitted to accept. As of August, the central bank raised to 25 per cent from 20 per cent the ratio of liquid foreign assets that commercial banks must maintain against their short-term foreign liabilities. The previously imposed 35 per cent marginal ratio for foreign liabilities exceeding a prescribed amount remains in effect, but now applies to increases above the level of July 1964 instead of December 1962. Also, in April, June, and September, the authorities altered the suggested maximum rates commercial banks may pay on Euro-currency deposits.