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New Reserve Requirements in the Netherlands

The Netherlands authorities have recently taken three related measures affecting the banking system and, in particular, bank reserves. First, the Netherlands Bank is completing preliminary steps towards requiring the commercial banks to hold a minimum of 30 per cent of their deposits in the form of liquid resources, and towards enabling the Bank to set absolute limits on the extension of credit. Secondly, on the basis of a gentlemen's agreement between the commercial banks and the Netherlands Bank effective March 22, 1954, the banks will be bound to maintain fixed cash balances at the Netherlands Bank. Finally, those banks that sign the gentlemen's agreement will exchange part of their holdings of Treasury bills for medium-term government securities (eligible for bank investment but not eligible to be counted as liquidity reserves) and thus reduce the present liquidity of the banking system.

As the result of a heavy inflow of foreign exchange, the liquidity of the Netherlands banking system greatly increased during the past two years. Although inflationary pressures are not currently in evidence in the Netherlands economy, the growth in bank liquidity represents a potential inflationary danger. The authorities seek to minimize this danger by means of the new measures which sterlilize a considerable part of the liquid assets held by the banks. This re-establishment of adequate central bank control of the liquidity of the banking system also seems to be connected with the steady movement towards guilder convertibility. With the Netherlands Bank now better able to control short-term capital movements through changes in its monetary policy measures, it has been made possible for the Netherlands authorities to make further progress in the dismantling of discriminatory restrictions on foreign trade and payments.

Monetary and financial conditions in 1953

For the past two years, the most important factor affecting the monetary situation in the Netherlands has been the rise in foreign exchange holdings as a result of a very large balance of payments surplus. Gold and foreign exchange holdings of the Netherlands Bank rose by fl. 785 million in 1953 and by fl. 1,990 million in 1952; these increases contributed directly to the expansion of the money supply by fl. 540 million in 1953 and by fl. 770 million in 1952. In 1952, the inflationary effect of the inflow of foreign exchange was largely offset by a budget surplus which increased the Treasury's cash balances by fl. 839 million. In 1953, however, extraordinary expenditures — arising primarily from the flood damage in February 1953 — made it impossible to achieve a similar surplus; in fact, the Treasury cash balances declined by nearly fl. 600 million.

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For several reasons, the growth in liquidity has had little if any inflationary consequences. International prices have been stable if not falling; there has been every confidence that domestic price stability, too, would be maintained. Private consumption has increased only slightly and investment has shown relatively little change. Most important, industrial production in 1953 rose 11 per cent over 1952. Despite the absence of inflationary pressures at present, however, the growth in liquidity has been a cause of concern. The memories of the inflation of 1950-51 are strong, and the authorities wish to be prepared for a similar contingency.

During 1953, the authorities attempted to reduce the liquidity of the economy, and particularly that of the banking system, mainly by means of debt management policy. Consistent efforts were made to fund the shorter maturities of the public debt into long-term issues. Treasury bills and short-term bonds outstanding declined by nearly fl. 900 million while the internal funded debt increased by about fl. 500 million, the difference being due to the retirement of short-term securities. Public long-term bond issues totalling fl. 740 million were successfully floated during the year. 1/

In the process of reducing the over-all liquidity of the banks, the authorities also wished to increase both the proportion and the absolute amount of idle cash held by the banks as part of their remaining liquid assets. To this end, they adopted the policy of restricting the amount of short-term government securities available by systematically retiring such securities, and of lengthening the maturities of bank-held Treasury bills. The success of this policy may be illustrated by the following figures. In 1953, cash holdings of the major commercial banks rose by fl. 309 million. 2/ Total deposits rose by fl. 178 million while total commercial bank loans and investments declined by fl. 102 million, an increase in credit to the private sector by fl. 378 million and to the municipalities by fl. 149 million being more than offset by a decline in credit to the Central Government by fl. 629 million.

The decline in government security holdings of the commercial banks was brought about by constantly reducing the volume of Treasury bills. The Ministry of Finance stopped issuing Treasury paper on tap in July 1952, and new issues have been infrequent since that date. As most banks had always relied on Treasury bills as liquid investment for idle cash, the only source for such securities became the Netherlands Bank. By the end of April 1953, bank purchases had exhausted the Netherlands Bank's portfolio of Treasury

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1/ In January and February 1954 the Ministry of Finance issued an additional fl. 450 million of long-term bonds.

2/ The commercial banks referred to in this paper are the 37 major commercial banks for which balance sheets are published regularly.

paper. 1/ Lacking alternative forms of equally liquid investment, the banks had to increase their cash holdings; in view of the impending imposition of cash reserve requirements, they could not use them for longer-term investments.

Moreover, since the fall of 1952, the banks have been encouraged to switch their holdings of Treasury bills into Treasury bonds of 3 and 5-year maturities. The spread between rates on 12-months Treasury bills and 5-year bonds was increased from 3/4 of 1 per cent to 1-3/8 per cent. When the Ministry of Finance did issue new short-term government securities, as from April to June 1953, they were largely in the form of 3 and 5-year bonds. From November 1953 to January 1954, issues of 1, 3, and 5-year Treasury paper were made only upon surrender of maturing securities. Because of this restriction, prices of securities about to mature began to rise, and even to command a premium in the market: market rates on 3-months Treasury bills, which were at 1/2 of 1 per cent in August, declined successively to zero for a short period in December; the present market rate is 1/4 of 1 per cent. As a result of these policies, Treasury bills in circulation declined during 1953 by nearly fl.2 billion while short-term Treasury bonds outstanding increased by about fl. 1.1 billion.

The new monetary measures

Cash reserve requirements have not been in force in the Netherlands since early in 1952. At the beginning of 1951, cash reserve requirements were introduced as part of an over-all anti-inflationary program, but they were discarded in 1952 when inflationary pressures subsided. Now, by the terms of a gentlemen's agreement, which went into effect March 22, 1954, the commercial banks are required to hold as cash balances at the Netherlands Bank a minimum of 2-1/2 per cent of their deposits above fl. 10 million but below fl. 50 million, and of 5 per cent of their deposits above fl. 50 million. The Netherlands Bank has the authority to increase these percentages to 7-1/2 and 15 per cent, respectively. Insofar as can be determined from published banking statistics, the initial cash reserves required of the commercial banks amount to about fl. 200 million. Since commercial bank deposits at the Netherlands Bank on March 15, 1954 totalled fl. 278 million, the banks can have had no difficulty in meeting the requirement. The move probably seeks to sterlilize these cash holdings and to prevent them from declining. A gentlemen's agreement was needed to introduce cash reserve requirements because there is no provision for such a measure in existing banking legislation.

1/ In June 1953, the Netherlands Bank's portfolio of government securities was replenished to the extent of fl. 300 million by the partial conversion of the Government's "blocked" war-time debt to the Bank. The new securities, however, were nearly all 3 and 5-year bonds.

The banking legislation of 1952, however, permits the Netherlands Bank to impose minimum liquidity reserve ratios (ratio of liquid assets -- cash, call-loans, and short-term government securities -- to total deposits) after consultation with the credit institutions involved. The Bank now intends to establish such a ratio at a minimum of 30 per cent, reserving the right to raise the ratio to a maximum of 45 per cent. Preparatory consultations to this end were held coincident with the negotiation of the gentlemen's agreement with the commercial banks on cash reserves. As a result of these conversations, the completion of the necessary consultations should be but a matter of form. The establishment of minimum liquidity reserve ratios has probably the same purpose as the imposition of the cash reserve requirements: even after the consolidation of a large portion of the banks' liquid assets, discussed below, the ratios currently envisaged can easily be met by the banks; hence, this measure seems to aim primarily at sterilizing present liquid asset holdings and at preventing them from declining in the event of an increase in the demand for private credit.

The Netherlands Bank has also started consultations with the commercial banks which may lead to the setting of absolute limits on the extension of credit by the banks. This procedure is required by the banking legislation of 1952 which gave the Netherlands Bank authority to impose such limits.

The issuance of new medium-term securities for bank investment is the continuation of the debt management policy instituted early in 1952 to reduce the liquidity of the banks. At the present time, between 50 and 60 per cent of the total assets of the major commercial banks are in the form of cash, call-loans, and short-term government securities. To the banks that signed the gentlemen's agreement on cash reserve requirements, the Ministry of Finance offered some fl. 1,200 million of 5-year certificates at 2-3/4 per cent in exchange for cash or short-term government securities. These certificates are to be converted at a later date, after legislative authorization has been obtained, into 8, 10, and 12-year bonds bearing interest at 2-5/8, 2-3/4, and 2-7/8 per cent respectively. The rate on the 5-year certificate is appreciably above the last tender rate on such securities, 2 per cent, and thus offered considerable incentive to the banks to accept the cash reserve requirements in order to be able to purchase the certificates. On the other hand, the rates on the 8, 10, and 12-year bonds are slightly lower than the rate of the only comparable issue, which is currently quoted at about 3 per cent. This lower rate is justified by the fact that these securities will retain much the same liquidity as 12-months Treasury bills for the Netherlands Bank has agreed, in case bank deposits decline below their average 1953 level, to make advances against these securities up to 50 per cent of any such decline in deposits and, if necessary, to purchase the securities at the end of a year at an agreed price. Apart from this repurchase option, the securities are to be negotiable only among the banks signing the gentlemen's agreement; the ban on their sale in the capital market is designed to encourage other investors to accept longer-term bonds. Banks that declined to become parties to the gentlemen's agreement will have to rely on the capital market for the investment of funds released through the maturing of their short-term government securities; in most cases, they will then have to accept much less liquid investments.

Significance of the new measures

The new monetary measures in the Netherlands form an integrated attempt to reduce the present liquidity of the banking system and to establish more efficient central bank control. Such control would be important both in the event of a renewal of inflationary pressures and in connection with a drive towards guilder convertibility. Should inflationary pressures reappear in the Netherlands economy, the new cash and liquid asset reserve requirements would limit the opportunities for an expansion of bank credit; as mentioned above, moreover, the Netherlands Bank could, if necessary, place an upper limit on the extension of bank credit.

The new measures also seem to be associated with progress towards convertibility of the guilder. Under conditions of convertibility, effective central bank regulation of the banking system, particularly by means of the discount rate mechanism, would be important for the control of international short-term capital movements. During 1953, for instance, short-term interest rates in the Netherlands declined to extremely low levels: since the middle of 1953, call money has remained at 1/2 of 1 per cent, the legal minimum, and three-months Treasury bills have fallen to 1/4 of 1 per cent. Yet there is little evidence that Netherlands capital has moved abroad in response to higher interest rates in, say, London or New York even though permission has been granted to maintain larger balances abroad; moreover, despite the arbitrage facilities now available among the major EPU countries, it appears that foreigners have taken only slight, if any, advantage of low rates in Amsterdam for international trade financing. If the guilder became convertible, however, foreign nationals might greatly increase their demand for guilder credits because of the low rates prevailing in Amsterdam; moreover, even if capital movements remained controlled, the possibilities for evading such controls would be enhanced and Netherlands nationals might be tempted to leave their balances abroad to take advantage of higher interest rates. By reducing liquidity, the new monetary measures will probably lead to a rise in short-term rates in the Netherlands and thus reduce the danger of a large increase in foreign demand for credit in Amsterdam or of large movements of Netherlands short-term capital to foreign money centers.

On the last day of 1953, well in advance of the announcement of the present measures, the Government converted an additional fl. 300 million of its "blocked" war-time debt to the Netherlands Bank into short-term government securities. This addition to the Bank's holdings will, together with the new monetary measures, permit the Bank to execute a more active open market policy. This possibility, together with the increased significance of the discount rate as a result of the reduced liquidity of the banks, will no doubt enable the Bank to pursue a more effective monetary policy. In particular, the Bank will thus be in a better position to limit, by monetary measures, an unwanted outflow of gold or foreign exchange.

Because of these developments, further progress has been possible in relaxing restrictions on the Netherlands trade and payments, thereby preparing the way for guilder convertibility. On March 15, 1954, the Netherlands Bank authorized commercial banks to cover forward sales of foreign exchange in leading currencies to the extent of 100 per cent instead of 25 per cent as previously; spot exchange held as a hedge may be invested in foreign money markets.

On March 22, 1954, moreover, restrictions on capital transfers from the Netherlands were relaxed: blocked accounts of residents of the EPU area were unfrozen; greater freedom was permited in the international trading of Netherlands securities; and foreigners were released from their obligation to reinvest in the Netherlands the proceeds of sales of Netherlands securities and other assets. In particular, the distinction between "international" and "domestic" Netherlands securities was eliminated. Since foreign holders who are residents of countries with convertible currencies, or acquired the securities for convertible currencies, are permitted to export securities from the Netherlands, this provision enables such holders to exchange Netherlands "domestic" securities for Netherlands shares which are also traded in New York and other foreign markets, and thus to convert their holdings into convertible currencies. In this manner, repatriation of convertible currency investments in the Netherlands has been achieved without entailing a drain on the Netherlands gold and dollar reserves.

Finally, it is expected that swifter progress will now be made in the current negotiations among the Benelux countries for the liberalization of capital movements in the Benelux area.

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Causes of the Decline in Japan's Sterling Exports

Reed J. Irvine

Japan's payments position vis a vis the sterling area has deteriorated with surprising rapidity since June 1952, when Japan's sterling holdings reached a peak of £126.9 million ($355 million). The attitude of Japanese officials has switched from one of deep concern over the excessive accumulation of sterling to equally deep concern over the depressed state of exports to the sterling area and the large payments deficit that has virtually exhausted Japan's once large sterling reserves. As of December 31, 1953, Japan's sterling holdings were down to £42.5 million ($119 million).

In addition to drawing down its sterling holdings by £84.4 million ($236 million) in a year and a half, Japan purchased a total of £44.3 million ($124 million) from the International Monetary Fund. 1/ Moreover, Japan arranged with the United Kingdom several temporary swaps of dollars for sterling in the course of 1953. At the end of the year, £12 million ($33.6 million) was held by Japan under these arrangements, and due to be repaid in January 1954. 2/

This sudden reversal in Japan's balance of payments with the sterling area was primarily the result of a sharp decline in the volume of Japanese exports to the sterling countries, although an increase in Japan's imports from this area was in part responsible. Receipts from exports to the sterling area dropped from the equivalent of $385 million in the first half of 1952 to $150 million in the same period in 1953. Payments for imports, on the other hand, rose from $246 million to $363 million for the same periods. Despite this 27 per cent rise in imports, Japan would have continued to enjoy a small surplus with the sterling area had exports maintained their earlier rate.

1/ Japan originally purchased a total of £22.3 million for yen, bringing the Fund's holdings of yen up to 100 per cent of Japan's quota. In December, when additional sterling was required, Japan paid $61.6 million to repurchase yen and immediately drew another £22 million.

2/ Japan's swaps in 1953 totaled £30 million. Sterling was purchased for dollars with Japan having the right to reverse the transaction within 90 days, later extended to 180 days. Transactions were as follows:

	Purchases		Sales
May	£ 8,730	November	£ 8,730
June	9,250	December	9,250
July	6,000		
August	6,020	Total	£17,980
Total	£30,000		

Reasons for the loss of exports

The causes for the decline in exports have become a serious point of contention between the British and the Japanese. Japan has insisted that the main factor has been the discriminatory restrictions placed upon Japanese imports by the United Kingdom and the Commonwealth countries. The Japanese have sought to remedy the situation by pressing for the removal or relaxation of these restrictions in the two conferences held to review the Anglo-Japanese Payments Agreement in the last two years. In January 1953, the British agreed to urge the Commonwealth countries to relax their restrictions on Japanese goods. Japan entertained hopes that this would result in a favorable trade balance with the sterling area in the last half of 1953. However, receipts from exports in the second half rose only 8 per cent. Imports payments dropped 30 per cent, but Japan nevertheless had a deficit with the sterling area equivalent to $91 million for the half year.

At the conference concluded in January 1954, Japan again strongly insisted that further relaxation of Commonwealth controls was necessary. The British agreed to inform the colonies that all discriminatory restrictions on Japanese goods could be lifted. Also, the United Kingdom itself agreed to license imports of many types of Japanese goods which had been previously banned. However, the British have long contended that the basic reason for the decline in Japan's sterling area trade was not the Commonwealth restrictions but rather the high level of Japanese prices and the declining competitive position of Japanese exports. The argument has some plausibility since it is quite apparent that many Japanese prices are out of line with world prices. This is particularly true of iron and steel and heavy capital equipment. This price differential made little difference in the sellers' market that prevailed in 1951 and 1952, but it has become more important since European and American producers have been able to take orders for early delivery. It has also been argued that Japan has suffered, along with others, from the general effects of the sterling area retrenchment effort of 1952, in which total imports were sharply curtailed, as well as from the worsened competitive status of its export products.

Plausible though these explanations are, the facts tend to bear out Japan's claim that discrimination has been the primary cause of its sterling plight. It is possible to measure roughly the impact of discriminatory restrictions on Japan's exports by examining the changes in the relative importance of imports from Japan by various countries. Declining competitiveness of Japanese goods should be reflected in a general decline in imports from Japan as a percentage of total imports for most countries, or at least those importing similar types of commodities from Japan. On the other hand, if the change varies radically from one country to another and cannot be explained by such factors as differences in the composition of imports, discrimination of some type would be indicated.

In applying this test to determine whether or not discrimination has been an important factor in the decline of Japan's trade with the sterling area, the changes in imports from Japan as a percentage of the total imports of Japan's principal trading partners in the British Commonwealth (excluding Canada) have been examined and compared with the corresponding changes in selected countries. 1/ In the first half of 1952, 3.2 per cent of the total imports of the Commonwealth countries came from Japan. This compared favorably with the average of 2.9 per cent in 1937-38 and represented a postwar high. In the second half of the year, the percentage dropped to 2.6 and in the first half of 1953 to 1.6, a 50 per cent decline from the same period the previous year. Since total Commonwealth imports declined sharply in the interval, these figures show that Japan's loss of sterling trade was relatively greater than that of other countries. The decline in Japanese exports to the sterling area clearly reflected more than the general curtailment of imports by Commonwealth countries.

However, these figures reveal nothing about the causes of the relative decline in Japan's position. Was the decline the result of discrimination and, if so, was it discrimination against Japan or against the non-sterling area in general? To answer the second question, it is clear that Japan's loss was greater than that of other non-sterling countries as a whole. In the first half of 1952, 5.9 per cent of the Commonwealth's imports from outside the sterling area came from Japan. In the same period in 1953, the percentage was but 3.3, a 44 per cent drop. The ratio of Commonwealth imports from the non-sterling area to total imports fell only 13 per cent in this same period.

To determine whether or not the sharper decline in imports from Japan was the result of discrimination it may be asked whether Japan's position varied to the same extent with respect to its individual trading partners. The figures show that the decline in Japan's position was not uniform even among the Commonwealth countries.

1/ The Commonwealth countries included are the United Kingdom, Australia, New Zealand, South Africa, Hong Kong, Pakistan, India, Singapore and Malaya, Ceylon, West Africa (Nigeria and the Gold Coast), and East Africa (Uganda, Tanganyika, Kenya). The non-Commonwealth countries with which comparisons have been made include the United States, Indonesia, Iraq, Philippines, Mexico, Italy and Burma. These were chosen because the composition of their imports from Japan resembles that of one or more of the Commonwealth countries.

Percentagewise, Japan's relative loss was greatest in Australia, New Zealand, and East Africa. In these countries the ratio of total imports supplied by Japan declined about 90 per cent from the first half of 1952 to the first half of 1953. In Pakistan, Japan's share of total imports dropped by 71 per cent comparing these same two periods. Substantial drops were also recorded for the United Kingdom, Hong Kong, Singapore and Malaya, and Ceylon. The West African Colonies showed a more moderate decline, and Japan's relative position improved in South Africa and India. In the case of South Africa, however, a large cut-back had taken place in 1952.

The fact that in two Commonwealth countries the relative amount of Japanese imports actually increased provides some indication that the Japanese have not been mistaken in their claim that the sharp drops in other Commonwealth countries have been the result of discrimination rather than the worsening of the competitive position of Japanese exports. If South Africa, for example, was able to increase imports from Japan while reducing total imports by 8 per cent, it is not clear why East Africa, which imports similar types of goods, should have cut imports from Japan by 95 per cent while reducing total imports by only 13 per cent.

If comparison is made with non-Commonwealth countries the results tend to confirm the claim of discrimination. The following table groups countries whose imports from Japan in 1952 were roughly similar in composition and shows the percentage change in the ratio of imports from Japan to total imports between the first half of 1952 and the first half of 1953.

Country 1/	Per Cent Change in the Ratio of Imports from Japan to Total Imports, 1st half 1952 to 1st half 1953
CEYLON	- 30
Indonesia	- 12.5
Iraq	+ 24
HONG KONG	- 33
United States	+ 22
NEW ZEALAND	- 90
Italy	+ 12
AUSTRALIA	- 89
Philippines	+ 11
INDIA	+ 9
Mexico	- 14
UNITED KINGDOM	- 50
MALAYA and SINGAPORE	- 50
PAKISTAN	- 71
EAST AFRICA	- 93
WEST AFRICA	- 20
UNION OF SOUTH AFRICA	+ 76
Burma	+ 4

1/ Commonwealth countries in capital letters.

While these figures do not permit any precise estimates of the impact of discrimination, the evidence points to the application of rather strong discriminatory measures of some type in at least eight out of eleven of the British Commonwealth countries. 1/ In all of these countries, Japan's share of total imports declined by percentages ranging from 30 to 93. In five of the seven non-Commonwealth countries Japan's relative position improved in the same period by percentages ranging from 4 to 112 per cent. 2/ In the two countries in which there was a decline the drop was under 15 per cent. 3/

It is also interesting to note that the changes in Japan's relative position do not correlate at all closely with the composition of a country's imports from Japan. Australia, New Zealand, and East Africa reduced the relative importance of Japanese imports by almost exactly the same percentage, but whereas New Zealand imports from Japan in 1952 were composed of 90 per cent metal products and 3 per cent textiles, Australian imports were but 48 per cent metal products and 14 per cent textiles, proportions more akin to India than New Zealand. East African imports were about 55 per cent textiles. Pakistan and South Africa imported textile and metal products in almost identical ratios in 1952, but in Pakistan Japanese imports lost ground by 71 per cent and in South Africa they gained 76 per cent.

Actually the record of Japanese textile exports itself provides strong evidence of the importance of discriminatory curbs imposed by the sterling area. The volume of textile exports to the sterling area in 1953 was 39 per cent below 1952, but exports to the dollar area were 132 per cent higher and to the open account area 126 per cent higher.

While no one would question the necessity of Japan making every effort to insure that its exports are competitive in world markets, this evidence suggests strongly that the solution to Japan's sterling problem may lie to a large extent in securing the removal of discrimination exercised against Japanese goods by Commonwealth countries. It is, however, recognized that more detailed country by country analysis of differences in the composition of imports and changes in the internal demand patterns of the various countries compared in this study might to some extent result in qualification of this conclusion.

1/ Australia, New Zealand, Pakistan, East Africa, Malaya and Singapore, United Kingdom, Hong Kong, and Ceylon.
2/ Iraq, United States, Italy, Philippines, and Burma.
3/ Indonesia and Mexico.