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Foreign Exchange Market and Reserves Developments
-- September-November 9 pages

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SUMMARY

Available data suggest that, in the three months of September through November, the United States balance of payments continued to be in deficit, while most of the Common Market countries, the United Kingdom, Canada, and Japan continued to be in surplus. At the end of September, the combined official reserves of the Common Market countries exceeded those of the United States for the first time in the postwar period.[1/]

The United States payments deficit was very large in October, but it appears to have declined again in November. The higher rate of deficit since mid-year and the bulge in October can be attributed mainly to transactions with Canada. There was a surge of funds into Canada in October and a reversal of this flow in November.

In Europe, the reserves of the Common Market countries, adjusted for special transactions, increased by $177 million in September and $219 million in October. The United Kingdom lost reserves in September, but this was more than compensated for by adjusted reserve gains in October and November. (See Table 2.) Germany acquired some additional reserves in September, and in October there was an inflow of private capital in contrast to an outflow in earlier months. Therefore, the German reserve gain in October was larger than the losses for the third quarter as a whole.

During the week of October 22-26, the foreign exchange markets were disturbed by the Cuban crisis. A moderate movement of capital into Swiss francs took place. Purchases of gold on the London gold market were estimated to have been $60 million, according to unofficial sources. The interest rates on Euro-dollar deposits rose sharply.

The trade deficit of the Common Market countries widened during the third quarter (seasonally adjusted) from $52 million to $158 million. This can be attributed to both a slight decline in exports and to a rise in imports. Monthly averages of total export and import figures for the Common Market countries for recent quarters are as follows (seasonally adjusted, in millions of U.S. dollars):

1/ Since the end of March, 1962, the foreign exchange assets of the Common Market countries have exceeded those of the U.S. but only if the foreign assets of the German commercial banks are included along with the official reserves.

	1961		1962		
	III	IV	I	II	III
Imports, c.i.f.	2,672	2,789	2,854	2,911	3,000
Exports, f.o.b.	2,770	2,728	2,815	2,859	2,842
Balance	+ 98	- 61	- 39	- 52	- 158

I - DEVELOPMENTS IN SELECTED COUNTRIES

United States - The balance of payments deficit for the third quarter, with or without negligible seasonal adjustments, was $720 million. This figure includes advance debt repayments of $470 million; without them, it would have been nearly $1,200 million. The October rate of deficit was much larger even than this, mainly because of an exceptionally heavy flow to Canada. A portion of this sum represented window-dressing operations by Canadian banks over their October 31 fiscal year end, and there was a reflux of money back to the United States in November.

An important factor tending to increase the U.S. payments deficit this year has been a substantial increase in merchandise imports. After rising very sharply in the summer of 1961, following the domestic business upturn, imports have continued to increase. During the first 10 months of 1962, imports were 12 per cent higher than in the corresponding period of 1961, an increase of $1.8 billion at an annual rate. The September-October monthly average for exports was well below the high second and third quarter rates. Recent monthly average U.S. trade figures seasonally adjusted are as follows (in millions of dollars):

	1961		1962				
	III	IV	I	II	III	July-Aug.	Sep.-Oct.
Imports f.o.b.	1,302	1,310	1,323	1,368	1,409	1,365	1,4[illegible]
Exports f.o.b.	1,665	1,736	1,714	1,809	1,768	1,685	1,719
Balance	363	426	391	441	359	320	300

Canada - The Canadian dollar gained strength on the foreign exchange markets in September and October, and Canadian official gold and foreign exchange reserves rose by $114 million in September and $169 million in October. The exchange rate rose from 92.84 U.S. cents per Canadian dollar on September 7 to 92.95 on November 2. (See Table 4.) Canada has more than regained all the reserves lost during the first half of 1962. Part of the continued reserve gain by Canada can be explained by the renewed inward flow of long-term capital. This is confirmed by the fact that there were net sales of securities by Canadians to foreigners in August, the first net sales reported since January.

The Canadian reserve gain in October was influenced by the following special transactions:

Gross reserve change			+$169
Adjusted for:			
Government of Canada borrowing in the U.S.		-125	
Advance debt payment by the Netherlands		- 30	
Partial repayment of aid received in June 1960:			
To U.K.	+ 50		
To U.S.A.	+125	+175	+ 20
Adjusted reserve change			+189

After the Bank of Canada reduced its discount rate from 5 to 4 per cent on November 13, the Canadian reserve accumulation slowed sharply. The exchange rate levelled off after the first week in November. Official reserve figures for the end of November showed a decline of U.S. $6 million after special outpayments of $50 to the U.S. Federal Reserve System and $25 million to the Bank of England. Adjusted for these transactions, reserves rose by $69 million. Part of the decline in reserve gains may be attributed to the reflow of funds brought in from the U.S. late in October for window-dressing purposes.

France - The French balance of payments continues in heavy surplus. Official gross reserves increased by $116 million in September, $86 million in October, and $103 million in November. The surplus during the first half of 1962 of the total franc area was $698 million, as compared with $659 million in the first half of 1961 and $575 million in the second half. This measure covers changes in net official reserves, commercial banks' foreign position, and France's IMF position, adjusted to exclude the effect of advance debt repayments. In September and October, the French franc remained at its ceiling of 20.41 cents in the exchange markets.

Germany - In September, monetary gold and the combined foreign exchange assets of the Bundesbank and the commercial banks increased by $23 million after an upward adjustment of $3 million on account of the Egyptian drawing of DM from the IMF. In spite of the net acquisition of reserves during September, the balance of payments continued to exhibit a deficit, which was financed by an increase in the foreign liabilities of the Bundesbank. The balance of payments deficit was incurred despite an improvement in the goods and services account and despite a net reduction of official payments on capital account. The unfavorable balance of payments developments in September were concentrated in the private capital accounts. Net foreign purchases of German securities declined sharply, and a further $40 million in unidentified private capital transactions moved out of Germany.

In October, there was a substantially larger gain of reserves. Official reserves rose by $80 million. Commercial bank foreign assets went up by $32 million. Excluding the effects of a $20 million Iranian repayment of an IMF drawing in deutsche mark, the adjusted reserve increase in October was $93 million. Bundesbank foreign liabilities increased by $13 million in October, so the balance of payments may be said to have been in surplus by $80 million. The improvement in the balance of payments may be attributed entirely to favorable developments on private capital account, in spite of the disturbance of the Cuban crisis. There was a net inflow of private capital of $60 million in October in contrast with an outflow of $81 million in September,[2/] including the $40 million mentioned above.

Switzerland - Swiss National Bank gold and foreign exchange assets fell slightly in August and September. In October, during the Cuban crisis, (see discussion of that period below) there was a surge of foreign funds into Switzerland. Market reports state that this flow came chiefly from West Germany and, to a lesser extent, from France, Austria, and other countries.

In order to minimize the conversion of these dollars into gold, two measures were taken by the Swiss National Bank and the U.S. authorities:

(1) The Swiss National Bank sold $30 million of dollars back to the Swiss commercial banks. The Federal Reserve System then purchased these dollars forward against Swiss francs.

(2) The Federal Reserve System purchased another $20 million equivalent of Swiss francs under the July swap agreement with the Bank for International Settlements. With these francs, it bought $20 million of dollars previously acquired by the Swiss National Bank.

As a result of these transactions, the Swiss National Bank's gold and dollar reserves on October 31 were only $7 million greater than on October 23. During the previous weeks of the month, Swiss reserves declined by $2 million, making the net gain in October $5 million.

United Kingdom - The United Kingdom's payments position has gained strength in recent months. While reserves in September fell by $40 million (excluding the effects of a $16 million gold subscription to the IMF of three independent sterling area countries), they increased by $31 million in October and by $62 million in November. In the absence of full balance of payments

2/ The measure of private capital movements used here includes errors and omissions, which the Bundesbank says consists mainly of unrecorded private capital movements, and excludes commercial banks' foreign exchange assets.

data, the explanation for this improvement is not yet clear. Trade developments through October have been adverse. Exports in the months August through October were seasonally below exports of the previous three months, and imports have been rising steadily. In October, exports did rise sharply, but they were more than matched by increases in imports. Therefore, the gain in reserves must be attributed to either favorable balances on services or to a net inflow of capital.

There was a movement of some short-term funds to London from the United States at the end of October and in early November in response to large covered arbitrage opportunities on three-month Treasury bills, owing to a rise in the U.K. bill rate and an unusual closing of the forward discount on sterling in the wake of the Cuban crisis. The covered interest rate differentials in favor of London on selected dates were as follows (in per cent per annum):

Oct. 11	+0.14	Nov. 2	+0.54	Nov. 23	+0.28
Oct. 19	+0.41	Nov. 9	+0.52	Nov. 30	+0.33
Oct. 26	+0.74	Nov. 16	+0.46		

II - THE IMPACT OF THE CUBAN CRISIS ON INTERNATIONAL FINANCE

The Cuban crisis disturbed the foreign exchange markets on October 23 and 24, but the pressures which developed on these days eased quickly as the crisis was contained. As usual in times of uncertainty, there was a large-scale movement of funds into Swiss francs and gold. The exchange rate for the Swiss franc rose to 23.178 in the New York market on October 24, equal to the upper support level fixed in Switzerland by the Swiss National Bank. The Swiss franc was also at its ceiling in Germany, Belgium, France, and Italy. A movement of funds from Germany was reported by the press, but this is not confirmed by the German October balance of payments figures.

Purchases of gold on the London gold market were very heavy. The Financial Times estimates the turnover to have been $60 million in the early days of the crisis, and the price at the fixing rose to $35.19 per fine ounce on October 24. Gold coins were in demand, too. In London, the gold sovereign rose from $9.75 on October 22 to $10.00 on October 24. The Paris gold market reported that on October 24, the Napoleon rose by 90 centimes to NF 43.30 and the Swiss Louis rose by NF 2 to NF 46.90. The demand for gold subsided on October 25. In London, the fixing price for gold returned to pre-Cuban levels by the end of the month. The gold fixing price on selected dates is as follows (in dollars per fine ounce):

Oct. 19	35.14	Oct. 26	35.17
Oct. 22	35.14	Oct. 31	35.11
Oct. 24	35.19	Nov. 16	35.09
		Dec. 7	35.08

During the Cuban crisis, rates on Euro-dollar deposits in London rose sharply. Because of the crisis, some funds which would ordinarily have been loaned in this market were shifted into gold or into Swiss francs. However, the high level of rates is also the result of pressures which were not directly related to the crisis. European banks were less willing to tie up funds over the year-end period when normally large shifts are made from Euro-dollars for window-dressing. Italian banks were especially influential in the market. As a result of a change in official policy, some banks sold some Euro-dollar holdings to the Bank of Italy and other banks borrowed Euro-dollars which were converted into lira assets to improve their domestic credit availabilities. The rates on 90-day deposits in London during and since the Cuban crisis were as follows (in per cent per annum):

Oct. 19	3-15/16	Oct. 26	4-1/4
Oct. 22	3-7/8	Oct. 31	4-1/4
Oct. 24	4-1/8	Nov. 16	4-1/8
		Dec. 7	4-1/4

III - STATISTICAL APPENDIX

Table 1

Changes in Official Gold, Foreign Exchange Reserves, and Related Items, Selected Countries
(In millions of dollars)

	1961	1962 Jan.-Mar.	1962 Apr.-June	1962 July-Sept.	1962 Oct.	1962 Nov.	Outstanding Sep. 30, 1962
United States							
Official Gold and foreign exchange reserves	- 857	-190	+208	-550	-167	n.a.	16,531
Liquid liabilities to foreigners	+1,744	+354	+643	+302	n.a.	n.a.	26,707
United Kingdom							
Official Gold and foreign exchange reserves	+ 87	+134	- 19	-666	+ 31	+ 62	2,792
Sterling liabilities	+ 212	-548	+ 5	-742	n.a.	n.a.	11,337
European Economic Community:							
Official Gold and foreign exchange reserves							
Belgium	+ 235	+ 5	- 59	+ 32	- 10	- 9	1,626
France	+ 869	+282	+263	+ 46	+ 86	+103	3,530
Germany	- 195	-454	+145	+240	+ 81	a/- 70	6,473
Italy	+ 339	-140	- 40	+ 13	+ 30	n.a.	3,252
Netherlands	- 27	+ 30	+ 50	- 14	- 10	a/- 2	1,781
Total	+1,221	-277	+359	+317	+177	n.a.	16,662
Commercial bank foreign assets:							
Germany b/	+ 380	+601	-269	-209	+ 32	n.a.	820
Italy (net)	- 12	- 61	+ 12	+ 69	n.a.	n.a.	c/- 75
Other official gold and foreign exchange reserves:							
Canada	+ 227	-346	+100	+636	+169	- 6	2,446
Japan	- 338	+ 76	+ 61	+ 97	+ 86	- 12	1,720
Switzerland	+ 435	-151	+ 96	- 77	+ 5	- 21	2,628

a/ Figures derived from weekly balance sheets and are not entirely comparable with figures for earlier months. The figure for the Netherlands is the change in net reserves.
b/ Balances with foreign banks and money market investments abroad.
c/ Net liabilities

Table 2. Adjusted Changes in Official Reserves, Selected Countries a/
(In millions of dollars)

	1961	1962 Jan.-June	1962 July	1962 Aug.	1962 Sept.	1962 Oct.	1962 Nov.
Belgium	+ 274	-124	+ 13	- 6	+ 10	- 10	- 9
France	+1,414	+641	+154	+132	+116	+ 86	+103
Germany	+1,516	- 17	- 46	- 11	+ 23	+ 93	n.a.
Italy	+ 577	-180	+ 66	+ 78	+ 22	+ 30	n.a.
Netherlands	+ 119	+ 15	+ 46	- 91	+ 6	+ 20	n.a.
Total Common Market	+3,900	+335	+233	+102	+177	+219	--
Switzerland	+ 558	+ 41	+108	- 2	- 8	+ 55	n.a.
United Kingdom	-1,670	+690	- 6	- 17	- 40	+ 31	+ 62
Canada	+ 286	-947	+245	+216	+114	+189	+ 69

a/ This table shows changes in official gold and foreign exchange reserves after eliminating the effects of official transactions whose principal purpose is to affect the balance of payments and after eliminating the effects of changes in the IMF's holdings of a country's currency which results in a loss or gain in reserves.

Table 3. Changes in U.S. International Liquidity
(In millions of dollars)

	1961	1962 Jan.-Mar.	1962 Apr.-June	1962 July	1962 Aug.	1962 Sept.	1962 Oct.
Decline (+) in total U.S. gold stock	+ 857	+304	+116	+345	+ 43	+ 58	a/+ 89
Decline (+) in U.S. official holdings of convertible foreign currencies	- 116	-114	-324	+ 58	+ 73	- 27	n.a.
Change in dollar holdings of foreign countries at F.R. banks b/	+ 342	-302	+579	-288	+301	+421	+323
Other c/	+1,402	+676	+ 86	-135	+ 48	- 55	n.a.
Net transfers to foreigners	+2,485	+564	+457	- 20	+465	+397	n.a.

a/ Treasury gold stock only.
b/ Deposits and holdings of U.S. Government securities.
c/ Official holdings outside Federal Reserve Banks, holdings of international institutions (at F.R. Banks and commercial banks) and all private foreign holdings reported by banks.

Table 4

Spot Foreign Exchange Rates against the Dollar a/
(In U.S. cents per unit of foreign currency)

	U.K.	Canada	Germany	Switzer-land	Nether-lands	France	Italy
Parity	280.00	92.50	25.00	22.87	27.62	20.26	.1600
Official limits:							
Buying	278.00	91.575	24.81	b/ 22.47	27.42	20.10	.1588
Selling	282.00	93.425	25.19	b/ 23.28	27.84	20.41	.1612
Date							
Sept. 7	280.15	92.84	25.01	23.14	27.75	20.41	.1611
14	280.09	92.84	25.00	23.14	27.75	20.41	.1611
21	280.06	92.86	24.99	23.12	27.76	20.41	.1611
28	280.08	92.86	24.99	23.11	27.79	20.41	.1611
Oct. 5	280.10	92.89	24.98	23.11	27.80	20.41	.1611
11	280.17	92.91	24.97	23.12	27.77	20.41	.1611
19	280.22	92.92	24.97	23.13	27.72	20.41	.1611
26	280.04	92.74	24.94	23.17	27.72	20.41	.1611
Nov. 2	280.11	92.95	24.92	23.17	27.70	20.41	.1611
9	280.13	92.86	24.94	23.17	27.72	20.41	.1611
16	280.11	92.75	24.95	23.17	27.77	20.41	.1611
23	280.32	92.82	24.95	23.16	27.78	20.41	.1611
30	280.32	92.83	24.97	23.17	27.77	20.41	.1611

a/ Certified noon buying rates in New York for cable transfers.
b/ Legal limits. Since early March 1961, the Swiss National Bank has not allowed the Swiss franc to rise above approximately 23.17 U.S. cents.