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REVIEW OF FOREIGN DEVELOPMENTS

June 11, 1963

Recent Economic Development in Belgium,
December 1962 to May 1963 16 pages

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Summary

Belgium's official gold and dollar reserves rose \$140 million in the first five months of this year, principally because of renewed borrowing of foreign currencies by the Belgian Treasury.^{1/} The gain would have been larger in the absence of the purchase by the National Bank of Belgium in May of \$30 million equivalent of U.S. Treasury 2-year bonds denominated in Belgian francs. Internally, expansion resumed in March and April after a setback caused by the severe winter, and short-term interest rates have risen slightly despite another small cut in the discount rate last December 6. An event of lasting importance was the reform of income taxation enacted last November.

This year's large reserve gains contrast with virtual balance in external payments in the last half of 1962. The Belgian Treasury's renewed resort to borrowing of foreign currencies reflects the adverse effects of the winter on both its revenues and expenditures, in addition to several other factors. The foreign currency borrowing has included both a rise in the short-term certificates (taken up by Belgian banks as well as abroad) and two medium-term dollar loans of \$20 million each from banks in London and New York.

The worsening of the Treasury's position this year comes after further progress had been made in 1962 in reducing both the deficit and the short-term foreign currency debt. Initial budget estimates for 1963 called for a further small decrease in the deficit, but this year's events to date now make an increase likely.

^{1/} A review of earlier economic developments may be found in "Recent Economic Developments in Belgium: May-December 1962" dated December 13, 1962.

The Belgian income tax laws were thoroughly reformed last November. The new laws correct many former inequities and distortive effects on economic activity, and increase withholding taxes on investment income to check evasion.

Belgian interest rates have shown mixed movements since last summer. Short-term market rates have risen slightly to 3.0 per cent for 90-day money (despite the 1/4 of 1 per cent reduction in the discount rate last December) while long-term yields have dropped somewhat further to about 4.9 per cent. This relative stability comes after the sharp declines in all rates in early 1962 caused by the abolition of regulations that had kept rates artificially high and by four discount rate reductions (totalling 1 per cent) between December 1961 and August 1962.

Renewed foreign currency borrowing causes reserves to rise

Gold and dollar holdings of the National Bank of Belgium have risen in each of the first five months of this year for a total increase over this period of \$140 million. (See Table 1.) Much of the gain was caused by renewed borrowing of foreign currencies by the Belgian Treasury. The short-term debt in foreign currencies rose BF 4.1 billion (\$82 million) in January-April (see Table 2) and in May the Belgian Treasury placed abroad two medium-term dollar loans for \$20 million each with bank consortia in London and New York at yields of 5 per cent and 4-7/8 per cent respectively. However, the \$40 million increase in official reserves resulting from these two loans was largely offset by the purchase by the National Bank of Belgium (announced on May 21) of \$30 million equivalent of two-year Belgian franc bonds of the U.S. Treasury.

The big rise in Belgian reserves this year comes after a period of virtual balance in Belgium's international position. The balance of payments recorded a small deficit in the last half of 1962 (discussed below) and official reserves rose only \$19 million in that period. What factors other than foreign-

Table 1. Belgium: Official Reserves, 1959-63
(In millions of dollars; end of period)

	<u>Gold</u>	<u>Foreign Exchange</u>	<u>Total</u>
1959	1,134	88	1,222
1960	1,170	252	1,422
1961	1,248	409	1,657
1962			
March	1,297	365	1,662
June	1,335	268	1,603
September	2,341	285	1,626
December	1,365	257	1,622
1963			
January	1,362	289	1,651
February	1,364	314	1,678
March	1,372	357	1,729
April	1,372	379	1,751
May	1,372	390	1,762

Sources: IMF and Federal Reserve Bank of New York.

Table 2. Belgium: Treasury Direct Debt, 1960-63
(In billions of Belgian francs; end of period)

Debt in	1960	1961	1962		1963	
	<u>Dec.</u>	<u>Dec.</u>	<u>Mar.</u>	<u>Dec.</u>	<u>Mar.</u>	<u>Apr.</u>
<u>Belgian francs</u>	<u>330.6</u>	<u>338.4</u>	<u>348.1</u>	<u>358.6</u>	<u>367.2</u>	<u>n.a.</u>
Long-term	211.6	217.4	222.6	251.6	254.6	n.a.
Medium-term	18.1	17.4	18.4	20.9	16.7	n.a.
Short-term	68.6	70.8	75.1	50.0	60.5	n.a.
Postal checking accounts	32.3	32.8	32.0	36.1	35.4	n.a.
<u>Debt in</u>						
<u>foreign currency</u>	<u>44.4</u>	<u>47.1</u>	<u>45.1</u>	<u>37.1</u>	<u>40.5</u>	<u>n.a.</u>
Long-term a/	17.4	18.8	18.7	19.5	19.3	n.a.
Medium-term	1.5	6.3	6.3	4.8	4.8	n.a.
Short-term	25.5	21.9	20.1	12.8	16.4	16.9
<u>Total debt</u>	<u>375.0</u>	<u>385.5</u>	<u>393.2</u>	<u>395.7</u>	<u>407.7</u>	<u>n.a.</u>

a/ Excluding World War I intergovernmental debt.

Source: National Bank of Belgium and press reports (for April short-term foreign currency debt).

currency borrowing contributed to this year's reserve rise is not known; however, it did not stem from any improvement in the balance on trade shipments. The unadjusted trade deficit (customs basis, imports c.i.f.) averaged \$15 million per month in the first quarter of 1963, compared with only \$1 million per month in the same period last year, and ran at about the same rate as in both the second quarter, and the last two quarters combined, of 1962.

The resort to foreign currency borrowing by the Government this year is also in marked contrast with last year, when continued progress in cutting the budget deficit allowed the Belgian Treasury to reduce substantially its foreign currency debt (see below), and with expectations of a still smaller deficit in 1963 on the basis of initial budget estimates. Four causes have been cited for this year's increase in the foreign-currency debt:

1. The severe winter depressed economic activity and tax revenues, and caused unexpected government expenditures for unemployment relief and road repairs. These two factors had a combined adverse effect of some \$100 million equivalent in the months January-April.

2. These untoward events came at a time when, for seasonal reasons, expenditures are normally largest relative to revenues and the debt increase is usually largest in any event.

3. The results of the Treasury's first 1963 long-term Belgian franc bond issue in March were disappointing. This loan, which yielded investors 5.09 per cent, raised only \$118 million equivalent of new funds compared with \$210 million equivalent from an issue with similar yield and terms in November 1962. It is thought that subscriptions were unfavorably affected by the new income tax laws effective this year (discussed below) which not only abolished the

former tax exemption on government bond interest but also applied a withholding tax on such interest.

4. According to the Belgian Finance Minister, the Treasury this year could borrow at short-term more favorably abroad than at home.

The \$20 million medium-term dollar loan in May from a group of British banks was for three years at 5 per cent interest, and was the first non-sterling loan in the United Kingdom since World War II. The \$20 million loan from U.S. banks was at 4-7/8 per cent interest and for three to five years, with one-third of the notes maturing in each of the last three years. Proceeds were drawn between May 22 and 31.

Activity rises again after winter setback

Economic indicators for March and April show a revival in activity from the downturn in December-February caused by the very severe winter weather. The AGEFI industrial activity index adjusted for working days only was provisionally up 7.3 per cent in March-April over a year earlier. (See Table 3.) Previously, the year-to-year gain had dropped to 2.8 per cent in January-February from 6.5 per cent in the fourth quarter of 1962. The industrial production index showed seasonally-adjusted declines in both December and January, and seasonally-adjusted unemployment rose in January. (See Table 4.)

Foreign trade has also rebounded after being severely depressed by weather conditions. (See Table 5.) In January-February, seasonally-adjusted imports were down 8 per cent from the fourth quarter while exports were down 6 per cent. March saw sharp increases in both which put exports 10 per cent higher than in the last quarter of 1962 and imports 4 per cent higher.

As happened in other countries of Western Europe, the weather caused prices to rise last winter. In Belgium the consumer price index rose

Table 3. Belgium: Industrial Activity Index, 1961-63
(1953=100)

	<u>1961</u>	<u>1962</u>	<u>1963</u>
January	116.0	156.6	164.7
February	143.9	152.8	153.7
March	162.7	164.2	a/174.8
April	154.2	159.0	b/172.4
May	158.4	165.1	
June	160.6	164.6	
July	140.3	145.4	
August	155.4	162.0	
September	160.6	165.6	
October	160.0	175.9	
November	156.2	165.0	
December	153.8	166.0	

a/ Provisional.

b/ Estimate.

Source: Agence Economique et Financière.

Table 4. Belgium: Selected Economic Indicators, Seasonally-Adjusted
(Indexes 1953=100; unemployment in thousands)

<u>Year</u>	<u>Industrial production index</u>	<u>Sales indexes</u>		<u>Un- employment</u>
		<u>Dep't. stores</u>	<u>Wholesale food</u>	
1960	129	143	142	110
1961	135	145	147	88
1962	143	151	154	47
<u>Quarter, 1962</u>				
I	140	146	153	60
II	141	154	153	44
III	145	149	146	41
IV	145	155	165	39
<u>Month</u>				
1962-				
Oct.	143	151	175	39
Nov.	148	158	175	39
Dec.	145	155	145	39
1963-				
Jan.	144	144	170	40
Feb.	n.a.	153	n.a.	n.a.

Sources: OECD (production and unemployment) and National Bank of Belgium (sales)

Table 5. Belgium: Foreign Trade, Seasonally-Adjusted^{a/}
 (In millions of dollars; monthly average or month)

	<u>Imports c.i.f.</u>	<u>Exports</u>	<u>Balance</u>
1960-Year	324	312	-12
1961-			
Quarter I	349	303	-46
II	349	331	-18
III	343	338	- 5
IV	350	333	-17
1962-			
Quarter I	357	359	+ 2
II	382	359	+23
III	366	367	+ 1
IV	391	366	-25
1963-			
January	350	328	-22
February	367	357	- 9
March	406	401	- 5

^{a/} -- Includes Luxembourg.

Source: OECD.

1.7 per cent, and the wholesale price index 1.1 per cent, between December and February. Earlier, Belgium had continued to enjoy price stability throughout 1962.

Until last winter's interruption, the Belgian economy was continuing to expand. In the last half of 1962, seasonally-adjusted data showed increases over the first six months of the year of 3.2 per cent in industrial production, 2.1 per cent in exports, and 2.4 per cent for imports, while seasonally-adjusted unemployment decreased further in the last two quarters of the year. For the full year 1962 it is estimated that Belgium's real GNP rose about 4 per cent.

Public finances showed further improvement in 1962

Belgium's central government finances underwent additional and substantial changes for the better in 1962. The progress made in this area in 1961-62 rates as perhaps the foremost achievement of the present Belgian administration in the economic sphere. A further reduction in the deficit is shown by the 1963 budget estimates, but the adverse factors cited earlier will probably result in a somewhat larger deficit this year than last.

The Treasury's cash deficit (shown in Table 6) excluding amortization of long-term direct debt ^{2/} dropped to BF 8.9 billion (\$178 billion) in 1962, from BF 11.5 billion the year before and BF 19.2 billion in 1960, and current receipts and expenditures were brought into balance for the first time since 1957. The trimming of the deficit in 1962--as also in the previous year--resulted from a smaller increase in outlays than in receipts. Cash disbursements

^{2/} Belgium includes long-term debt amortization among current expenditures. The Belgian statistics thus show a deficit of BF 16.2 billion in 1962 that includes amortization. In addition to the direct debt (incurred by the Treasury), the Treasury has some "indirect debt." This is debt incurred by public institutions which is serviced and redeemed by the Treasury. At the end of March 1963 the direct debt totalled BF 407.7 billion (\$8,154 million) and the indirect debt BF 27.5 billion (\$550 million).

Table 6. Belgium: Treasury Cash Deficit and Its Financing, 1959-62
(In billions of Belgian francs)

	<u>1959</u>	<u>1960</u>	<u>1961</u>	<u>1962</u>
<u>Receipts</u>	<u>100.4</u>	<u>108.4</u>	<u>120.7</u>	<u>131.7</u>
<u>Expenditures</u>	<u>126.6</u>	<u>134.9</u>	<u>140.6</u>	<u>147.9</u>
Ordinary <u>a/</u>	108.4	111.3	<u>b/126.0</u>	130.1
Extraordinary	<u>18.1</u>	<u>23.7</u>	<u>b/ 14.6</u>	<u>17.8</u>
<u>Deficit a/</u>	<u>26.2</u>	<u>26.5</u>	<u>19.8</u>	<u>16.2</u>
<u>Financing of Deficit</u>	<u>26.2</u>	<u>26.5</u>	<u>19.8</u>	<u>16.2</u>
<u>Borrowing in Belgian francs</u>	<u>20.1</u>	<u>19.9</u>	<u>18.0</u>	<u>27.4</u>
Long-term (gross)	20.3	27.2	13.0	20.1
Medium-term (net)	- 2.4	- 6.1	--	- 1.1
Short-term (net):				
National Bank	0.4	- 2.2	0.5	- 1.4
Postal checking accounts	2.2	2.7	0.4	3.5
Other	--	- 3.9	4.6	4.9
<u>Borrowing in foreign currencies</u>	<u>5.2</u>	<u>10.6</u>	<u>3.4</u>	<u>- 9.2</u>
Long-term (gross)	1.2	0.1	2.2	1.4
Medium-term (net)	0.5	0.1	4.8	- 1.5
Short-term (net)	3.5	10.4	- 3.6	- 9.2
<u>Other Treasury operations</u>	<u>0.4</u>	<u>- 1.8</u>	<u>- 2.1</u>	<u>- 0.6</u>

a/ Including long-term debt amortization. Amortization of long-term direct debt amounted to BF 7.3, 8.5, and 7.3 billion 1960-62, respectively.

b/ In 1961 about 9 billion of current expenditures were shifted from the extraordinary to the ordinary budget.

Source: Ministry of Finance.

were up 5.2 per cent in 1962 while receipts rose 9.1 per cent. The Belgian Finance Ministry estimates that receipts rose close to 4 per cent because of higher real national income; nearly 2 per cent as a result of a higher average price level in 1962 than the year before; and somewhat less than 4 per cent on account of tax measures, most of which were applied in 1961 but were not effective for a full year until 1962. On the expenditures side, the 3 per cent rise in current outlays was proportionately much smaller than the 22 per cent increase in extraordinary expenditures, most of which are for investment.

The increase in the direct public debt of BF 10.2 billion in 1962 was much smaller than in the immediately preceding years, and the debt maturities were better distributed. The Treasury was able to raise much more long-term money in 1962--and at lower cost--than in 1961. New money raised through long-term bond issues increased from BF 15.2 billion to BF 21.5 billion, of which nearly all in domestic currency. There was one long-term foreign-currency issue for \$30 million (BF 1.5 billion) floated in New York in April 1962. The long-term flotations more than covered the Treasury's needs (inclusive of BF 7.3 billion of amortization), and the floating (short- and medium-term) debt was reduced BF 4.7 billion. In particular, the short-term debt in foreign currencies (held by Belgian banks as well as abroad) was slashed by BF 9.2 billion, or from \$438 million equivalent to \$256 million equivalent.

In addition, BF 19.8 billion of special one-year Treasury certificates held by Belgian banks in partial fulfillment of the compulsory liquidity ratio was funded into a long-term issue at a higher rate of interest. The rate on the certificates was 1-15/16 per cent; on the funded issue, a 3-1/2 per cent rate will be applied in stages over a three-year period to the three tranches of the issue. Belgian banks had long complained of the low return on compulsory holdings of certificates.

External payments were in balance in last half of 1962

External payments of the Belgium-Luxembourg Economic Union registered a negligible deficit of \$4 million dollars in the last half of 1962 (latest data available). (See Table 7.) This represented some deterioration from the surpluses of \$164 million in the last half of 1961 and \$82 million in the first half of 1962.

The surplus on current account transactions (excluding government unilateral transfers) dropped to \$10 million in July-December 1962 from \$94 million a year earlier, even though the balance on trade shipments improved slightly between these two periods. In the absence of the necessary information, it is not possible to know if the reduction was caused by changes in services or in leads and lags in trade payments. Net private capital inflow of \$14 million was practically unchanged from the first half of the year but down from \$24 million in the second half of 1961. The declines in Belgian interest rates over this period contributed to these changes.

Public capital transactions showed a net outflow of \$36 million, up from the smaller deficit of \$26 million in the January-June half and in very marked contrast with the \$40 million inflow in the second half of 1961.

Public capital flows have been greatly influenced in recent years by the large variations in the foreign currency debt of the Belgian Treasury. But because some of this debt has been held by residents as well as by foreigners, and because of public capital flows other than on foreign currency debt account, there has been little or no correlation between the total net public capital flows and the changes in the foreign currency debt of the Treasury.^{3/} The Treasury's foreign currency debt outstanding was reduced \$58 million in the

^{3/} In the monetary movements, changes in foreign currency debt held by Belgian banks do affect the official reserves, but there are offsetting movements, e.g., changes in the banks' foreign assets or liabilities.

Table 7. Belgium: Balance of Payments, 1961-62 a/
(In millions of dollars)

	By Years		By Half-Years			
	b/1961	b/1962	1961		1962	
	Year	Year	I	II	I	II
A. <u>Balance on goods, services and private transfers</u>	106	70	- 38	94	60	10
Trade, f.o.b. (payments basis)	-114	n. a.	n. a.	n. a.	n. a.	n. a.
Services	150	n. a.	n. a.	n. a.	n. a.	n. a.
Transfers	70	n. a.	n. a.	n. a.	n. a.	n. a.
B. <u>Government transfers</u>	- 16	- 2	- -	- 16	- -	- 2
C. <u>Public capital</u>	- 72	- 62	-112	40	- 26	- 36
Federal Government	-116	n. a.	n. a.	n. a.	n. a.	n. a.
Other	44	n. a.	n. a.	n. a.	n. a.	n. a.
D. <u>Private capital</u>	20	30	- 2	24	16	14
Known short-term	- 26	- 4	2	- 28	- 6	2
Securities	- 64	} 34	} - 4	} 52	} 22	} 12
Other	110					
E. <u>Unidentified transactions, errors and omissions</u>	- 26	38	- -	22	32	6
F. <u>Surplus or deficit</u>	12	78	-152	164	82	- 4
G. <u>Monetary movements (change in net foreign assets; - = increase)</u>	- 12	- 78	152	-164	- 82	4
National Bank of Belgium:						
1. Gross reserves	-235	35	- 50	-185	54	- 19
2. Other net foreign assets	- 9	- 1	8	- 17	8	- 9
Belgian banks	180	} -112	} 200	} - 20	} -160	} - 32
Other institutions	52					

a/ Includes Luxembourg.

b/ For 1961, annual figures do not equal the sum of the half-yearly figures for many components (notably trade and unidentified transactions) because of reclassifications. However, the annual figures shown here for 1962 are the sum of published half-yearly data (annual data not having yet been released). Therefore, the 1961 and 1962 annual figures above are not comparable for some of the components.

Sources: National Bank of Belgium and International Monetary Fund.

second half of last year, or by appreciably more than the \$36 million public capital outflow.

In earlier recent periods, the two series showed much larger differences. In both the second half of 1961 and the first half of 1962, the impact of reductions in this debt was greatly cushioned or even entirely offset, either by the fact that some of the retired debt was in Belgian hands to begin with, or by shifts in the holding of this debt from foreigners to residents. On the other hand, when the foreign-currency debt was still rising rapidly in the first half of 1961, shifts in the debt from foreigners to residents caused the public capital account in the balance of payments to show a big deficit.

Interest rates show mixed trends

Interest rates in Belgium have shown mixed movements since last summer. This development contrasts with the sharp declines in all interest rates that occurred during the first eight months of 1962.

At the short end, "bill" rates have moved up somewhat from the lows of last August-September. (See Table 8.) Gradual increases between August 1962 and March 1963 in the auction rates on the 4-, 6-, 9-, and 12-month Treasury certificates and the 4-month certificates issued by the Securities Stabilization Fund ranged from 13 to 19 basis points. The upward movement was not interrupted by a further reduction of 1/4 of 1 percentage point in the National Bank of Belgium discount rate on December 6, 1962. This was the sixth in a series of reductions since August 1961 which in all brought the discount rate from 5 to 3-1/2 per cent. In January 1963 the government also reduced by 1/4 of 1 percentage point the interest paid on deposits of under BF 250,000 in the Caisse Générale d'Epargne (The State-run savings bank), and the private savings banks (which have much fewer deposits than the Caisse Générale d'Epargne) followed suit. These reductions followed with a lengthy time lag the reductions made

Table 8. Belgium: Selected Interest Rates, 1961-63
(end of period)

	<u>1961</u>	<u>1962</u>		<u>1963</u>		
	<u>Dec.</u>	<u>Aug.</u>	<u>Dec.</u>	<u>Jan.</u>	<u>Feb.</u>	<u>Mar.</u>
<u>Discount rate, Nat. Bk. of Belgium</u>	4.50	3.75	3.50	3.50	3.50	3.50
<u>4-month certificates of the Securities Stabilization Fund</u>	4.25	3.15	3.30	3.30	3.35	3.35
<u>Treasury certificates</u>						
4-month	4.25	3.15	3.30	3.30	3.35	3.35
6-month	4.28	3.30	3.36	3.39	3.40	3.45
9-month	4.36	3.38	3.42	3.40	3.45	3.51
12-month	--	3.38	3.45	3.45	3.50	3.55
<u>Deposits</u>						
<u>Commercial banks:</u>						
15 days notice	1.30	1.00	1.00	1.00	1.00	1.00
3-month	3.15	2.50	2.50	2.50	2.50	2.50
Caisse Générale d'Epargne (up to BF 250,000)	3.00	3.00	3.00	2.75	2.75	2.75
<u>Bond yields (5 to 20 years to maturity)</u>						
Treasury	6.07	4.96	4.96	4.71	4.64	4.90
Parastatal and municipals	5.70	5.09	5.02	4.82	4.70	4.83

Source: National Bank of Belgium

in commercial bank time deposits in January and August of last year.

Long-term bond yields have dropped somewhat since last summer, but the rate of decrease has been much slower than in the earlier months of 1962. The average yield on 5-20 year government bonds fell from 4.96 per cent at the end of August 1962 to 4.90 per cent at the end of March 1963; a larger decline was registered in yields on bonds of parastatal institutions and municipalities. (See Table 8.)

The change in interest rate trends since last summer appears to have two main causes. In the first place, interest rates had been held up artificially prior to 1962;^{4/} when rates fell sharply in January-August 1962, they were in the process of seeking their own (lower) levels as determined by market forces. Second, the authorities have of late taken less action to reduce rates. The one reduction of 1/4 of 1 percentage point in the discount rate last December contrasts with four reductions, each in the same amount, between December 28, 1961, and August 9, 1962.

Fundamental reform of income taxation is made

The first fundamental reform of income taxation in Belgium since 1919 was accomplished by the Fiscal Reform Bill enacted on November 20, 1962. It applies to personal incomes from 1963 and corporate incomes from 1962. The objective is not to change total income tax revenue but to correct inequities, reduce fiscal distortions of economic activity, increase progressivity, and combat evasion.

The core of the reform is the imposition of a single progressive tax on total personal net income. Formerly, one set of progressive rates applied to net income from wages, salaries, etc., while widely different flat rates were levied on gross incomes of other types, depending not only on the

^{4/} By the linkage of certain short-term rates to the discount rate, which was ended on January 1, 1962.

source but in many cases on other arbitrary factors as well. These latter rates ranged from 30 per cent on most dividends to 11 per cent on most corporate bond interest and no tax at all on interest on bonds issued by the government or Belgium's many public institutions. A very low rate surtax was applied to total personal net income. The new corporation income tax now taxes distributed and undistributed profits almost equally, and shareholders get credit for one-half of the flat 30 per cent tax on corporate distributed profits.

To reduce tax evasion, withholding taxes on dividends and interest have been increased. Effective withholding rates determined by a new "two-stage" withholding process ^{5/} work out to 30-1/2 per cent on dividends, 27-3/4 per cent on corporate bond interest, and 15 per cent on public-sector bond interest. Previously there was no withholding at all until 1961, and a "one-stage" 10 per cent withholding rate in 1961-62.

A thorough-going "reform" of taxation of real estate income had already been carried out in March, 1962 by an updating of the assessed incomes from real estate. The previous assessed incomes dated from 1931, and their low levels were totally unrealistic.

^{5/} Once by the payer and once by the encashing bank. The first is not applied to public-sector bond interest.