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REVIEW OF FOREIGN DEVELOPMENTS

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U. S. Balance of International Payments in January-February 1951 By Arthur B. Hersey and Edward Marcus	2 Pages
Present Monetary and Credit Issues in Norway By Paul Gekker	3 Pages
An Upward Conversion of French Government Securities By Robert Solomon	2 Pages

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U. S. BALANCE OF INTERNATIONAL PAYMENTS
IN JANUARY-FEBRUARY 1951

Arthur B. Hersey and
Edward Marcus

During January and February the trade and service accounts in the U. S. balance of payments showed a smaller export surplus than in late 1950.^{1/} The value of merchandise imports continued to increase, while non-military exports rose only a little above the high level of the fourth quarter of 1950; the visible trade balance (excluding shipments under the Mutual Defense Assistance Program) changed from a small positive to a small negative figure. It is unlikely that there were significant changes in the service accounts, and it is accordingly estimated that the over-all surplus on goods and services decreased from \$300 million (excluding MDAP) to a quarterly rate of perhaps \$150 million.

Despite this shift, the estimated increase in foreign assets in the first two months of this year was at a rate slightly lower than in the fourth quarter of 1950. This was due partly to the subsidence of the speculative capital outflows that had occurred in the third quarter and, to a lesser extent, in the fourth quarter of 1950, and possibly also to a continuation of the generally downward trend in U. S. Government aid. The increase in foreign assets still exceeded the amount of U. S. Government non-military aid (grants and loans), in contrast with the pre-Korean period; in other words, even if government assistance had been absent, foreign assets would have risen slightly in recent months.

It will be noted from the table that the "errors and omissions" item, which was a debit of \$50 million in the Commerce Department preliminary results for the fourth quarter, seems to have shifted back to the credit side where it characteristically appeared in 1946-1949. Considering the degree of uncertainty in the other items, one can not attach much significance yet to this change.

Basis of estimates

Merchandise trade--January-February 1951 recorded trade excluding recorded MDAP shipments, raised to quarterly rate by ratio of number of days (90:59); plus adjustments for other transactions estimated on basis of data for recent quarters.

Services--Estimated from historical data, adjusted for seasonal changes.

Private donations, U. S. Government grants and loans, and U. S. private long-term capital--Estimates based on extrapolation of earlier trends.

U. S. private short-term capital and foreign long- and short-term capital and purchases of gold from the U. S.--Based on Federal Reserve January-February data raised to quarterly rate.

^{1/} See Federal Reserve Bulletin, April 1951, "Trends in International Trade and Payments."

RESTRICTED

U. S. Balance of Payments
(In millions of dollars)

	Estimate Jan.-Feb. 1951 (Quarterly rate)	<u>Dept. of Commerce data</u>	
		1950 Fourth quarter (p)	1950 First quarter
Exports of goods and services:			
Total	n.e.	+4,067	+3,271
Total excluding MDAP	<u>+3,950</u>	<u>(+3,762)</u>	<u>(+3,266)</u>
Merchandise, adjusted	+3,000*	+3,119**	+2,448**
Services	<u>+950*</u>	<u>+948**</u>	<u>+823</u>
Imports of goods and services:			
Total	<u>-3,800</u>	<u>-3,464</u>	<u>-2,567</u>
Merchandise, adjusted	-3,100	-2,801	-1,961
Services	<u>-700</u>	<u>-663</u>	<u>-606</u>
Balance on goods and services:			
Total	n.e.	+603	+704
Excluding MDAP	+150	(+298)	(+699)
Private unilaterals	<u>-100</u>	<u>-118</u>	<u>-109</u>
Balance on goods, services, and private unilaterals			
Total	n.e.	+485	+595
Excluding MDAP	<u>+50</u>	<u>(+180)</u>	<u>(+590)</u>
U. S. Government capital and unilaterals:			
MDAP	n.e.	-305	-5
Other	-750	-815	-1,092
U. S. private capital:			
Long-term	-200	<u>1/-93</u>	-227
Short-term	-50	-141	+151
Errors and omissions	+100	-50	+127
Foreign capital and purchases of gold from United States ...	+850	+919	+451

n.e. Not estimated.

* Excluding MDAP goods and services.

** Including MDAP goods and services.

1/ Net outflow in fourth quarter was reduced by redemption of U. S.-held portion of Canadian loan totaling \$100 million.

RESTRICTED

April 24, 1951

PRESENT MONETARY AND CREDIT ISSUES IN NORWAY

Paul Gekker

Recent trends in the credit and capital markets of Norway appear to indicate that a turning point has been reached in postwar financial experience. ^{1/} Throughout the postwar period, excess liquidity of business enterprises and banks had permitted the financing of a volume of investments which, in spite of direct controls, included a large number of postponable projects and contributed to the persistence of inflationary pressures. Through the contractive effects of the budget and import surpluses, however, the ability of the banks to continue their previous scale of lending activities has been steadily reduced. A situation is developing in which the chief weakness of direct investment controls -- the impossibility of preventing some undesirable credit extension -- is now being corrected. Although the private banks are not yet in a reserve-deficient position, relative stringency is finally introducing some desirable selectivity in the granting of credit and thus a more natural balance between the supply and demand for credit may well be expected. The Norwegian authorities, however, apparently do not feel that credit facilities are sufficient under present conditions and have evidently decided to provide central bank support for the continuation of bank lending. They are prepared to do this immediately and on a large scale so as to offset the restrictive effects that would otherwise be felt.

Credit stringency

The financing of the balance of payments deficit and the contractive effects of the budget surplus have steadily reduced the excess reserves of the commercial banks, although the present ratio of liquid reserves to demand liabilities is still higher than prewar. Table I illustrates the trend of bank liquidity in the postwar period.

Table I

Norway - Liquidity of the Joint Stock Banks
(Millions of kroner)

	December 1939	May 1945	December 1948	December 1949	December 1950
Liquid assets ^{1/}	52	2901	1636	1386	750
Demand deposits	157	1864	2022	1885	1701
Total deposits	949	3209	3886	3892	3817
Ratio of liquid assets to:					
Demand deposits	33	156	81	74	44
Total deposits	6	90	42	36	20

^{1/} Cash, central bank balances and wartime issue of Treasury bills, discontinued as of July 1, 1950.

Source: Norges Aksjebanker og Sparebanker 1947 og 1948, p. 55; Manedsstatistikk over de norske private aksjebanker og sparebanker pr. 31. desember 1950. (Statistics covering banks accounting for 98 per cent of total assets of the joint stock banks).

^{1/} For an account of Norway's postwar inflation, see this Review, June 20, 1950.

RESTRICTED

The postwar decline in bank reserves reflects the substitution of earning assets for accumulations of excess liquid holdings. During the period 1946-1950 the banks expanded their loans by 5.3 billion kroner. The larger part of this lending was made possible by the redemption of 4.3 billion kroner in Treasury bills, exhausting the banks' holdings of these wartime issues. Increases in deposits contributed only one billion kroner. Bank liquidity has recently been further reduced, as a result partly of the withdrawal of funds for ECA counterpart deposits and partly because of increased demands for bank financing by producers and importers. The liquid funds of industrial concerns, heretofore available for the financing of expansion, have apparently been greatly reduced by the high rates of taxation. Importers, on the other hand, are being officially encouraged to maintain adequate stocks, and their increased demand for credit accommodation is stimulated by their trading position under current price regulations. These regulations stipulate that their profits be limited to a constant kroner per unit amount prevailing in some earlier base period, and also that their selling prices are to be governed by the original rather than the replacement cost of imports.

As a result of these demands, which have continued through the first two months of this year, it is expected that bank reserves will be reduced by approximately 300-400 million kroner during 1951. This development has led to a movement to abandon legislation on higher commercial bank reserve requirements which has been under consideration for some time, and which was earlier prompted by the desire to control lending activity more effectively than was possible with existing investment controls alone. The need for this more effective credit control is now being met by the natural reduction in reserves.

Capital market

The tightened liquidity situation in the private banks has served to accentuate a shortage of funds in Government-lending institutions, such as the State Housing Bank and the State Industrial Bank; the former reportedly has a backlog of approved building projects requiring 300 million kroner annually. The financing needs of the State Banks are ordinarily met from the proceeds of the sale of their low interest, long-term bond issues to the private banks. The ability of the latter in turn to subscribe to the State Bank issues is limited as much by their own shortage of resources as by their reluctance to invest in 2½ percent securities whose market value has been declining below par during the past half-year.

These three tendencies -- the continuing reduction of bank reserves, the shortage of funds experienced by the Government banks and their unwillingness to raise funds at the market rate of interest -- are responsible for a current proposal to transfer a sum of 400 million kroner from a Government deposit in the Bank of Norway to the State banks.

RESTRICTED

Approximately one-half of the amount is scheduled to be used by the State lending institutions to repay advances from the private banks, while the remainder will permit the financing of projects which currently lack funds. It may therefore be expected that the greater part of the sums so disbursed will revert to the private banks in the form of deposits. Thus virtually the entire sum to be transferred will eventually form the basis for a continued expansion of credit. If the present situation is one in which the restraint of higher compulsory reserve requirements is no longer considered necessary, there is nevertheless ground for concern that the proposed direct transfer of central bank funds -- approximately equivalent to the expected further reduction of bank reserves during 1951 -- will completely offset the restrictive effects that might have been felt from a reduction in liquidity.

Monetary policy

Norway has passed through a prolonged period of repressed inflation with the aid of a comprehensive system of direct controls. Even after the emergence of intensified inflationary forces since June 1950, Norway has made less use of monetary policy measures than other Western European countries. The $2\frac{1}{2}$ per cent discount rate has been unchanged since 1945. The central bank, however, does not support the market for Government bonds, for the price level decline of the past six months has been unopposed and the market yield is currently about 2.7 per cent. It is evidently the Government's unwillingness to accept a slightly higher rate of interest, which might encourage the market for long-term issues to revive, that has prompted the alternative of a simple injection of funds into the banking system. In attempting to cope with possible inflationary implications of this step, the Government will probably place some reliance on the recently organized Bank Credit Committee, composed of representatives of the Government and the private banks. The Committee, which is headed by the Governor of the Bank of Norway, is expected to review individual bank lending policies in order to assure accommodations of priority projects and deferment of less essential demands.

In the face of increased defense programs, the policy of providing for budgetary surpluses has been continued, some deferment of planned investment is intended, and a decision to restrict consumption is evident in the recent increase of from $6\frac{1}{2}$ to 10 percent in the general sales tax. On the other hand, the proposal for higher reserve requirements appears to have been set aside. Moreover, the transfer of Government funds to supplement indirectly the dwindling resources of the banks indicates a reluctance to accept the control over credit which would ordinarily be introduced by the current trend in bank liquidity.

RESTRICTED

April 24, 1951

AN UPWARD CONVERSION OF FRENCH GOVERNMENT SECURITIES

Robert Solomon

The recently-announced Treasury issue at 2 3/4 percent recalls to mind the French flotation of early 1949 which also involved a conversion to a higher interest rate. While there are certain similarities between the French and the current American operation, it appears that the differences are considerably more striking.

The French flotation

Under the terms of the French flotation, holders of certain outstanding French securities -- mainly the 3 percent perpetual -- were permitted to turn them in at par in payment for one-half their subscription to the new 5 percent perpetual. The other half had to be paid in cash, with a few minor exceptions. Before the announcement of the new issue, the 3 percent perpetual was quoted at a price of about 62, thus yielding about 4.8 percent.

An investor who purchased the 3 percent security at 62 and added 100 francs in cash to acquire 200 francs worth of the new issue acquired an asset yielding 6.2 percent on his investment [10:162 * .062]. Naturally the market price for the 3 percent perpetual rose immediately after the announcement of the terms of the new issue. But it rose only to about 74. At this price an investor who purchased the 3 in order to turn it in would still acquire an asset yielding 5.7 percent. On the other hand, the cost to the Government of the new money was 7 percent, since it not only paid 5 percent on the cash subscription to the new security but increased by 2 percent its payments on an equal amount of existing debt. ^{1/} Correspondingly a holder of the 3 percent security who put up 100 francs in cash to acquire two of the new 5's, earned 7 percent on his new investment. If, however, he later sold one of them at the market price of 82 (see below), he would have increased his annual income by two francs with an outlay of 18 francs, thus earning 11 percent on his new investment.

The fact that the old 3 percent did not rise further so as to bring the effective yield on the new security closer to 5 percent indicated that the market anticipated that the introduction of the higher yield security portended an upward trend in the level of interest rates. In this connection it should be noted that the new 5 percent perpetual carried a commitment on the part of the Treasury to accept it at par in exchange for any future issue, during the next ten years, carrying a higher rate of interest.

When the new 5 percent issue was introduced on the market it was

^{1/} Actually the cost to the Government was 6.9 percent since 20 percent of the 360 billion of securities eligible for conversion carried a coupon rate of 3.5 percent.

quoted at about 82, yielding 6.1 percent to a new investor. This was just over the average price $(100 + 62 \div 2)$ paid by an investor for the 5 percent perpetual, if he had acquired the old 3 percent at 62. For those who purchased the 3 percent at the post-announcement rate of about 74, disposal of the 5 percent security at any price below 87 would involve a capital loss. This factor may have induced purchasers to hold the new security -- with its yield to them of about 5.7 percent.

Comparison with U.S. issue

It should first be noted that the problem in France was entirely different from that in the United States. In this country, the primary purpose of the new issue is to prevent further monetization of the long-term debt. The U.S. Treasury is willing to pay more on outstanding debt in order to secure non-marketability. Furthermore, the new security appears to have been introduced as part of a general agreement regarding the bond-support policy.

In France the major problem was to enable the Treasury to raise funds with which to help finance the large budget deficit. There was no bond-support policy in France. Furthermore, the holdings of the banks, consisting almost entirely of Treasury bonds with maturities up to two years, were "frozen in" by a special reserve requirement. Thus the main purpose in France was not to induce investors to hold securities, but to induce them to put fresh money into new securities. To accomplish this, the French Treasury was willing to pay a higher rate on outstanding debt as well as for the new money. Inasmuch as the yields available to holders of the convertible securities were more favorable than those to new investors, the operation implied a special reward for those who had held on to the securities during the post-war inflation. While the French authorities would of course have preferred that investors hold securities rather than attempt to sell them and depress the market rate -- thus making future Treasury loans difficult or more expensive -- the primary purpose was not in that direction.

It appears then that the major element of similarity between the two experiences is that they both involved an upward conversion. While there appears to be a parallel in the fact that, both the issues could fall below par (the U.S. security via the market price on 5-year Treasury notes for which they are exchangeable) and thus make it unattractive to investors to unload, this possibility is always present unless a rigid bond-support policy is in force. This similarity then, is not particularly striking.

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