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The Balance of Payments of the Sterling Area in 1954
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The recent weakness of the sterling-dollar rate has raised doubts as to developments in the international position of the sterling area. Since the middle of the year, the trade balance of the United Kingdom with the non-sterling world has indeed somewhat deteriorated, but its net foreign exchange position has continued to improve.

In the first half of 1954, the global as well as the dollar balance of payments of the sterling area, and of the United Kingdom in particular, showed greater strength than in any other postwar period. The United Kingdom earned large surpluses on current account with the outer sterling area and with the non-sterling world as a whole, and reduced its current deficit with the dollar area to an almost negligible amount. The entire sterling area had current surpluses not only with the non-sterling world as a whole, but also with the dollar area; a sizeable surplus would remain even if all "special" receipts (grants as well as troop expenditures and off-shore purchases) were eliminated.

On capital account, the United Kingdom experienced in that period a sizeable net outflow, its large net investments in the outer sterling area and the non-dollar non-EPU world exceeding net inflows of capital from the dollar and the EPU area. Its foreign exchange position also developed favorably: its gold and dollar reserves rose and its EPU debt declined considerably; the resulting improvement was much greater than the increase in its sterling liabilities.

Current accounts in the first half of 1954

For the United Kingdom, balance-of-payments data confirm the result of the previously published trade figures, which showed that in the first half of 1954 exports rose substantially more than imports (as compared with the first half of 1953); the trade deficit (with imports computed f.o.b.) was only £46 million, as against £151 million in the first half of 1953. Service transactions did not show much change, except for a large rise in "other" receipts, which include among many other items revenues from foreign oil investments; this rise was responsible for an increase in the net surplus on service account to £200 million, from £150 million in the first half of 1953.

About 70 per cent of the increase in exports went to the outer sterling area; this development was primarily responsible for the rise in the U. K. surplus on current account with the outer sterling area to £108 million, as compared with only £15 million in the first half of 1953.

In the transactions with the dollar area, exports declined by £8 million (about 4 per cent) from the first half of 1953, while imports declined by £18 million; in spite of the slight recession in the United States, the trade deficit with the dollar area was thus actually reduced by £10 million, and amounted to only £28 million. The surplus on service account rose by £12 million to £20 million, reflecting almost entirely an increase in "special" receipts from troop expenditures and off-shore purchases. The entire deficit on current account (net of defense aid) was thus reduced to £8 million, from £30 million in the first half of 1953.

The current surplus with the EPU area remained virtually unchanged at £52 million; both imports and exports showed significant increases, commensurate with the general rise in European economic activity. Current transactions with the rest of the non-sterling world showed almost complete equilibrium, as against a sizeable deficit last year. The total surplus with the non-sterling world was £46 million, in contrast to a deficit of £16 million in the first half of 1953.

For the outer sterling area, the published balance-of-payments data refer only to transactions with the United Kingdom, the dollar area, and the EPU area; however, trade with these three regions usually accounts for more than 80 per cent of the area's global trade. Total exports to these regions had virtually the same value as in the first half of 1953. An increase in exports to the United Kingdom and the EPU area was about balanced by a reduction in exports to the dollar area; this reduction amounted to £22 million or almost exactly 10 per cent of the figure for the first half of 1953. The U. S. recession thus apparently had a greater impact on the outer sterling area than on the United Kingdom, but in neither case was the effect large enough to produce a significant change in the international position; both these developments conformed to earlier predictions.

Imports of the outer sterling area from the United Kingdom and the EPU area rose substantially, but imports from the dollar area showed little change. In consequence, the trade surplus of the outer sterling area with the United Kingdom and the EPU area declined sharply, and trade with the dollar area, which in the first half of 1953 had shown a surplus of £9 million, resulted in a deficit of £13 million. Total trade of the outer sterling area with the two non-sterling regions covered by the data resulted in a surplus of only £11 million, as against £69 million in the first half of 1953.

On service account, the deficit of the outer sterling area with the United Kingdom rose somewhat, but the rise was overbalanced by the increase in the proceeds from gold sales to the United Kingdom to £67 million, from £31 million in the first half of 1953. In relation to the dollar and EPU areas, service account data cannot be exactly calculated since only the sums of service and capital accounts have been published; the combined figures indicate, however, that no important changes in these accounts took place in the first half of 1954.

Defense aid and capital accounts in the first half of 1954

Grant aid to the United Kingdom dropped from £68 million in the first half of 1953 to £24 million; receipts from military expenditures of the United States and Canada (troop expenditures and off-shore purchases) rose from £38 million to £49 million. Total "special" receipts thus declined from £96 million to £73 million.

Since the combined U. K. and outer sterling area current account surplus with the dollar area (net of defense aid) was about £85 million, the deduction of the other "special" receipts of £49 million would still leave a surplus of £36 million as against £14 million in the first half of 1953.

On capital account, the U. K. net investment in the outer sterling area amounted to £117 million, more than twice the figure for the first half of 1953. The amount this year was almost exactly equal to the current account surplus of the United Kingdom with the outer sterling area, while last year it exceeded substantially the surplus earned in that period. The fact that the United Kingdom now seems able to finance a substantial amount of net investments in the outer sterling area out of its own current surplus might prove to be an important factor in preserving the financial stability of the sterling area as a whole.

Net investment in the non-sterling world outside of the dollar and EPU areas amounted to £41 million, in contrast to a (negligible) net inflow of capital in the first half of 1953. This reversal may be connected with the fact that the United Kingdom this year was in current account equilibrium with that part of the world, as against a sizeable current deficit last year.

In contrast to these two regions of net investment, the United Kingdom experienced a significant inflow of capital from both the dollar and the EPU areas. The inflow from the dollar area amounted to £34 million, more than twice the figure for the first half of 1953. The inflow

from the EPU area was £36 million, as compared with an outflow of £5 million last year. The changes occurred predominantly in the sphere of "other" (private) capital transactions; it seems reasonable to assume that they were related to the reopening of the international gold and commodity markets in the United Kingdom and the general expectation of continued strength of the sterling position.

Foreign exchange position in the first half of 1954

The official gold and dollars reserves of the United Kingdom rose by £179 million, almost the same amount as in the first half of 1953. However, the share of that increase attributable to defense aid and other "special" receipts, plus capital transactions and transfers from the non-sterling world, was reduced to 80 per cent, from about 90 per cent last year. Main offsets to the drop in grant aid and in the current dollar surplus of the outer sterling area were the decline in the current dollar deficit of the United Kingdom and the increase in U. K. gold purchases from the outer sterling area.

Official holdings of non-dollar foreign exchange rose by £8 million and the debt to the European Payments Union declined by £23 million, making for a total improvement in the non-dollar non-sterling position by £31 million, as against £5 million in the first half of 1953.

The U. K. sterling liabilities rose by £120 million, as compared with £171 million in the first half of 1953. Virtually the entire increase (£118 million) occurred in the sterling balances of the outer sterling area: those of the U. K. dependent overseas areas rose by £86 million, those of the independent sterling countries by £32 million. Last year, the rise was smaller for the colonies, but much larger (£151 million) for the independent countries. The sterling balances of the non-sterling areas remained virtually unchanged this year, while in the first half of 1953 the balances of the dollar area rose somewhat and those of the other non-sterling countries declined sharply.

The rise in the balances of the outer sterling area was almost exactly equal to that of the net capital outflow to that area. The balance-of-payments figures do not indicate whether this equality was a mere coincidence or whether it reflected a tendency of those countries that receive capital from the United Kingdom to increase their liquid sterling assets. Data published by the independent members of the outer sterling area show that among these nations Ceylon, India, New Zealand, and South Africa increased their sterling holdings most substantially. In the case of Ceylon and New Zealand, the increase apparently coincided with a rise in the flow of capital from the United Kingdom. In the case of South Africa, the rise was probably connected with the reopening of the London gold market, since all sales of South African gold are now being channelled through London.

At first glance, the movement -- or rather lack of movement -- in the sterling balances of the dollar and EPU areas might be puzzling. It would seem reasonable to assume that the large inflow of capital from these areas, especially insofar as it was related to speculative hopes and to the reopening of the U. K. international gold and commodity markets, should have been accompanied by a corresponding rise in sterling balances, and in particular in the newly created "registered sterling" balances, which must be used for gold transactions. The lack of such an increase might be due to the fact that, had it not been for the inflow of capital, the sterling balances would probably have been reduced as the result of the current surplus of the sterling area with the non-sterling world. However, the interpretation of the data would be greatly facilitated if the published figures were made available on a country-by-country basis, distinguishing between "transferable", "security", and "registered" sterling balances, and were given month by month, just as the data on official gold and dollar holdings, rather than only twice a year.

A comparison between the changes in official foreign exchange holdings and in sterling liabilities shows that the net foreign exchange position of the United Kingdom improved greatly during the first half of 1954. Including the sterling liabilities to the outer sterling area, the net debit balance on foreign exchange account declined by £90 million, as compared with a decline by only £20 million in the first half of 1953; excluding the sterling liabilities to the outer sterling area -- which in some respects at least might be treated more like domestic rather than international obligations -- the balance declined by £208 million.

Developments in the second half of 1954

The optimistic view of the international position of the United Kingdom and the sterling area in general, which was confirmed by the balance-of-payments figures for the first half of 1954, has most recently seemed to be contradicted by the current weakness of the sterling-dollar rate. ^{1/} At the end of November 1954, the dollar spot rate for convertible sterling dropped to the lowest point in two years, and the discount for transferable sterling increased to about 3 per cent -- a quotation dangerously close to the figure at which commodity "switch" transactions in "cheap sterling", reducing the dollar proceeds of sterling area exports, would again become profitable.

^{1/} See also the paper prepared by Mr. Samuel I. Katz on Recent Developments in the Sterling Exchange Market (November 16, 1954).

The balance of current payments of the sterling area appears indeed to have developed somewhat less favorably in the second than in the first half of the year. However, the hitherto published figures on the foreign trade and the foreign exchange position of the United Kingdom in the second half of 1954 do not indicate a fundamental deterioration.

In the four-month period July through October 1954, the United Kingdom had a global trade deficit of only £160 million, as against £195 million in the corresponding period of 1953. 1/ However, the improvement was confined to the U. K. trade with the sterling area, in which the 1953 deficit of £42 million was replaced by a surplus of £23 million. In relation with the non-sterling world in general, and the dollar area in particular, the U. K. trade deficits rose from £153 million to £183 million, and from £84 million to £93 million, respectively.

The trade figures for November are expected to show a further increase in the deficit as the result of the London dock strike, and the trade balance of the outer sterling area with the non-sterling world also seems to have been less favorable than last year. Nevertheless, the trade data, and especially the small size of the increase in the dollar trade deficit, do not seem to justify any fear of an impending crisis in the international trade position of the United Kingdom.

The recent development of U. K. foreign exchange situation is even less alarming. It is true that the gold and dollar reserves of the United Kingdom dropped between the end of June and the end of November 1954 by the equivalent of £33 million, in contrast to a rise by £70 million in the corresponding period of 1953. However, at the same time, the U. K. debt to the European Payments Union was reduced in 1954 by the equivalent of £54 million (in part because of a gold payment of £35 million) while it had risen by £10 million in 1953; moreover, the United Kingdom repaid this year its outstanding dollar indebtedness to the International Monetary Fund in the equivalent of £40 million. Adding together the changes in gold and dollar reserves, the EPU debt, and the U. K. position in the International Monetary Fund, the net foreign exchange position of the United Kingdom in relation to the non-sterling world improved in the months from July through November 1954 by £61 million, almost exactly the same amount as in the corresponding period of 1953. These figures are particularly significant for the international position of the sterling area because they reflect capital and current transactions of the outer sterling area as well as of the United Kingdom itself.

1/ These figures are based on trade statistics, in which imports are computed c.i.f., and therefore present a considerably higher deficit than the balance-of-payments statistics, in which imports are computed f.o.b.

The increased trade surplus of the United Kingdom with the outer sterling area and the withdrawal of some foreign-held sterling balances indicate that the foreign sterling liabilities of the United Kingdom also have been reduced, making for a further improvement in the country's total net foreign exchange position. However, the payments on the U. K. debts to the United States and Canada, due at the end of the year, will presumably reduce its gold and dollar holdings well below the November figure.

Conclusions

With all due reservations on account of the incompleteness of published data, the following conclusions appear justified:

1. In the first half of 1954, the United Kingdom's balance of current account with the non-sterling world was in equilibrium, even disregarding defense aid as well as all other "special" receipts from military expenditures. In other words: the United Kingdom "stood on its own feet".

2. In that period, the sterling area as a whole had a sizeable surplus on current account with the dollar area, even disregarding all "special" receipts. In other words, under any reasonable definition of the "dollar gap", the sterling area's "gap" had been closed. This movement occurred in spite of the sizeable reduction in exports to the dollar area, caused by the mild recession in the United States.

3. "Special" dollar receipts, capital transactions, and transfers from the non-sterling world contributed somewhat less to the rise in U. K. gold and dollar reserves than in the first half of 1953.

4. The rise in official foreign exchange holdings was much greater than the rise in sterling liabilities; while the net foreign exchange position of the United Kingdom still showed a debit balance, this balance was substantially reduced.

5. Data on trade and foreign exchange developments during the second half of this year are less conclusive. The recent drop in the sterling dollar rate and the moderate rise in the U. K. trade deficit with the non-sterling world indicate some weakening of the current balance of payments; however, the continuing improvement in the net foreign exchange position of the United Kingdom seems to permit the judgment that the fundamental soundness of the international financial position of the sterling area has not been endangered.

APPENDIX

Table 1

United Kingdom Balance of Payments, 1953-54

(Millions of pounds sterling)

	<u>1953</u> <u>1st</u> <u>half</u>	<u>1953</u> <u>2nd</u> <u>half</u>	<u>1954</u> <u>1st</u> <u>half</u>
Imports (f.o.b.)	- 1,467	- 1,412	- 1,471
Exports and re-exports	<u>1,316</u>	<u>1,352</u>	<u>1,425</u>
Trade balance	- 151	- 60	- 46
Shipping (net)	65	55	74
Interest (net)	40	7	33
Government services (net)	- 78	- 79	- 74
Other services (net)	<u>123</u>	<u>184</u>	<u>167</u>
Service balance	150	167	200
Surplus on current account	- 1	107	154
Grant aid	58	47	24
Foreign investment (-)	- 37	- 156	- 88
Rise in £ liabilities, etc.	<u>166</u>	<u>56</u>	<u>89</u>
Rise in gold and dollar reserves	<u>186</u>	<u>54</u>	<u>179</u>

Source: U. K. Balance of payments 1946 to 1954 (White Paper, Cmd. 9291) Table 1 (Government service and grant aid figures corrected to conform to the table on "special receipts", p. 40).

APPENDIX

Table 2

United Kingdom Balance of Payments with Outer Sterling Area, 1953-54

(Millions of pounds sterling)

	<u>1953</u> <u>1st</u> <u>half</u>	<u>1953</u> <u>2nd</u> <u>half</u>	<u>1954</u> <u>1st</u> <u>half</u>
United Kingdom imports (f.o.b.)	- 696	- 621	- 704
United Kingdom exports & re-exports	<u>598</u>	<u>611</u>	<u>673</u>
Trade balance	- 98	- 10	- 31
Service balance	<u>113</u>	<u>166</u>	<u>139</u>
Total current balance	15	156	108
Foreign investment (-)	- 50	- 98	- 117
Transfers <u>1/</u>	<u>- 175</u>	<u>- 101</u>	<u>- 109</u>
Rise in £ liabilities (-)	- 210	- 43	- 118

1/ Including gold purchases

Source: Cmd. 9291, Table 2.

APPENDIXTable 3United Kingdom Balance of Payments with non-Sterling Area, 1953-54

(Millions of pounds sterling)

	<u>1953</u> <u>1st</u> <u>half</u>	<u>1953</u> <u>2nd</u> <u>half</u>	<u>1954</u> <u>1st</u> <u>half</u>
Imports (f.o.b.)	- 771	- 791	- 767
Exports & re-exports	<u>718</u>	<u>741</u>	<u>752</u>
Trade balance	- 53	- 50	- 15
Service balance	<u>37</u>	<u>1</u>	<u>61</u>
Total current balance	- 16	- 49	46
Grant aid	58	47	24
Foreign investment (-)	13	- 58	29
Transfers <u>1/</u>	175	101	109
Rise in £ liabilities, etc.	- <u>44</u>	<u>13</u>	- <u>29</u>
Rise in gold and dollar reserves	186	54	179

1/ Including gold purchases

Source: Cmd. 9291, Table 2 (service and grant aid figures corrected)

APPENDIX

Table 4

United Kingdom and Outer Sterling Area Balance of Payments with Dollar Area, 1953-54
(Millions of pounds sterling)

	<u>1953</u> <u>1st half</u>	<u>1953</u> <u>2nd half</u>	<u>1954</u> <u>1st half</u>
U. K. imports (f.o.b.)	- 254	- 265	- 236
U. K. exports & re-exports	<u>216</u>	<u>225</u>	<u>208</u>
U. K. trade balance	- 38	- 40	- 28
U. K. service balance	<u>8</u>	<u>- 47</u>	<u>20</u>
Total U. K. current balance	- 30	- 7	- 8
Grant aid	58	47	24
U. K. capital balance	<u>15</u>	<u>- 20</u>	<u>34</u>
Total U. K. balance	<u>43</u>	<u>- 60</u>	<u>50</u>
OSA imports (f.o.b.)	- 209	- 217	- 209
OSA exports & re-exports	<u>218</u>	<u>187</u>	<u>196</u>
OSA trade balance	9	- 30	- 13
OSA service & capital balance	42	65	39
OSA gold sales	<u>31</u>	<u>48</u>	<u>67</u>
Total OSA balance	<u>82</u>	<u>83</u>	<u>93</u>
EPU area transfers (net)	34	- 16	17
Other transfers (net)	<u>19</u>	<u>27</u>	<u>20</u>
Total transfers (net)	53	11	37
Rise in £ liabilities	<u>8</u>	<u>20</u>	<u>- 1</u>
Rise in gold and dollar reserves	186	54	179

Source: Cmd. 9291, Table 9 (U. K. service and grant figures corrected)

APPENDIX

Table 5United Kingdom "Special" Receipts, 1953-54

(Millions of pounds sterling)

	<u>1953</u> <u>1st</u> <u>half</u>	<u>1953</u> <u>2nd</u> <u>half</u>	<u>1954</u> <u>1st</u> <u>half</u>
Troop expenditures in United Kingdom	30	25	35
U. S. off-shore purchases	<u>8</u>	<u>10</u>	<u>14</u>
Total U. S. military expenditures	38	35	49
Grant aid	<u>58</u>	<u>47</u>	<u>24</u>
Total "special" receipts	96	82	73

Source: Cmd. 9291, page 40.

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APPENDIX

Table 6

United Kingdom and Outer Sterling Area Balance of Payments with

EPU Area, 1953-54

(Millions of pounds sterling)

	<u>1953</u> <u>1st</u> <u>half</u>	<u>1953</u> <u>2nd</u> <u>half</u>	<u>1954</u> <u>1st</u> <u>half</u>
U. K. imports (f.o.b.)	- 335	- 343	- 359
U. K. exports & re-exports	<u>374</u>	<u>385</u>	<u>398</u>
U. K. trade balance	39	38	39
U. K. service balance	<u>15</u>	<u>14</u>	<u>13</u>
Total U. K. current balance	54	52	52
U. K. capital balance	- <u>5</u>	- <u>40</u>	- <u>36</u>
Total U. K. balance	49	12	88
OSA imports (f.o.b.)	- 209	- 238	- 256
OSA exports & re-exports	<u>269</u>	<u>268</u>	<u>280</u>
OSA trade balance	60	30	24
OSA service & capital balance	- <u>25</u>	- <u>33</u>	- <u>32</u>
Total OSA balance	35	- 3	- 8
Transfers (net)	- 13	- 32	- 26
Rise in £ liabilities	- <u>20</u>	<u>2</u>	- <u>1</u>
EPU surplus	51	- 21	53

Source: Cmd. 9291, Tables 10 and 11

APPENDIX

Table 7

Outer Sterling Area Balance of Payments, 1953-54 1/

(Millions of pounds sterling)

		<u>1953</u> <u>1st</u> <u>half</u>	<u>1953</u> <u>2nd</u> <u>half</u>	<u>1954</u> <u>1st</u> <u>half</u>
Imports from:	United Kingdom	- 598	- 611	- 673
	Dollar Area	- 209	- 217	- 209
	EPU Area	- 209	- 238	- 256
	Total	-1,016	-1,066	-1,138
Exports to:	United Kingdom	696	621	704
	Dollar Area	218	187	196
	EPU Area	269	268	280
	Total	1,183	1,076	1,180
Trade balance with:	United Kingdom	98	10	31
	Dollar Area	9	- 30	- 13
	EPU Area	60	30	24
	Total	167	10	42
Service & Capital balance with:	United Kingdom	- 63	- 68	- 22
	Dollar Area <u>2/</u>	73	113	106
	EPU Area	- 25	- 33	- 32
	Total	- 15	12	52
Rise in £ balances	210	43	118	
Residual	- 58	- 21	- 24	

1/ Fragmentary

2/ Including gold sales to United Kingdom

Source: Cmd. 9291, Table 2 and pages 43 and 45.

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APPENDIX

Table 8United Kingdom Foreign Exchange Position, 1952-54

(Millions of pounds sterling)

	<u>December 31, 1952</u>	<u>June 30, 1953</u>	<u>December 31, 1953</u>	<u>June 30, 1954</u>
<u>£ Liabilities to:</u>				
Dollar Area	34	42	62	61
Other non-£ Area	<u>721</u>	<u>675</u>	<u>711</u>	<u>709</u>
Total non-£ Area	<u>755</u>	<u>717</u>	<u>773</u>	<u>770</u>
United Kingdom Colonies	1,034	1,093	1,103	1,189
Other £ Area	<u>1,648</u>	<u>1,799</u>	<u>1,832</u>	<u>1,864</u>
Total £ Areas	<u>2,682</u>	<u>2,892</u>	<u>2,935</u>	<u>3,053</u>
Non-Territory organizations	<u>567</u>	<u>566</u>	<u>509</u>	<u>514</u>
Total	<u>4,004</u>	<u>4,175</u>	<u>4,217</u>	<u>4,337</u>
Holdings of non-dollar currency (-)	- 40	- 16	- 10	- 18
EPU debt	<u>219</u>	<u>190</u>	<u>198</u>	<u>175</u>
Total non-dollar liabilities	<u>4,183</u>	<u>4,349</u>	<u>4,405</u>	<u>4,494</u>
Gold & Dollar reserves (-)	- <u>659</u>	- <u>845</u>	- <u>899</u>	- <u>1,078</u>
Net foreign exchange liabilities	<u>3,524</u>	<u>3,504</u>	<u>3,506</u>	<u>3,416</u>
Net foreign exchange liabilities to non-£ Area	<u>842</u>	<u>612</u>	<u>571</u>	<u>363</u>

Source: Cmd. 9291, Tables 13 and 14.

APPENDIX

Table 9United Kingdom Foreign Trade, 1953-54 1/

(Millions of pounds sterling)

		<u>1953</u>	<u>1953</u>	<u>1954</u>	<u>1954</u>
		<u>1st</u>	<u>2nd</u>	<u>1st</u>	<u>2nd</u>
		<u>half</u>	<u>half</u>	<u>half</u>	<u>half</u> 2/
Imports (c.i.f.):	global	1,692	1,653	1,678	1,606
	from £ area	794	710	797	645
	from \$ area	297	338	272	320
	from EPU area	385	385	392	413
Exports & re-exports:	global	1,310	1,378	1,399	1,366
	to £ area	608	661	678	679
	to \$ area	204	200	186	181
	to EPU area	373	377	392	380
Trade balance:	global	- 382	- 275	- 279	- 240
	with £ area	- 186	- 49	- 119	+ 34
	with \$ area	- 93	- 138	- 86	- 139
	with EPU area	- 12	- 8	0	- 33

1/ The data presented in this table are based on trade statistics and not strictly comparable with the data presented in Table 1-7, which are based on balance-of-payments statistics; in particular, imports in this table are computed c.i.f. rather than f.o.b.

2/ July-October data at semi-annual rates.

Source: For 1954, 2nd half: The Economist (London), November 26, 1954;
all other: Board of Trade, Report on Overseas Trade, October 1954.

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