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Foreign Exchange Markets and Reserve
Developments -- May and June

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Summary

Foreign exchange developments in May and June were dominated by emergency measures to end the intense selling pressures on the Canadian dollar, by further large reserve accruals by European countries, and by payments difficulties in India, Argentina, Brazil, and Chile. The dollar weakened against the Deutsche Mark and Swiss franc and was at its lower limit against other major European currencies.

Doubts that the new par value of the Canadian dollar, established on May 2, would be maintained led to a resumption of speculation against the Canadian dollar towards the end of May, which became intensified after the indecisive Parliamentary elections on June 18. To halt the heavy drain on reserves, the Canadian Government on June 24 introduced an emergency austerity program (involving reduced government spending, a tighter monetary policy, and import surcharges) and announced arrangements whereby its foreign exchange reserves would be increased (or potentially increased) by \$1.05 billion. These arrangements included (1) a \$300 million drawing from the International Monetary Fund; (2) establishment of reciprocal balances, equivalent to \$250 million each way, between the Bank of Canada and the Federal Reserve System; (3) a \$100 million deposit from the Bank of England; and (4) a \$400 million credit line from the Export-Import Bank. Following these measures, the Canadian dollar recovered to and rose above its par value.

After adjustments for special government transactions, the Common Market countries reported reserve gains of \$242 million in May, with France reporting a gain of \$143 million in June. Britain reported further accruals of \$89 million in May and June, while Switzerland gained \$128 million in June.

The U.S. balance-of-payments deficit was reduced sharply in the second quarter, but a substantial part of the improvement apparently resulted from capital movements related to uncertainties about the Canadian dollar.

In Asia, Japan's reserves continued to rise with the aid of U.S. bank credits, but India had to take steps to avert an impending foreign exchange crisis. In Latin America, Argentina grappled with speculation against the peso, while Brazil depreciated the cruzeiro and tightened exchange controls.

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

	1961	1962			
	Jan.-Dec.	Jan.-Mar.	April	May	June
Belgium	+ 262	- 10	- 57	+ 16	- 64
France	+1,379	+261	+123	+174	+143
Germany	+1,227	+ 63	-128	+ 52	
Italy	+ 577	-160	- 5	- 65	
Netherlands b/	+ 175	- 19	+ 16	+ 65	- 49
Total Common Market	+3,620	+135	- 51	+242	
Switzerland	+ 546	- 87	- 13	- 3	+128
United Kingdom	-1,527	+519	+ 90	+ 73	+ 16

Note: Actual unadjusted reserve changes and reserve holdings for these and other countries are found in Table I in the Appendix at the end of this paper.

a/ For all countries, adjustments have been made, when applicable, for prepayments of public debt, changes in IMF position, and reciprocal balances with the Federal Reserve System. Other adjustments are: (1) for Germany, changes in commercial banks' balances with foreign banks and money market investments abroad, and Bundesbank loans to the IBRD; (2) for France, scheduled debt repayments in June 1962; (3) for France and Belgium, indemnity payments from Germany; (4) for Switzerland, short-term foreign investments by the Confederation (to the extent reported), and 1961 Confederation long-term loan to the United Kingdom.

b/ Net reserves.

Adjusted for special governmental transactions, the Common Market countries added to their reserves \$135 million in the first quarter and an average of \$96 million in April and May compared with an average monthly surplus of \$300 million in 1961. In 1962, France has continued its rapid reserve accruals but the German increases have been significantly lower. Despite the 5 per cent appreciations of the D-mark and the Dutch guilder, the foreign trade of the Common Market countries has changed little since the first quarter of 1961 when German exports and the German trade surplus were at an all-time peak. Despite the reduced German surplus, the trade balance of the Six was slightly more favorable in the first four months of 1962 than in the first quarter of 1961, as the following seasonally-adjusted figures show:

Net Exports
(In millions of U.S. dollars at monthly rates)

	1961				1962		
	<u>I</u>	<u>II</u>	<u>III</u>	<u>IV</u>	<u>I</u>	<u>April</u>	<u>May</u>
Common Market	+ 18	+ 21	+ 88	- 63	a/ - 69	+ 41	n.a.
<u>Compare:</u>							
Switzerland	- 55	- 49	- 58	- 58	- 78	- 86	- 71
United Kingdom	-182	-119	- 94	-114	-135	- 87	-137
United States	+546	+446	+364	+426	+392	+421	+390

a/ Imports are overstated at an average monthly rate of \$52 million. A change in French statistical procedures caused allocation to January 1962 of \$155 million of French imports actually effected in 1961.

The marked improvement in Britain's trade balance, which has contributed to recent reserve accruals, has reflected reduced imports, rather than a marked expansion in exports, since the first quarter of 1961.

Since early 1961, the combined Common Market exports have risen much more substantially than have those of Britain or the United States, as shown by the following seasonally-adjusted figures:

Exports
(In millions of U.S. dollars at monthly rates)

	1961				1962		
	<u>I</u>	<u>II</u>	<u>III</u>	<u>IV</u>	<u>I</u>	<u>April</u>	<u>May</u>
Common Market	2,625	2,720	2,762	2,741	2,846	2,920	n.a.
<u>Compare:</u>							
United Kingdom	897	895	909	901	892	918	927
United States	1,698	1,610	1,666	1,736	1,715	1,795	1,775
Switzerland	166	168	171	174	181	162	185
Canada	472	476	493	504	484	n.a.	n.a.

(Detailed foreign trade statistics of major countries are found in Appendix Table II on page 11.)

Exchange rates

Following the adoption of a fixed parity effective May 2, the Canadian dollar declined almost uninterruptedly from 92.78 U.S. cents on May 3 to 91.75 U.S. cents on May 31 in response to the continuing selling pressures. Official support operations maintained the rate at approximately 91.75 U.S. cents during the first 21 days of June. After announcement on June 24 of the emergency measures to defend the Canadian dollar, that currency rose to 92.61 U.S. cents on June 27, and was generally quoted at from 92.5 to 92.8 U.S. cents from then through July 12.

The beginning of renewed capital flows to Switzerland and a consequent abrupt strengthening of the Swiss franc coincided with the adoption of the fixed par value for the Canadian dollar on May 2. The Swiss authorities had supported the franc in April to keep it from falling below 23.0 U.S. cents. The rate rose to 23.05 cents on May 3, continued to rise during the rest of the month, and reached the present de facto upper limit of 23.17 cents on May 31. The Swiss franc held at this upper limit throughout June and in early July.

The pound sterling was traded at about 281-1/4 U.S. cents during most of May but weakened seasonally in late May and early June, falling below 281 cents. The pound was traded at 280-3/4 U.S. cents on July 12.

The Deutsche Mark was traded at only slightly above its par of 25.0 U.S. cents in May but strengthened in June, to 25.06 cents on June 29, as German commercial banks repatriated funds. There was a further rise to 25.10 U.S. cents by July 6, probably caused in part by foreign participation in a \$100 million Federal Government issue in Germany.

The French franc, Italian lira, and Netherlands guilder remained at, or very close to, their upper limits in May, June and early July.

The Philippine peso was relatively stable at about P3.90 per dollar in May and June. The Indonesian rupiah depreciated further in the Djakarta free market from Rp. 600 per dollar on May 4 to Rp. 900 to the dollar on June 28. The rate for SIVA permits under the new export retention system was Rp. 988 per dollar on June 13.

The Brazilian cruzeiro depreciated 14 per cent, to 420 to the dollar, in the unauthorized market between mid-May and mid-July, reflecting the continuing inflationary pressures. The Bank of Brazil rate, which had been pegged since January at 318 cruzeiros per dollar, was changed to 359 cruzeiros per dollar on May 21 and then to 365 cruzeiros per dollar on June 30. Effective July 7, all foreign exchange must "temporarily" be surrendered to the Bank of Brazil. On July 2, the Argentine authorities imposed a 100 per cent advance deposit requirement on importers, and a tax on exporters which amounts to fixing the effective rate received for

exports at 110 pesos per dollar, but on July 11 suspended the application of this tax for 30 days. These measures followed a 20 per cent depreciation of the peso in June, to 135 per dollar on June 29, due mainly to speculation. The peso firmed to 124 per dollar on June 12. Continuing inflationary pressures in Chile were reflected in a further 10 per cent depreciation of the escudo in the free market in June, to 1.74 escudos to the dollar.

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

	<u>U. K.</u>	<u>Canada</u>	<u>Germany</u>	<u>Switzer- land</u>	<u>Nether- lands</u>	<u>France</u>	<u>Italy</u>
Parity	280.00	b/92.50	25.00	22.87	27.62	20.26	.1600
Official limits:							
Buying	278.00	b/91.575	24.81	c/22.47	27.42	20.10	.1588
Selling	282.00	b/93.425	25.19	c/23.28	27.84	20.41	.1612
<u>Date</u>							
April 27	281.20	95.20	24.99	23.02	27.81	20.41	.1611
May 4	281.26	92.71	25.00	23.07	27.82	20.41	.1611
11	281.22	92.41	25.00	23.08	27.83	20.41	.1611
18	281.25	91.88	25.00	23.10	27.83	20.41	.1610
25	281.13	91.80	25.03	23.15	27.83	20.41	.1611
June 1	280.95	91.73	25.02	23.17	27.83	20.41	.1611
8	280.79	91.72	25.03	23.17	27.77	20.41	.1611
15	280.93	91.73	25.04	23.17	27.80	20.41	.1611
22	280.90	91.85	25.06	23.17	27.83	20.41	.1611
29	280.84	92.45	25.06	23.17	27.83	20.41	.1611
July 6	280.67	92.60	25.10	23.17	27.83	20.41	.1611
13	280.71	92.66	25.12	23.17	27.83	20.41	.1611

a/ Certified noon buying rates in New York for cable transfers.

b/ Effective May 3, 1962. c/ 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.

International Monetary Fund transactions

The major IMF transactions in May were a \$20 million drawing by the United Arab Republic, and another \$70 million repurchase by the United Kingdom which increased the IMF's holdings of U.S. dollars, Canadian dollars, Deutsche Marks and Swedish kronor. The \$300 million Canadian drawing on June 24 included \$100 million of sterling, \$80 million each of Deutsche Marks and French francs, and \$20 million each of Netherlands guilders and Belgian francs. The IMF granted a \$100 million standby to India on July 9 which may be drawn on over a 12-month period.

Net Change in IMF Holdings of Major Currencies
(Millions of dollars equivalent)

Currency of:	Net Change				Holdings, May 31	
	Apr.	May	June a/	Apr.--Jun. Total	Amount	Per cent of quota
United States	+ 22	+ 24		+ 46	2,719	66
Canada	+ 20	+ 20	+300	+340	388	71
Belgium	+ 15	--	- 20	- 5	211	63
France	--	--	- 80	- 80	389	49
Germany	+ 35	+ 20	- 80	- 25	281	36
Italy	--	- 5		- 5	42	16
Netherlands	--	--	- 20	- 20	215	52
United Kingdom	- 70	- 75	-100	-245	2,113	108

a/ Canadian drawing only.

Reserve Developments in Selected Countries

North America

The over-all deficit in the United States balance of payments (measured by the increase in U.S. liquid liabilities to foreigners less the increase in U.S. reserves of gold and convertible foreign currencies) was substantially reduced in the second quarter of 1962. The deficit for April was approximately \$200 million; data for May and preliminary data for June indicate that the deficit was negligible in both those months. However, much of this improvement apparently resulted from capital movements (including leads and lags in commercial payments) related to uncertainties about the Canadian dollar, rather than from more fundamental and lasting adjustments. Net outflows of private capital from the United States to areas other than Canada appear to have continued at the high 1960-61 rate through May of this year. A small underlying improvement in the U.S. trade position this year is indicated by the trade figures through May. (See Table II in the Appendix.)

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

	1961			1962			
	Jan.- June	July- Sept.	Oct.- Dec.	Jan.- Mar.	Apr.	May	June
Decline (+) in total U.S. gold stock	+201	+146	+510	+304	+124	+ 61	a/ --
Decline (+) in U.S. official holdings of convertible foreign currencies	-186	+124	- 54	-114	- 13	b/- 50	n.a.
Change in dollar holdings of foreign countries at F.R. Banks c/	--	+405	- 63	-302	-202	+196	+585
Other d/	+287	+233	+882	+673	+290	n.a.	n.a.
Net transfers to foreigners	+302	+908	+1275	+561	+199	n.a.	n.a.

a/ Treasury gold stock only. b/ Federal Reserve System holdings only.

c/ Deposits and holdings of U.S. Government securities.

d/ 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.

Canadian reserves declined \$102 million in May as heavy selling pressures on the Canadian dollar continued despite the depreciation of that currency on May 2. Speculative pressures intensified after the indecisive Parliamentary elections on June 18, and reserves fell rapidly from \$1,493 million at the end of May to about \$1.1 billion on June 24. The rise in reserves to \$1,809 million at the end of June reflects the Canadian IMF drawing, the reciprocal balance arrangement with the Federal Reserve System, and the credit from the Bank of England.

Europe

British reserves, adjusted for special transactions, increased \$73 million in May and \$16 million in June. There has been a continuous decline in adjusted reserve accruals since March. Actual reserves rose \$53 million in May; this increase should be adjusted upward for a \$70 million IMF repayment, and downward for the purchase of \$50 million of sterling by the Federal Reserve System. Actual reserves decreased \$92 million in June before taking account of (1) \$100 million foreign exchange cost of the United Kingdom's assistance to Canada, and (2) \$8 million of interest payments to the U.S. on the 1946 loan. Canada drew \$100 million of sterling from the IMF.

On a seasonally-adjusted basis, Britain's trade deficit rose from \$87 million in April to \$137 million in May. (See Table II.) While exports continued to increase slowly, imports rose substantially because of temporary increases in demand for food and feed imports resulting from unseasonably cold weather.

French reserve movements show a continuation of the very large structural balance-of-payments surplus. The May reserve gain amounted to \$175 million with no known special transactions. In June, actual reserves decreased \$8 million. However, in June France made scheduled payments, totaling \$71 million, of principal and interest on debts owed to the United States and Canada, and Canada drew \$80 million of French francs from the IMF. "Normal" operations were officially reported to have yielded a \$143 million accrual.

In May, official gross reserves of Germany increased \$48 million, and gross German commercial bank foreign assets (bank balances and money market investments) rose \$24 million. This \$72 million increase in combined official and commercial bank holdings compares with a \$25 million increase in March and an adjusted \$128 million decrease in April. In June, official gross reserves rose \$159 million despite Canada's drawing of \$80 million of DM's from the IMF, largely because commercial banks liquidated foreign assets in June in response to tighter domestic money market conditions. Early in June, the Treasury bill rate was raised another one-eighth per cent to 2-1/4 per cent. Germany's trade surplus, seasonally-adjusted, declined again from \$137 million in April to \$62 million in May.

There was a sharp rise in official Swiss reserves of \$128 million in June, following a \$17 million drop in May. The decrease in May resulted mainly from \$14 million of short-term foreign investments by the Swiss Confederation, and occurred despite reported flows of capital to Switzerland from Canada and the United Kingdom and a rapid strengthening of the Swiss franc. The large reserve accrual in June reportedly resulted from both window-dressing operations by Swiss banks and returns of Swiss funds from foreign stock markets. In early July Switzerland continued to experience heavy accretions to official holdings, which rose a further \$50 million in the first week of the month.

Belgian reserves rose \$16 million in May despite a further reduction of \$5.8 million in the foreign-currency debt of the Belgian Treasury. (It is now known that \$31.5 million of such debt retirement was the primary cause of the \$42 million drop in Belgian reserves in April). From May 31 to July 2, Belgian reserves declined \$34 million despite a \$50 million reciprocal currency agreement between the National Bank of Belgium and the Federal Reserve System. The Belgian press has reported \$65 million of foreign-currency debt repayments in June. A decline in Belgian reserves of \$28.5 million in the week ending July 2 immediately followed Canada's drawing of \$20 million of Belgian francs from the IMF.

In the first four months of this year, data for Italy show a \$145 million decrease in official reserves and a \$45 million decline in the net foreign assets of the authorized banks (in foreign currencies and lire). This is a period of seasonal weakness in the Italian balance of payments; in the comparable period of 1961, these two series showed a combined decrease of \$117 million. Account must also be taken of the U.S. Treasury's borrowing of \$75 million of lire from the Bank of Italy, which increased the authorized banks' lira liabilities to foreigners and thereby reduced their net foreign assets. In May, official reserves fell \$70 million. However, because of the large volume of swap transactions being made between the Italian Foreign Exchange Office and the banks, a change in official reserves alone cannot be taken as an indicator of the change in the over-all reserve position.

Asia and Africa

Further reserve gains by Japan of \$27 million in May and \$37 million in June brought Japan's total reserve increase since the beginning of this year to \$237 million. However, \$205 million of the increase reflects the special short-term credits from U.S. banks. In June, Japan drew an additional \$24 million of the \$125 million credit arranged with seven U.S. banks in January, bringing such drawings to \$105 million. Japan's seasonally-adjusted trade deficit contracted from \$121 million in April to \$30 million in May and \$19 million in June. (See Table II.) This deficit has now been reduced to an average of \$89 million per month in the first half of this year, well below the average of \$166 million in the second half of last year.

Because of continuing losses of reserves, India in late June cut import licenses severely, and in early July obtained a \$100 million stand-by from the IMF. The gold and foreign exchange holdings of the Reserve Bank of India decreased another \$68 million in the April-June quarter to \$452 million on June 29, a record low and close to the statutory minimum of about \$420 million.

Despite continued reductions of its short-term foreign indebtedness, Philippine reserves rose \$17 million in May to \$143 million.

South African reserves increased again by \$67 million in May-June in continued reflection of import and exchange controls and high levels of gold production and merchandise exports. The favorable balance of payments situation, in what is normally a deficit period, permitted a reduction in Bank rate from 4-1/2 to 4 per cent on June 13.

APPENDIX

Table I

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

	<u>1961</u>		<u>1962</u>				Total holdings, June 30
	<u>Jan.- Dec.</u>	<u>Jan.- Mar.</u>	<u>Mar.</u>	<u>Apr.</u>	<u>May</u>	<u>June</u>	
Belgium	+ 235	+ 5	+ 13	- 42	+ 16	<u>a/- 34</u>	<u>a/ 1,602</u>
France	+ 869	+282	+164	+ 97	+174	- 8	3,484
Germany: Official	- 483	-463	+232	- 56	+ 48	+159	6,825
Commercial banks ^{b/}	+ 380	+601	-207	- 37	+ 24		<u>c/ 1,283</u>
Italy: Official	+ 339	-140	- 44	- 5	- 70		3,204
Authorized banks ^{d/}	+ 6	- 61	- 53	+ 16			<u>e/- 115</u>
Netherlands ^{f/}	+ 29	+ 26	+ 57	+ 16	+ 65	<u>a/- 19</u>	<u>a/ 1,752</u>
Total Common Market	+1,375	+250	+162	- 10			
Switzerland	+ 436	-151	- 44	- 13	- 17	+128	2,705
United Kingdom	+ 87	+134	+ 28	+ 20	+ 53	- 92	3,433
Canada	+ 227	-346	- 37	-114	-102	+316	1,809
Japan	- 338	+ 76	+ 47	- 2	+ 27	+ 37	1,623
South Africa	+ 149	+ 86	+ 30	+ 28	+ 36	+ 31	571
Venezuela	- 27	- 28	- 2	+ 59	- 60	- 21	491

a/ To July 2.

b/ Balances with foreign banks and money market investments abroad.

c/ End of May.

d/ Net foreign assets in foreign currencies and lire.

e/ End of April.

f/ Net reserves.

APPENDIX

Table II

Seasonally-Adjusted Foreign Trade, Selected Countries
(In millions of dollars; monthly average or month)

	1961				1962			
	I	II	III	IV	I	Apr.	May	June
<u>Belgium-Lux.</u>								
Imports c.i.f.	352	347	348	353	361	354	n.a.	n.a.
Exports f.o.b.	303	336	339	337	359	358	n.a.	n.a.
Balance	- 49	- 11	- 9	- 16	- 2	+ 4		
<u>France</u>								
Imports c.i.f.	538	561	550	605	a/620	584	615	n.a.
Exports f.o.b.	588	609	633	595	630	618	581	n.a.
Balance	+ 50	+ 48	+ 83	- 10	+ 10	+ 34	- 34	
<u>Germany</u>								
Imports c.i.f.	852	933	907	955	989	1,021	1,048	n.a.
Exports f.o.b.	1,047	1,078	1,061	1,060	1,101	1,169	1,110	n.a.
Balance	+195	+145	+154	+ 98	+112	+148	+ 62	
<u>Italy</u>								
Imports c.i.f.	434	437	449	446	488	487	n.a.	n.a.
Exports f.o.b.	324	344	363	388	380	381	n.a.	n.a.
Balance	-110	- 93	- 80	- 58	-108	-106		
<u>Netherlands</u>								
Imports c.i.f.	431	421	420	439	457	433	n.a.	n.a.
Exports f.o.b.	364	351	365	361	376	394	n.a.	n.a.
Balance	- 67	- 70	- 55	- 78	- 81	- 39		
<u>Total, Common Market</u>								
Imports c.i.f.	2,607	2,699	2,674	2,797	2,915	2,879	n.a.	n.a.
Exports f.o.b.	2,625	2,720	2,762	2,741	2,846	2,920	n.a.	n.a.
Balance	+ 18	+ 21	+ 88	- 63	- 69	+ 41		
<u>Switzerland</u>								
Imports c.i.f.	221	217	229	232	259	248	256	n.a.
Exports f.o.b.	166	168	171	174	181	162	185	n.a.
Balance	- 55	- 49	- 58	- 58	- 78	- 86	- 71	
<u>United Kingdom</u>								
Imports c.i.f.	1,079	1,014	1,003	1,015	1,027	1,005	1,064	n.a.
Exports f.o.b.	897	895	909	901	892	918	927	n.a.
Balance	-182	-119	- 94	-114	-135	- 87	-137	n.a.
<u>Canada</u>								
Imports f.o.b.	469	446	480	501	512	n.a.	n.a.	n.a.
Exports f.o.b.	472	476	493	504	484	n.a.	n.a.	n.a.
Balance	+ 3	+ 30	+ 13	- 3	- 38			
<u>Japan</u>								
Imports c.i.f.	427	464	506	546	492	482	477	439
Exports f.o.b.	343	351	357	364	371	361	447	420
Balance	- 84	-113	-149	-182	-121	-121	- 30	-19
<u>United States</u>								
Imports f.o.b.	1,152	1,164	1,302	1,310	1,323	1,374	1,385	n.a.
Exports f.o.b.	1,698	1,610	1,666	1,736	1,715	1,795	1,775	n.a.
Balance	+546	+446	+364	+426	+392	+421	+390	

(Footnotes on the following page.)

Footnotes:

a/ Imports for January-March are overstated at an average monthly rate of \$52 million. Because of a change in statistical procedures, the January 1962 imports figure includes \$155 million of imports actually effected in 1961.

Sources: For the United States, U.S. Census Bureau; for all other countries, OECD.