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January 4, 1966

Economic Developments in France,
September-December 1965

20 pages

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Summary

In the period under review, expanding consumer and other demands pulled French industrial production to new high levels.^{1/} The gains were achieved without much further upward price movement. In financial markets, Treasury operations led to unexpected tightness in the money market, and bond yields also advanced. Imports rose sharply, but further increases in exports helped to keep the over-all balance of payments in sizable surplus.

Seasonally adjusted industrial production (excluding construction) rose in each month from June to October, to a level 6.3 per cent above the recession low in January 1965; at an annual rate, the rise from January to October was 8.4 per cent. Consumer demand, which had started the economy upward again last spring, continued to be the main demand force behind the rising level of total output, and it became particularly buoyant in the automobile sector where depressed conditions had prevailed for over a year. Consumer incomes were favorably affected by recent increases in working hours and by a levelling out of the rate of increase in wage rates, which earlier had been slowing down. Rising exports added to incomes, as did the upward trend of government outlays for both consumption and investment. Although the housing boom

^{1/} For a review of earlier developments, see Economic Developments in France: June-September 1965, October 4, 1965.

showed signs of tapering off, total construction activity continued to advance on the strength of public works programs. Private investment demand was still believed to be lagging, but the outlook for business investment plans was brightened by rising order backlogs and declining inventories in most branches of manufacturing, as well as by the increasingly optimistic view which producers themselves took with regard to production levels in the next few months.

Demand pressures were not strong enough to upset the favorable trend of French prices, which continued to increase at quite moderate rates: 1 to 1-1/2 per cent a year for wholesale prices, and about 2-1/2 per cent yearly for consumer prices. These rates were less than half of those in the pre-stabilization years 1962-63, and compared favorably with recent rates of price rise in other major European countries.

Rising output has not required any speeding up of the rate of bank credit expansion. Despite the removal of the quantitative limits on bank credit expansion at the end of last June, credit outstanding rose more slowly from June through the end of October than last year at the same time. At the end of October, outstanding credits were up 9-1/2 per cent over a year earlier. The money market became tight in November, quite contrary to the expectation that monetary ease would prevail after the September slash in the banks' liquid assets reserve requirement. This tightening stemmed from large-scale retirements of

Treasury debt to the Bank of France. The reasons for the sudden improvement in the Treasury's cash position are not yet clear; in the first nine months of the year, cash receipts and disbursements were both up 9 per cent over 1964 (more than the 7 per cent year-to-year rise shown by the 1965 budget). Operations were virtually in balance in both periods. The banks' reserve requirement was reduced again in December to ease money market tensions which typically become most acute at the very end of the month. Long-term bond yields rose about 15 basis points from the end of August to mid-December. Part of the upward pressure on rates can be ascribed to the increase in the total volume of bond flotations, caused largely by the Treasury's one billion franc issue, to be used for relending to industry, in October.

French imports began to respond to domestic recovery after mid-1965. In November, imports were up 11 per cent over the second quarter monthly average, after seasonal adjustment. The impact of this rise on the French balance of payments was offset, however, by a combination of seasonal factors and a further sharp gain in exports. French official reserve gains dropped off in September, and were almost nil in October, when improved sentiment towards the pound sterling affected leads and lags. But reserve accruals have resumed again, amounting to \$80 million in November and about \$25 million in the first half of December.

Industrial production continues to rise

French industrial production moved up into new high ground during the summer and autumn. In June, the general index (commonly used in recent years to measure changes in industrial production) had already regained its previous high. Subsequently, this index (which excludes construction) rose by 3.4 per cent (seasonally adjusted) from May-June to October, to a level 6.3 per cent above the January 1965 recession low. (See Table 1.) At an annual rate, the rise from January to October was a satisfactory 8.4 per cent. This index dipped sharply in July-August because of technical inadequacies: there was no adjustment for the fourth week of paid vacation granted since 1963. The new INSEE series, which takes the longer vacation period into account, shows seasonally-adjusted increases in both July-August and September. (See column 2, Table 1.)

Consumer demand, which started production upward again earlier in the year, was still the principal demand force behind the rise in output. Consumer purchasing power increased, and buying was aided by the relaxation of installment credit regulations at the end of June.^{2/} Production of most types of consumer goods increased, including automobiles, textiles, clothing, leather, furniture and appliances; notably sharp was a 15 per cent rise from June to October in seasonally-adjusted

^{2/} The limitation on outstanding loans of installment finance companies was raised from 8 to 9 times the company's net worth, and the maximum repayment period on new car purchases was lengthened from 21 to 24 months.

Table 1. France: Industrial Production Indexes, 1964-65
(base: 1959=100)

	General index (excludes construction; seasonally adjusted)		Building and public works (adjusted for working days)
	Standard series	Perfectured series ^{1/}	
<u>Quarters</u>			
1964 - I	137.5	137.1	129
II	139.8	138.2	153
III	133.3	137.7	138
IV	137.8	137.6	148
1965 - I	136.3	136.4	134
II	138.5	137.5	165
III	137.5	140.3	146
<u>Months</u>			
1964 - Sept.	139.0	137.8	155
Oct.	139.5	138.7	156
1965 - June	140.0	138.5	169
July)	135.0	139.9	157
Aug.)			116
Sept.	142.5	141.1	165
Oct.	143.5	n. a.	163

^{1/} This series was constructed in 1965. The seasonal adjustment factors take account of the lengthening of paid vacation, from three weeks to four weeks, which has occurred since 1963.

Sources: INSEE, Bulletin Mensuel de Statistique and Supplement No. 11 to Etudes et Conjoncture, 1965.

automobile production. Home and export demands for French cars increased in about equal proportions, according to business reports. In consumer goods industries as a whole, rising demand was reflected not only in rising output but also in increased order backlogs and declining inventories of finished goods at the producer level, according to the recent monthly INSEE surveys of industry.

Rising exports and expanding government expenditures also added to demand and incomes. Seasonally-adjusted exports rose 5.0 per cent from the second quarter to the third, and maintained this gain in October and November. Cash expenditures of the central government in the first nine months of 1965 were 9.2 per cent more than in the same period of 1964; this increase in outlays exceeded the 6.9 per cent rise indicated for the full year 1965 compared with the 1964 budget.

Production results in areas other than consumer goods were generally favorable, with the major exception of equipment goods. Demand improved for paper, metals, intermediate metal manufactures, chemicals, and rubber. In these branches, production rose and changes in unfilled orders and inventories, where they occurred, were nearly all in the favorable direction. However, in the equipment goods industries, output levels remained essentially static, orders still failed to pick up, and inventories of finished products were still above normal.

Construction activity, comprising building and public works, remained at advanced levels. In September-October, the output index covering building and public works, adjusted only for work days, was 5.5 per cent higher than a year earlier, a gain scarcely less than the 6.0 per cent year-to-year rise shown by the first eight months of 1965. But the maintenance of the upward trend in the autumn was reported to be the result solely of increased public works. The boom in housing has tapered off, and market reports state that builders have even become worried over the outlook for residential building this coming spring.

Increasing optimism of producers has been noted in the INSEE monthly industry surveys. The number of industrialists believing that their own output would increase in the next three or four months rose from 22 per cent of total respondents in July to 32 per cent in August, while the proportion anticipating a decline held steady at 13 per cent. (The balance expected no change.) According to press reports, the November survey showed a further improvement in sentiment.

Labor incomes increase

Consumer demand has been strengthened by rising incomes paid out as wages and salaries. Hourly wage rates in private employment (excluding agriculture) rose 1.3 per cent during the third quarter. (See Table 2.) This was the first time in 18 months that the gain during any quarter exceeded the rise in the year-earlier period. From the fourth quarter of 1963 through the first quarter of 1965, wage rate increases had tended to become smaller.

Increased working hours were another cause of higher labor incomes. On a seasonally-adjusted basis, the average work week increased 0.9 per cent during the second quarter, and this gain was retained in the third quarter; the second-quarter rise was, with one exception, the first increase in working hours in 21 months. Even though seasonally-adjusted employment fell further in the second and third quarters, man-hours worked rose 0.3 per cent in the second and third quarters combined. This gain contrasted with the sharp 2.1 per cent decline in man-hours which had earlier occurred in the nine months covering the second half of 1964 and the first quarter of 1965.

Table 2. France: Selected Economic Indicators, 1963-65
(all data are for the beginning of the month)

	Hourly wage rates ^{1/} (1960=100)	Average work week ^{2/} (hours)	Employment ^{2/} (1960=100)	Unemployment ^{2/3/} (000's)
<u>1963</u>				
January	122.3	46.8	103.5	n. a.
April	124.4	n. a.	104.1	n. a.
July	127.2	47.1	104.5	n. a.
October	129.4	47.1	104.9	n. a.
<u>1964</u>				
January	131.2	46.8	105.7	112
April	133.8	46.7	105.8	105
July	136.0	47.0	106.1	110
October	137.7	46.7	106.2	119
<u>1965</u>				
January	139.6	46.1	106.2	126
April	141.5	46.1	105.7	134
July	143.7	46.5	105.6	147
October	145.6	46.5	105.3	156
November	<u>4/</u>	<u>4/</u>	<u>4/</u>	<u>5/</u> 152
December	<u>4/</u>	<u>4/</u>	<u>4/</u>	<u>5/</u> 148

1/ Private sector; all occupations excluding agriculture.

2/ Seasonally-adjusted.

3/ Includes Algerian repatriates.

4/ These statistics are compiled only for January, April, July and October.

5/ Estimated from unadjusted data and 1964 seasonal factors.

Sources: OECD; INSEE (unemployment data through October); press reports (November and December unemployment).

The demand for workers evidently began to pick up again in the fourth quarter. Seasonally-adjusted unemployment declined in October and November after having risen steadily since the summer of 1964.

There has been an acceleration of the rate of rise of real incomes from wages, salaries, family allowances and pensions. After adjustment for both seasonal variation and changes in the consumer price index, these incomes increased 0.2 per cent in the first quarter; 0.5 per cent in the second (revised upward from 0.3 per cent); and 0.8 per cent in the third quarter, according to preliminary estimates.

Price increases remain moderate

The trends of wholesale and consumer prices have not changed in recent months despite the resumption of demand growth. French prices have been rising steadily since the stabilization program went into effect; nevertheless, the program has been successful in reducing the rate of price rise to less than half of what it had been in 1962-63.

In September-October, general wholesale prices were 1.2 per cent higher than a year earlier. This annual increase was only fractionally smaller than the 1.4 per cent increase in the 12 months ending with the first quarter. From the first quarter to September-October, wholesale prices of foodstuffs rose, compared with a decline in the corresponding months of 1964; but prices of industrial raw materials and of manufactures were stable in 1965 in contrast to increases in 1964.

Consumer prices in September-October were up 2.4 per cent over the same months of 1964, an advance equal to that which occurred

in the 12 months up to the first quarter. From the first quarter to September-October, prices of food and beverages rose more slowly than in 1964. In services, where prices have been increasing most rapidly, the pace of the rise quickened this year; by September-October services prices were 6.6 per cent higher than a year earlier. In these 12 months, the largest price increases were for rents (12 per cent), doctors' fees (11 per cent), house repairs (5 per cent) and restaurant meals (4 per cent, despite the imposition of price ceilings in October 1964). The smallest consumer price increases have been those for non-food manufactures, which have been at a steady rate of a little over 1 per cent a year.

Credit expansion rate does not accelerate

The rate of credit expansion in 1965 (through the third quarter) appears to have been unaffected by two important developments which could have been expected to cause it to pick up. Neither the renewed expansion of economic activity nor the abolition of the quantitative limitation of 10 per cent a year on the growth of credits granted by the commercial banks^{3/} at the end of June led to an accelerated growth in credit.

^{3/} The limitation applied to the amount of credits granted, not to the amount retained in the banks' portfolios. The latter is importantly affected by the volume of rediscounting.

After the removal of the credit expansion ceiling, outstanding credits granted by the banks were practically unchanged from June 30 to September 30, in contrast to the 3.1 per cent increase which occurred in the third quarter of 1964. (See Table 3.) However, in the year ending September 1965, credits granted by the commercial banks rose 9.9 per cent, or by less than the 12.4 per cent increase in the 12 months to September 1964. Credits financed by the banking system rose 10.3 per cent in the 12 months to September 1965; this was slightly less than the 10.5 per cent rise in the previous 12 months. Table 3 compares credits granted with credits financed by the banking system.

It would appear that there are three explanations for the failure of credit to rise faster in 1965 than in 1964. First, until June, an upper limit to the expansion was imposed. Second, French entrepreneurs' demand for credit from banks continued to increase rapidly in 1964, even though French industrial production levelled off in the first half of 1964, and declined later in the year. As a result, the banks generally increased their credits as fast as the regulations permitted. Finally, since the lifting of the ceiling, enterprises evidently find they have sufficient credits for the time being, because of the ample credit facilities obtained earlier.

Treasury operations induce money market tightness

The Paris money market was relatively easy in September and October; the average of daily opening rates for day-to-day money

Table 3. France: Credits Financed by the Banking System, 1963-65
(amounts outstanding, end of quarter, in billions of francs)

I. By Granting Institution

	<u>Commercial banks</u>	<u>Bank of France</u>	<u>Nonbanking institutions^{1/}</u>	<u>Total</u>
1963 - I	75.1	0.2	10.4	85.7
II	78.7	0.2	11.2	90.1
III	78.9	0.2	11.3	90.4
IV	85.2	0.2	12.9	98.3
1964 - I	85.8	0.2	10.0	96.0
II	86.0	0.2	11.4	97.6
III	88.7	0.2	11.0	99.9
IV	96.0	0.2	12.8	109.0
1965 - I	94.2	0.2	11.0	105.4
II	97.8	0.2	11.6	109.6
III	97.5	0.2	12.5	110.2

II. By Financing Institution

	<u>Commercial banks</u>	<u>Bank of France</u>	<u>Total</u>
1963 - I	67.3	18.3	85.7
II	70.0	20.1	90.1
III	71.6	19.1	90.4
IV	75.2	23.1	98.3
1964 - I	76.9	19.1	96.0
II	77.9	19.8	97.6
III	79.5	20.4	99.9
IV	86.4	22.6	109.0
1965 - I	85.9	19.5	105.4
II	87.3	22.3	109.6
III	89.8	20.4	110.2

Source: Conseil National du Cr dit.

1/ Rediscounts with the Bank of France, mainly of medium-term construction loans granted by the Cr dit Foncier de France and the Secours-Comptoir des Entrepreneurs.

against private paper declined from 4.00 per cent in August to 3.81 per cent in September and rose to 3.96 per cent in October. (See Table 4.) The reduction in the coefficient de trésorerie in September, from 36 to 34 per cent, helped produce an easier tone, and ease was expected to prevail through the remainder of the year.

Contrary to expectations, the market was tight in November and December. Rates for Thursday dates reported by the Bank of France averaged 4.60 per cent in November and 4.50 per cent in December (even though the coefficient de trésorerie was further reduced in December from 34 to 32 per cent). Over the November month-end, the banks had to rediscount in excess of the ceilings and were forced to pay penalty rediscount rates.

Money market tightness reflected a sharp increase in the banking system's requirements for accommodation from the Bank of France. Until late October, the commercial banks' rediscounts and other accommodation tended to run at about the same levels as in 1964. But from October 28 onward, recourse to the Bank of France was substantially greater than a year earlier. As shown by Table 5, page 15, the average level of accommodation rose from 14.9 billion francs to 17.9 billion francs.

A drop in the Treasury's indebtedness to the Bank of France forced the banks to seek more funds from the central bank. In the period from October 28 to December 23, the currency circulation

Table 4. France: Money Market Rates in 1965
(rates for day-to-day money against private paper)

	<u>High</u>	<u>Low</u>	<u>Average</u>
January	5.00	3.00	3.97
February	5.00	3.50	4.21
March	5.50	3.88	4.42
April	5.25	3.25	3.96
May	4.88	3.63	4.29
June	4.88	3.63	4.41
July	4.88	3.63	4.32
August	4.88	3.38	4.00
September	4.75	3.38	3.81
October	4.88	3.38	3.96
November	4.88	3.88	<u>1/</u> 4.60
December	4.88	3.50	4.50

1/ Average of rates on Thursday dates.

Sources: Conseil National du Cr dit and Bank of France.

averaged 4.6 billion francs more than in the same period of 1964.

(See Table 5.) The Bank of France's net foreign assets averaged 4.7 billion francs more than a year earlier, and the growth of these assets alone would have allowed the banks to purchase the additional currency provided that the Bank of France's claims on other sectors had not fallen. But claims on the Treasury in the period October 28 to December 23 averaged 1.9 billion francs less than in the comparable weeks of 1964; there was also a 600 million franc decline in Bank of France rediscounts of special constructions loans in favor of the Cr dit Foncier de France and its subsidiary. So far, the reasons for the drop in Treasury debts to the Bank of France are not known.

Table 5. France: Determination of Bank of France
Accommodation to Banks, 1964-65
(in billions of francs)

	Bank of France accounts					Volume of accommo- dation ^{2/}
	Note circu- lation	Net foreign assets	Claims on Treasury	Special constr. loans	Misc. other factors ^{1/}	
	(1)	(2)	(3)	(4)	(5)	
1964 - Feb. 13	-53.3	25.0	13.7	5.1	-1.8	11.4
Oct. 22	-56.3	27.3	11.1	6.5	-1.7	13.0
29	-57.0	27.3	9.1	6.9	-1.7	15.5
Nov. 12	-56.9	27.6	9.3	6.1	-1.3	15.2
26	-56.1	27.7	8.6	6.2	-1.8	15.4
Dec. 10	-57.3	28.0	10.6	6.4	-2.2	14.5
24	<u>-58.1</u>	<u>28.4</u>	<u>10.1</u>	<u>6.4</u>	<u>-1.6</u>	<u>14.8</u>
Avg., 10/29 to 12/24	-56.9	27.8	9.7	6.3	-1.8	14.9
1965 - Feb. 11	-57.6	29.3	12.7	4.5	-1.8	12.8
Oct. 21	-61.0	32.3	11.8	5.2	-1.9	13.7
28	-61.9	32.3	8.4	5.7	-1.6	17.1
Nov. 11	-61.9	32.3	7.1	6.4	-1.4	17.5
25	-60.2	32.4	6.9	5.3	-1.7	17.2
Dec. 9	-61.8	32.6	7.5	6.1	-2.0	17.6
23	<u>-62.4</u>	<u>32.8</u>	<u>7.6</u>	<u>5.2</u>	<u>-1.5</u>	<u>18.3</u>
Avg., 10/28 to 12/23	-61.5	32.5	7.8	5.7	-1.7	17.9

1/ Mainly Treasury coin circulation.

2/ 1 + 5 = 2 + 3 + 4 + 6, disregarding sign.

Bond yields rise; Treasury issues National Equipment Loan

Bond yields moved up in the period under review, and attained their highest levels in several years. As calculated by the Bank of France, market yields on public sector bonds rose from 5.70 per cent (net of the 10 per cent withholding tax) at the end of August to 5.89 per cent at the end of October. (See Table 6.) The yield stabilized at this level in November, and declined in December to 5.81 per cent late in the month. The composite yield on corporate bonds moved up steadily for four months, advancing from 6.29 per cent (net of withholding tax) to 6.46 per cent at the end of December.

Increases in gross (pretax) yields, as calculated by the INSEE for the last day of each month, are also shown in Table 6.

A heavy volume of new bond issues in the autumn put market yields under pressure. The main factor in the swelling of the new issue volume was the Treasury's 1 billion franc loan, for relending to industry, in October. But the Crédit Foncier de France borrowed more in September (F 700 million) than in the autumn of 1964 (F 600 million), and the National Railways loan of F 1 billion in November exceeded the F 790 million raised a year earlier.

The Treasury loan, called the National Equipment Loan, was for 15 years, was sold at par, and carried a 5-1/2 per cent coupon. The redemption price rises from 100 in the first five years to 105 in the second and 115 in the final five years; these terms gave the issue a 6.07 per cent yield to final maturity. The companies to which the funds are to be relented will pay the Treasury 5-1/2 per cent "on the average," according to official sources. The relending rate thus differs from borrower to borrower, but the average is much below what an industrial borrower would have to pay if it floated a bond issue or obtained medium- or long-term bank credit. The Finance Ministry stated that, as of early December, the amounts to be relented included the following allocations: a) F 100 million to Electricité de France and F 60 million to Gaz de France (both nationalized); b) F 155 million to auto and truck companies, including Citroen,

Table 6. France: Bond Yields, Selected Dates, 1965 ^{1/}

A. Bank of France series (net of withholding tax)

<u>Week ended</u>	<u>Public sector</u> ^{2/}	<u>Corporate</u>
January 8	5.72	6.23
March 12	5.73	6.26
June 18	5.81	6.46
July 30	5.70	6.31
August 27	5.70	6.29
October 1	5.75	6.34
November 5	5.89	6.39
November 26	5.89	6.42
December 10	5.85	6.45
December 24	5.81	6.46

B. INSEE series (gross yields) ^{3/}

<u>Date</u>	<u>Public sector</u> ^{2/}	<u>Corporate</u>
February 28	6.31	7.16
March 31	6.31	7.23
April 30	6.32	7.32
May 31	6.28	7.28
June 30	6.27	7.24
July 31	6.15	7.12
August 31	6.16	7.06
September 30	6.22	7.13
October 31	6.34	7.15

^{1/} Excluding indexed and participating bonds.

^{2/} Excluding Treasury bonds, on which yields are artificially low because of tax exemption features.

^{3/} These yields are computed only for the last day of each month, beginning February 1965.

Sources: Bank of France and Conseil National du Cr dit.

- Renault, Berliet and Saviem; c) F 125 million to the chemical industry; d) F 120 million to the Caisse Centrale de Cr dit Hotelier, Industriel et Commercial for loans to small- and medium-sized industries; and e) F 115 million to the electrical and electronic equipment industry.

Imports advanced sharply; export rise continues

In the second half of 1965, French imports began to respond to the recovery of domestic demand. The rise in imports was in fact quite pronounced: in October-November, imports from all sources were up almost 12 per cent, seasonally adjusted, over the second quarter. (See Table 7.)

French exports have also continued to rise; in October-November, exports were nearly 5 per cent above the second quarter (seasonally-adjusted), and 12 per cent over a year earlier. The third quarter year-to-year gain in total exports was 17 per cent on a geographical basis, exports to other Common Market countries increased proportionately more than total exports. However, exports to countries outside the Common Market showed a substantial 12 per cent gain over a year earlier. Exports to the rest of the Common Market rose 25 per cent. There was a 25 per cent increase in exports to Germany, which is France's largest market and takes almost one-half of all French exports to the Common Market. But the largest gain, in percentage terms, was the 32 per cent increase in exports to Italy, where economic activity and imports were both at recession lows in the third quarter of 1964.

On a seasonally-adjusted basis, the trade balance, shifted from approximate balance in the second and third quarters to a deficit in October-November averaging \$67 million per month (imports valued c.i.f.). However, because of the seasonal pattern, the unadjusted or

Table 7. France: Foreign Trade, 1964-65
(in millions of dollars; monthly average for month)

<u>Quarters</u>	<u>Seasonally adjusted</u>			<u>Unadjusted</u>		
	<u>Imports</u> <u>c.i.f.</u>	<u>Exports</u>	<u>Balance</u>	<u>Imports</u> <u>c.i.f.</u>	<u>Exports</u>	<u>Balance</u>
1964 - I	838	742	-97	863	750	-113
II	825	737	-88	889	758	-131
III	829	735	-94	743	669	- 74
IV	864	782	-82	862	821	- 41
1965 - I	826	777	-49	849	789	- 61
II	833	825	- 8	880	839	- 40
III	866	866	1	773	784	12
<u>Months</u>						
1965 - July	843	835	- 8	827	857	30
August	866	868	3	680	671	- 8
September	888	895	7	813	827	13
October	942	861	-81	889	938	49
November	922	869	-53	926	903	- 23

actual trade deficit actually changed favorably: a deficit in the second quarter was followed by a surplus in the third quarter and another surplus, averaging \$13 million per month, in October-November. The adverse movement of the adjusted trade balance did not adversely affect French reserve accruals.

Reserve accruals are erratic

French official reserve accruals slowed down to \$35 million in September, and came to \$5 million in October. The marked improvement in sentiment towards the pound sterling which occurred at that time is believed to have been a factor in this slowing, through its effects either on the timing of payments or the willingness of French residents

to hold sterling balances. In September, the French commercial banks increased their net foreign position by \$46 million and a further sharp improvement in October is believed to have occurred. These changes in the banks' foreign position reduced the gains in official reserves; conversely, in July and August, a \$66 million deterioration in the banks' foreign position helped to swell official reserve accruals in those months.

Official reserve gains were again large in November, when they totalled \$80 million. Accruals appear to have been around \$25 million in the first half of December.