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Foreign Exchange Markets and Reserve Developments -- February-March

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World exchange markets were dominated by a sustained large-scale inflow of short-term capital into Britain during February and most of March. Funds were attracted by high yields prevailing in British financial markets and also by hopes for capital gains as interest rates moved to lower levels. Spot sterling moved up about 1/4 cent in February and the rate was maintained in March despite the one-half per cent reduction of Bank Rate on March 8 and a similar reduction on March 22. This was taken by the British authorities to try and slow down the inflow.

There is evidence that these short-term funds came largely from central European countries rather than from the United States. Among the continental countries, only France achieved further substantial reserve accruals. Minor reserve declines were reported in February by the Netherlands, Belgium and Switzerland; Germany may also have had a small net exchange loss for the month. During this period, the Swiss franc declined continuously, in part as a result of outflowing short-term capital. The D-mark was maintained at close to parity with the dollar, also reflecting in part the effect of short-term outflows from Germany.

Unfortunately, the United States balance-of-payments estimates of our capital outflow for February are not yet available. However, the January estimates showed only a $10 million over-all payments deficit. This improvement over the large deficits recorded during the final quarter of 1961 reflected not only the reversal of some very short-term transactions that had occurred in December, but also a significant reduction in the capital outflows recorded in the fourth quarter.

Outside Europe, the Canadian authorities used reserves in substantial support operations to cushion the impact on the exchange rate of market pressures on the Canadian dollar. On March 9, this currency reached a low point but improved fractionally in mid-March. Further sizeable short-term borrowings abroad (mostly in the United States) account for the small increase in Japanese reserves in February. South African reserves rose further to the highest level since 1951.

Both Spain and France relaxed further their controls over invisible payments and capital transactions during the month.

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

	Jan.-June	July-Sept.	Oct. Dec.	Dec.	Jan.	Feb.	Total holdings (Feb. 28)
Belgium	+ 50	+ 80	+105	+ 18	+ 7	- 15	1,649
France	+707	+ 39	+123	+ 53	+ 53	+ 65	3,057
Germany							
Official	+ 17	-570	+ 70	+358	-731	+ 36	6,442
Commercial banks a/	+883	- 75	-428	-502	+818	n.a.	b/1,512
Netherlands c/	+ 34	+ 4	- 9	- 37	+ 18	d/ - 49	d/1,638
Switzerland	+276	+149	+ 10	+ 56	- 72	- 35	2,651
United Kingdom	-459	+781	-235	-238	+ 92	+ 14	3,424
Adjusted change	-1,339	+ 31	+490	- 50	+ 92	+224	
Canada	+157	- 61	+131	- 23	-134	-175	1,747
Japan	+ 89	-302	-134	- 3	+ 24	+ 4	1,514
South Africa	- 25	+ 62	+112	+ 38	+ 37	+ 19	446
Venezuela	+ 30	- 7	- 50	- 35	+ 3	- 29	506

a/ Balances with foreign banks and money market investments abroad.
b/ End of January.
c/ Net reserves.
d/ To February 26.

Exchange rate movements

Market demands for the pound and selling pressures on the Swiss franc and Canadian dollar produced the major changes in exchange rates in February and March. The spot pound rose in early February to around 281.50 U.S. cents where it was maintained by heavy purchases of dollars by the Exchange Equalization Account. Despite the one-half per cent reduction in Bank Rate on March 8, sterling rose as high as 281.79 U.S. cents on March 15. After Bank Rate was again lowered by one-half per cent on March 22, the pound dropped to 281.10 cents on March 26, but then rallied and closed at 281.33 U.S. cents on March 30.

The Swiss franc declined from 23.15 U.S. cents on February 2 to 23.03 cents on March 15, and in mid-March the Swiss National Bank had to intervene temporarily in order to slow down the decline. The franc fell further in late March and was quoted at 23.00 U.S. cents on March 30.

Continued pressures on the Canadian dollar led the Exchange Fund to provide substantial support to keep the rate from falling more rapidly during February. The Canadian dollar fell from 95.47 U.S. cents on February 1 to 95.22 cents on March 9, but then firmed and closed at 95.23 U.S. cents on March 30.

Among the European currencies, the French franc and Italian lira remained at or near their official upper limits in February and March. The Dutch guilder, after a pronounced weakening in January, rose steadily after mid-February. The D-mark fluctuated just above parity at about 25.00 to 25.04 U.S. cents during February and March.

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

	U.K.	Canada	Germany	Switzer-land	Nether-lands	France	Italy
Parity	280.00	--	25.00	22.87	27.62	20.26	.1600
Official limits:							
Buying	278.00	--	24.81	22.47	27.42	20.10	.1588
Selling	282.00	--	25.19	23.28	27.84	20.41	.1612
Date							
Feb. 2	281.25	95.45	25.03	23.15	27.64	20.40	.1610
9	281.45	95.31	25.01	23.13	27.62	20.40	.1610
16	281.53	95.31	25.01	23.11	27.62	20.41	.1610
23	281.51	95.30	25.00	23.08	27.64	20.41	.1610
Mar. 2	281.54	95.20	25.01	23.06	27.64	20.41	.1610
9	281.58	95.20	25.00	23.06	27.65	20.41	.1610
16	281.63	95.32	25.00	23.03	27.69	20.41	.1610
23	281.28	95.30	25.04	23.04	27.73	20.41	.1610
30	281.35	95.24	25.03	23.00	27.73	20.41	.1610

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

IMF transactions

The decision of the United Kingdom to make an additional prepayment of $210 million against its $1,450 million drawing last August replenished somewhat the Fund's holdings of U.S. dollars and of major European currencies during February. Even so, the Fund's holdings of D-marks were only 25 per cent and of Italian lira only 14 per cent of quota after the British transaction. Other repayments in February included: South Africa, $25.0 million; Argentina and the United Arab Republic, $7.5 million each. In March, South Africa repaid an additional $12.5 million, and Australia repaid in full its $175 million drawing made in April 1961. In January, Ceylon made a $29 million drawing in sterling.

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

Currency of:	Jan.	Feb.	Mar. a/	Holdings, Feb. 28 Amounts	Holdings, Feb. 28 % of quota
United States	+ 3	+123	+ 95	2,561	62
Belgium	--	+ 15	--	196	58
France	- 7	+ 20	+ 15	374	48
Germany	-11	+ 55	+ 35	194	25
Italy	--	+ 10	+ 10	37	14
Netherlands	--	+ 35	+ 10	205	50
United Kingdom	-29	-224	--	2,255	116

a/ Australian repayment only.

Reserve Developments in Selected Countries

North America

United States net exchange transfers to foreigners (gold, convertible foreign currencies, and liquid dollar assets) were $10 million in January, compared with average monthly transfers of $422 million in the fourth quarter of 1961, despite some decline in the trade surplus in January because of reduced agricultural exports. To some extent, the improvement resulted from the reversal of certain very short-term transactions that took place in December. But even after allowance for reversal of these special transactions, net transfers to foreigners in January were still substantially below the high fourth-quarter rate. The fact that short-term dollar claims on foreigners reported by U.S. banks were unchanged in January, after having expanded by $991 million in 1961, indicates that short-term capital outflow has diminished sharply.

Preliminary data for February and March, not yet released, indicate that net transfers to foreigners in those months were considerably larger than in January, but much smaller than in the fourth quarter.

The gold stock declined $100 million in January. Dollar holdings of foreign countries at Federal Reserve Banks declined $653 million, while other liquid assets in the U.S. rose $543 million. These shifts reflect large-scale transfers of dollars from foreign central to foreign commercial banks, only part of which can be ascribed to the reversal of year-end window-dressing operations. In Germany, the Bundesbank's reserves fell $731 million in January and the German commercial banks' foreign assets increased $818 million. The rise in the German commercial banks' assets in January is believed to have been almost entirely in the form of Euro-dollar deposits. The increase in "other" dollar holdings in the U.S. stemming from shifts in total German dollar holdings thus reflects increases in the dollar holdings of the commercial banks that accepted deposits from German banks.

United States: Gold and Dollar Transfers to Foreigners
(In millions of dollars)

	1961					1962		
	Jan.-June	July-Sept.	Oct.-Dec.	Nov.	Dec.	Jan.	Feb.	Mar. 1-28
Decline (+) in total U.S. gold stock	+201	+146	+510	+310	+74	+100	+52	a/+180
Decline (+) in U.S. official holdings of convertible foreign currencies	-186	+124	- 54	- 15	+11	--	n.a.	n.a.
Change in dollar holdings of foreign countries at F.R. Banks b/	--	+405	- 63	-246	+294	-653	+ 4	+350
Other c/	+265	+235	+873	+513	-110	+543	n.a.	n.a.
Net transfers to foreigners	+280	+910	+1,266	+562	+269	- 10	n.a.	n.a.

a/ Decline in Treasury gold stock only.
b/ Deposits and holdings of U.S. Government securities.
c/ 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.

Official Canadian sales of U.S. dollars were intensified in February, and exchange support operations resulted in an official reserve loss of $175 million compared to $134 million in January. The spot rate for the Canadian dollar firmed after March 9. This seems to be attributable in part to the recent statement by the Governor of the Bank of Canada indicating a reversal of the policy of discouraging Canadian borrowing in U.S. markets.

Europe

Capital inflow caused official British reserves to rise in February by $224 million, adjusted for a $210 million prepayment to the IMF. The increase, which occurred despite a trade deficit of $69 million, was one of the largest monthly reserve accruals in many years. Some of the capital inflow was invested in Treasury bills, probably in expectation of a rise in bill prices consequent upon a cut in Bank Rate. Other funds were attracted by the high prevailing yields offered on local-authority deposits and by hire-purchase finance houses. While part of this inflow moved into these markets directly, much, and perhaps most of the flow moved in indirectly via the London Euro-dollar market. London institutions used Euro-dollar deposits to buy sterling assets to take advantage of the 7 to 34 basis point differential in favor of 3-month local-authority deposits over Euro-dollar deposits (with the exchange risk of returning from pounds to dollars covered).

In February and the first week of March, covered Treasury bill arbitrage between the U.S. and the U.K. bill showed no significant incentives either way. With the two reductions in the U.K. Bank Rate, the yield spread in favor of the U.K. bill dropped from 2.75 per cent on March 2 to 1.59 per cent on March 30. The discount on 3-months forward sterling was reduced by somewhat less than the narrowing of the yield spread, and on March 30 there was a covered net incentive of 0.34 per cent in favor of the U.S. bill.

On a seasonally-adjusted basis, the British trade deficit declined from $190 million in January to $126 million in February, equal to the average for the fourth quarter of 1961, primarily because of lower imports. In February, both imports and exports (including re-exports) were identical with the averages for October-December of last year.

In France, the strength of the international position continues. Reserves rose $65 million in February. Accruals were heavy in the first half of March (apparently about $60 million), reflecting the structural surplus and probably some reflow of capital back to France as prospects improved for an Algerian cease-fire. Two special transactions in early March had offsetting effects on reserves, viz., the purchase of $50 million of francs from the Bank of France by the Federal Reserve System, and a $57 million prepayment by France of part of a 1947 loan from the IBRD.

The French trade balance, which had deteriorated in the last quarter of 1961, has improved. In January-February combined, seasonally-adjusted exports were up 9 per cent over the fourth quarter of last year, while imports were down 5 per cent. In late February, France liberalized international payments on current and capital accounts. The tourist allowance was raised to a level which apparently constitutes no effective restriction on foreign travel by French residents, and regulations affecting various other current payments were eased. In addition, restrictions were removed on purchases of foreign securities by French residents. This and certain accompanying measures restored full and free communication between French and foreign stock exchanges for both French and foreign securities.

The selling pressures on the Swiss franc in February and March were attributed to two factors. Unusually heavy imports widened the unadjusted trade deficit to $104 million in January and $69 million in February compared with a monthly average deficit of $49 million in the fourth quarter of 1961. On a seasonally-adjusted basis, these deficits came to $94 million in January and $76 million in February as against an average of $58 million in the final quarter of last year. In addition, there was a reduced inflow of short-term capital, and an increased outflow as funds moved from Switzerland to London. Official Swiss reserves fell $35 million in February and $23 million in the first half of March. These decreases were not due to exchange support operations; about $50 million of the reductions occurring in those weeks was caused by increases in the short-term foreign assets of the Swiss Federal Government. However, the $15 million decline in official reserves in the third week of March probably reflects Swiss National Bank sales of dollars to the market.

In Germany, gross gold and foreign exchange reserves of the Bundesbank rose by $36 million in February. All of the rise may have been due to British purchases of marks for repayment to the IMF on February 28.

In order to moderate the outflow of short-term banking funds, on February 14 the Bundesbank raised from one to two months the minimum period for which it would make dollar-DM swaps for banks at 0.50 per cent. On March 9, the minimum swap period was reduced again to one month, this time in order to slow the inflow of bank funds. Official reserves rose by $212 million in the first three weeks of March.

In the Netherlands, official net reserves of gold and foreign exchange declined $49 million in February, as commercial banks transferred funds abroad, reportedly using exchange rate cover facilities provided by the Netherlands Bank. The Netherlands money market was seasonally liquid in mid-February as a result of large payments by the Treasury. A substantial part of the funds placed abroad by the Dutch commercial banks in February were probably repatriated in March to meet liquidity needs occasioned by subscription payments on the fl. 300 million Government bond issue, and by the implementation of the special deposit scheme that was introduced to counter excessive credit expansion. In fact, in order to assist the banks over this period, the Netherlands Bank temporarily lowered the regular cash reserve requirement from 8 to 6 per cent for the period March 23 to April 22.

In late March, Spain removed restrictions on the transfer abroad of the earnings from foreign-owned Spanish securities acquired after July 27, 1959, and the proceeds of the sale of such securities, effective April 15. Foreigners are free to invest in Spanish securities except that not more than 50 per cent of the stock of Spanish companies may be acquired by foreign interests without special permission. This step reflects both Spain's desire to attract foreign investment, and the redressment of Spain's external position since the inception of the stabilization program in the summer of 1959. Official Spanish reserves were $902 million at the end of February compared with $63 million June 1959.

Asia and Africa

The gold and foreign exchange holdings of the Reserve Bank of India continued to decline in February and early March in reflection of the trade deficit. The decrease from the end of 1961 to March 16 was $35 million. Despite the loss of reserves, the Indian rupee since December has strengthened markedly on the Bangkok and Hong Kong bank note markets. This may be a result of the abolition of the gold trade in Goa and a consequent reduction in the illegal flow of rupee notes out of India in payment of gold imports.

Japan's official reserves rose $4 million in February. The trade deficit in February of $117 million was still large, but was down considerably compared with the $222 million deficit in January. The seasonally-adjusted trade deficit declined from $142 million in January to $93 million in February, principally because of increased exports. There was continued large-scale short-term borrowing in February, reflected in a rise of over $100 million in official and private short-term foreign liabilities. Japan drew the last $50 million of the $200 million credit from U.S. banks arranged late last year. At the end of January, the Bank of Japan obtained another loan of $125 million, for one year, from seven U.S. banks, under an Export-Import Bank guarantee, for the purchase of U.S. agricultural products, and $13 million of this loan was drawn in February.

On March 2, the Philippines abolished the 25 per cent import deposit requirement for three classes of essential imports. Partly as a result of this and other developments, the exchange rate depreciated from ₱ 3.50-3.55 to the dollar on March 2 to ₱ 3.70-3.72 to the dollar on March 8. However, the peso subsequently appreciated and on March 23 the buying and selling rates were ₱ 3.61 and ₱ 3.67 per dollar, respectively.

South Africa's reserves rose $19 million in February, the ninth successive monthly increase, despite a $25 million repayment to the IMF. Reserves of $446 million on February 28 were the highest since 1951 and compare with $215 million at the end of last May. A decline to about $439 million in mid-March reflected the final $12.5 million repayment of the $37.5 million IMF drawing at the end of 1960.

Latin America

The pressure on Argentina's foreign exchange reserves eased somewhat when the announcement, on February 26, of U.S. loans totalling $150 million to the Argentine Government caused demand for exchange to fall off. The premium on the 6-month forward dollar in Argentina dropped slightly in late February and was 15.6 per cent per annum on March 2. Because of the political crisis, foreign exchange operations were suspended on March 20.