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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

December 13, 1962

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Recent Economic Developments in Canada

Summary

On May 2, following a period of strong and sustained selling pressure on the exchange rate, Canada ended a 12-year experiment with a flexible exchange rate by depreciating the dollar and fixing its par value at 92.5 U.S. cents. The adoption of a par value for the Canadian dollar allayed the uncertainties of the market only temporarily, however. The indecisive elections of June 18 were followed by an intensification of selling pressures, and Canada lost almost $400 million in reserves in the first three weeks of June. On June 24, the Government announced a series of emergency stabilization measures including the imposition of temporary surcharges on imports, a high discount rate for the Bank of Canada and cut in government expenditures. To support the new par value in the exchange markets the Government of Canada secured $1.05 billion in short-term assistance from abroad.

Within a matter of days following the establishment of the emergency program the Canadian dollar gained strength as selling pressures subsided. As a result of a return flow of funds to Canada, the entire reserve losses during the earlier crisis period was recovered by October.

Canada's strengthened exchange position has made it possible to relax some of the June 24 austerity measures. As a first step, short-term money rates were allowed to decline from the very high levels of June and July, and the Bank of Canada discount rate was adjusted downward three times in as many months. The last of these, a one per cent cut on November 3, was accompanied by an official statement by Governor Rasminsky which named it as a turning point as Canadian monetary policy shifted to a policy of less restraint in the interest of domestic expansion.

Even though the expansion in business activity has not been maintained in the later part of this year, it appears certain that the best growth rate in recent years will be recorded in 1962. However, fears have been expressed by some Canadian observers that the present expansion may not be maintained during the coming year.

Despite the improved Canadian payments position, important problems cloud the Canadian economic outlook. There are mounting pressures, as the exchange crisis recedes into the past, to pursue expansionary domestic policies aimed at augmenting the rate of growth and lowering a stubborn core of unemployment. The extent to which devaluation leads to further wage and price advances is a critical uncertainty in the Canadian prospects over the next 12 to 24 months. Yet, even if the worst of the payments crisis is indeed in the past, Canadian policymakers should have gained from the experiences in 1962 a recognition that Canada's domestic policies cannot be shaped without regard to international considerations. At present, however, the government in power in Canada represents an exceedingly precarious and perhaps unstable balance of political forces that may tend to procrastinate rather than to attempt to fashion a set of unified and consistent long-term policies to get at the underlying factors responsible for the 1962 financial crisis.

<u>The spring exchange crisis: Capital inflow dries up</u>

Canada's 12-year experiment with a flexible exchange rate ended on May 2 when a par value of 92.5 U.S. cents was fixed for the Canadian dollar. This decision was the outgrowth of a foreign exchange crisis (characterized by a drying up of capital inflow) during which Canada lost slightly over $460 million in reserves between January and April 1962. The new par value, which was lower than the 95-cent rate in effect on May 1 and the 101 U.S. cent rate in effect 12 months earlier, temporarily strengthened the Canadian dollar in early May; but by mid-May selling pressures again developed, and $102 million of reserves were used to defend the rate by the end of the month. (See Table 1.)

TABLE 1. Changes in Official Canadian Reserves, March-November 1962.

End of Period	Official Holdings of Gold & U.S. dollars (millions of $ U.S.)	Unadjusted change during period	Special Non-Market Receipts (-) (net)	Adjusted Change
March	1,709.4	-37.3	-	-37.3
April	1,594.8	-114.6	-	-114.6
May	1,492.8	-102.0	-	-102.0
June 24	1,100.0	-392.8	-	-392.8
June (from 24th)	1,808.7	+708.7	-650.0 a/	+58.7
July	2,114.4	+305.7	-61.0 b/	+244.7
August	2,330.6	+216.2	-	+216.2
September	2,444.6	+114.0	-	+114.0
October	2,613.9	+169.3	+20.0 c/	+189.3
November	2,607.5	-6.4	+75.0 d/	+68.6

a/ External assistance received, as follows: $300 million from I.M.F.; $250 million from Federal Reserve; $100 million from Bank of England.
b/ Advance debt repayment by France.
c/ Special receipts included a $30 million debt prepayment by the Netherlands and receipt of $125 million proceeds of Government of Canada loan in the U.S.; payments included termination on October 31 of half the Swaps with the Federal Reserve System and the Bank of England ($175 million).
d/ On November 31, Canada terminated an additional $75 million of the Swaps with the Federal Reserve System and the Bank of England.

Speculative selling intensified just before and then after the elections of June 18. Canada lost almost $400 million in reserves during the first three weeks of June. This brought Canada's total official exchange reserves to $1.1 billion--about half the level of the preceding October.

Over the spring months, the developing foreign-exchange crisis produced perhaps the most rapid rise in Canadian short-term money rates in the postwar period. Speculative "leads and lags" in commercial payments resulted in a compensating need for Canadian funds by exporters and importers; in addition, financial markets generally began to anticipate the necessity of a tighter official monetary policy as an outgrowth of the exchange crisis. Between April 12 and June 20 the yields on the 3-month bills rose by 188 basis points, on a six-year bond by 61 basis points, on a 16-year bond by 27 basis points and on a 36-year bond by 16 basis points.

Emergency measures to check reserve losses

To cope with the foreign-exchange crises, the Prime Minister announced on June 24 a series of emergency measures. This program, which was designed to reduce Canadian outpayments to foreigners, to cut back domestic spending, and to end speculation against the Canadian dollar, included these main steps:

a. Temporary graduated surcharges (5 to 15 per cent) were placed on about half of Canada's imports.

b. The tourist duty exemption was cut from about $300 to about $75-100 per year.

c. Government spending was reduced by $250 million. These cuts, together with $200 million receipts from the import surcharges, reduced the Treasury's expected 1962-63 deficit from about $750 million to around $300 million.

d. The Bank of Canada's discount rate was raised to 6 per cent.

Two important changes in monetary arrangements were announced at this time. In the first place, the Government stated that the Exchange

Fund's receipts from sales of foreign exchange would no longer be available to the Treasury as a cash accrual (as had been the case of the severe reserve losses earlier in 1962) but would be segregated and used "only for the purpose of financing increases in our reserves." Secondly, the practice of fixing the discount rate each week at 1/4 per cent above the Treasury bill auction rate was abandoned and the Bank of Canada once again returned to a "fixed" Bank rate policy.

Simultaneously, the Prime Minister announced receipt of emergency external financial assistance, amounting to $1.05 billion, which nearly doubled Canada's foreign exchange reserves. The international financial assistance made available included:

International Monetary Fund	$300 million
(U.S.) Export-Import Bank	$400 million
Central Bank reciprocal deposits:	
Federal Reserve System	$250 million
Bank of England	$100 million

Reserve losses brought to an end

The emergency measures announced on June 24 had an immediate impact on the Canadian dollar in foreign-exchange markets. By June 27, the spot rate had risen from 91.75-U.S. cents (the support level at the new par value) to 92.64-U.S. cents. At the same time, sustained official reserve accruals were recorded. Official reserves rose about $59 million in the final week of June and about $245 million in July. (See Table 1.)

By the end of October, in fact, Canada had been able fully to make up the entire reserve losses experienced during the months of crisis. At the end of November, official reserves amounted to $2,608 million or, deducting the $400 million of temporary external credits still unpaid, to $2,208 million. By comparison, the pre-crisis high of reserves amounted to $2,111 million in October 1961.

Unwinding of restrictive emergency measures

The Canadian authorities were soon able to proceed with a gradual relaxation of some of the restrictive measures introduced on June 24. The improved position of the Canadian dollar in foreign exchange markets was paralleled by widespread nonbank demand for government securities in Canadian markets at the high mid-July yields. (See Table 2.) The Bank of Canada lent support to bond yields by supplying bonds to the market offset by corresponding purchases of Treasury bills.

TABLE 2. Canada: Change in Holdings of Treasury Securities.

	Change During Period (in $ millions)			
Held by:	June	July	August	September
Bank of Canada				
Treasury Bills	-37	+30	+134	+51
Other Securities	-278 a/	-34	-164	-50
Chartered Banks				
Treasury Bills	-39	-37	+15	+2
Other Securities	-262	-350	-175	-40
Government Accounts				
Treasury Bills	+46	-40	-90	-27
Other Securities	+105	+29	+17	+13
General Public				
Canada Savings Bonds	-23	-37	-57	-43
Treasury Bills	+30	+132	-60	+20
Other Securities	+304 a/	+315	+309	+90
Total	-154	+7	-69	+15

a/ Reflect the reciprocal currency arrangements made during June with the Federal Reserve System and the Bank of England in the amounts of U.S. $250 million and U.S. $100 million, respectively.

Source: Bank of Canada, "Weekly Financial Statistics."

With this policy, the Bank of Canada was able to permit short-term interest rates to decline from mid-July peaks very slowly but continuously in the months thereafter. From a post-crisis high of 5.51 per cent on July 18, the 3-month bill rate had fallen to 5.05 per cent on August 15, to 4.98 per cent on September 13 and to 4.94 per cent on October 4. (See Table 3.)

TABLE 3. Selected Market Yields, Canadian Government Securities.

		3-month Treasury bills	Bonds 1964	1965	1967-68	1975-78	1996-98
April	12	3.04	3.58	3.93	4.13	4.80	4.88
June	20	4.92	5.12	5.32	4.74	5.07	5.04
July	18	5.51	5.76	5.58	5.11	5.42	5.15
August	15	5.05	5.62	5.57	5.01	5.40	5.17
September	13	4.98	5.38	5.31	5.04	5.35	5.17
October	4	4.94	4.97	4.99	4.98	5.36	5.20
	18	4.22	4.19	4.35	4.50	5.13	5.10
November	8	4.09	4.33	4.40	4.53	5.11	5.12
	15	3.62	3.80	3.98	4.27	4.94	5.03
	29	3.71	3.98	4.14	4.38	5.06	5.07

Cuts in Bank rate. The decline in market yields on Treasury bills was followed by reductions in the Bank of Canada's discount rate. These changes included:

Date	Bank of Canada Discount Rate
Prior to June 24	"Floating" at 0.25 per cent above the 91-day Treasury bill auction rate
June 24	6.0 per cent
Sept. 7	5.5 per cent
Oct. 12	5.0 per cent
Nov. 13	4.0 per cent

The bank rate reductions of 1/2 of 1 per cent each in September and October were primarily technical moves, made in response to the downward trend of short-term money rates. These two adjustments were accompanied by official statements cautioning that the moves did not imply relaxation of the Bank of Canada's restrictive credit policy, or the restrictive emergency program of the government.

The full percentage point cut on November 13, however, clearly exceeded the limits of a technical adjustment to declining short-term interest rates. The two preceding reductions restored the discount rate to its "traditional" position--about 1/4 of 1 per cent above the weekly auction rate on 3-month Treasury bills--but the November action left the bank rate slightly below the preceding week's Treasury bill auction rate. On November 13, moreover, Governor Rasminsky said that the central bank felt that, in view of a resumption of "sizeable" long-term capital inflows and the "substantial" improvement in foreign exchange reserves, "greater weight could in the present circumstances be given to other factors." In addition, the high level of Canadian rates was leading to a continuing and, during October, accelerating inflow of funds into Canada, and to undesired exchange accruals.

Surcharge removals. On October 17 Finance Minister Nowlan announced that the 5 per cent surcharges were being removed from imports (chiefly industrial machinery and steel sheets) amounting to about $250 million per year. While Mr. Nowlan described the step as a major step toward removal of all surcharges, it must be considered a token gesture made primarily to reduce Canadian costs, since it involves only about one-sixth of the total imports originally affected by the surcharges and removed surcharges only on imports not directly competitive with Canadian manufactures.

On November 14 further surcharge eliminations (or, in a few cases, reductions) were announced by the Finance Minister. The most recent reductions (chiefly fish, food, and agricultural products) apparently represent an effort to lower consumer food costs which had been rising in recent months.

At the present time, the surcharges remain in effect on about five-sixths of the total annual import value originally affected.

Repayment of emergency assistance. Between mid-September and the end of November, Canada repaid or canceled about half of the total of $1.05 billion in external emergency assistance received at the end of June. The amounts repaid and still outstanding (in millions of U.S. dollars) are:

Source	Original Amount	Repaid Amount	Repaid Date	Amount Remaining
I. M. F.	300	--	--	300
Federal Reserve System	250	125	10/31	
		50	11/30	75
Bank of England	100	50	10/31	
		25	11/30	25
Export-Import Bank a/	400	250	9/13	150

a/ The Eximbank provided a $400 million standby line of credit upon which Canada has not drawn. Cancellation of $250 million of this line of credit was announced upon the conclusion of arrangements for the $250 million loan to the Canadian Government from private U.S. sources. Accordingly, the $150 million remaining with the Eximbank refers only to a line of credit remaining, not to actual drawings to be repaid.

Improvement in domestic activity

Canadian economic forecasters have recently become noticeably less gloomy as an expected fourth-quarter downturn in output has failed to materialize. To the contrary, it is becoming clear that 1962 will close as one of the best years for Canadian economic growth since the mid-1950's; (see Table 4) most estimates point to a 1962 increase of about 7 per cent in GNP in current prices, or about 6 per cent in real terms.

TABLE 4. Canada: Index of Industrial Production (1949=100)

Period	Monthly Average or Month (seasonally adjusted) Total	Manufacturing Total	Manufacturing Durables	Manufacturing Non-durables
1957	155.4	142.9	146.7	139.7
1958	154.4	140.7	139.9	141.3
1959	166.1	149.8	149.5	150.1
1960	167.4	149.3	146.4	151.8
1961	172.9	153.0	148.4	157.0
1961: Jan.	160.0	138.6	134.4	142.1
July	168.7	149.7	145.0	153.7
Dec.	173.8	151.6	148.6	154.2
1962: May	188.6	168.0	170.9	165.6
Sept.	189.3	n.a.	n.a.	n.a.

Source: Dominion Bureau of Statistics, "Canadian Statistical Review," October 1962, p. 8.

At the same time, however, continuing signs of sluggishness in the Canadian economy suggest to some observers that the activity may reach a peak in the spring of 1961. While total industrial production (seasonally adjusted) was expanding gradually in August (1 per cent) and September (0.3 per cent), for example, the increase was associated primarily with substantial gains in mining and public utilities. Non-durables manufacturing (adjusted) declined in both July and again in August to an index of 164.1 (1949=100), the same level it had been in February. The index of total manufacturing production stood unchanged during July and declined fractionally in August to 165.8, as compared with 163.0 for the preceding March.

Underlying adjustments not yet made

The gradual relaxations in the emergency steps taken last June were made possible by the strength of the Canadian dollar and of Canada's external payments position since the end of June. Thus surface strength, however, does not mean that the basic problems which helped to bring about the international financial crisis in the second quarter have yet been tackled.

On the contrary, faced with the precarious political balance, the present administration has been unable or unwilling to replace the June 24 temporary measures with a long-term program designed to strengthen the external payments position and reduce domestic unemployment. In fact, the government has not yet presented to Parliament a definitive budget for the 1962-63 fiscal year (ending March 31, 1963) but has been content to reintroduce a slightly altered version of the proposed budget introduced in April before the financial crisis reached its climax.

The lack of balance of payments data beyond June makes it difficult to determine how the substantial devaluation of the currency (and related measures) has altered the external accounts. Balance of payments data through the second quarter reflect primarily the impact of the foreign exchange crisis (see Table 5). Figures for merchandise imports and exports for the third quarter provide no evidence that the current-account deficit has yet been reduced by the end of September. (See Table 6.)

Perhaps the key uncertainty about Canada's longer-run external payments prospects is the extent to which the devaluation will lead to further price and wage advances over the next 12 to 24 months. In the shorter run, the main uncertainty appears to lie in the extent to which rising unemployment emerges again this winter as a major political problem, especially in the present general air of relaxation about the economic position. How and when the delicate political balance will be altered remains as a continuing source of instability in the Canadian outlook.

TABLE 5. Canadian Balance of International Payments
(Millions of $ Canadian)

	1961 II	1961 III	1961 IV	1962 I	1962 II
Current Account:					
Trade balance	-31	+138	+60	-5	-44
Other current	-284	-195	-332	-348	-333
Total	-315	-57	-272	-353	-377
Capital Account:					
Direct Investment (net)	+105	+60	+65	+60	+30
Securities Transactions (net)	+128	+85	-5	-61	+29
Other Long-Term Capital Transactions	-27	-1	+12	+14	-114
Bank balances and other short-term funds abroad (excluding official reserves)	+54	-140	+112	+49	-242
Other capital movements (excluding reserves, International agencies, & special assistance)	+187	+44	+180	-53	+6
Total	+447	+48	+364	+9	-291
Surplus or Deficit (-)	+132	-9	+92	-344	-668
Financing:					
Change in Canadian dollar holdings by foreigners	-72	-1	+44	-31	-34
Special International financial assistance	-	-	-	-	+707
Liabilities to International agencies (excluding special assistance)	-9	-52	-1	+11	+41
Change in official holdings of gold and foreign exchange (increase -)	-51	+62	-135	+364	-114
Total financing	-132	+9	-92	+344	+668

Source: Dominion Bureau of Statistics.

TABLE 6. Canada: Merchandise Imports and Exports
(Seasonally Adjusted)

		Monthly Average ($ million)		
		Exports (Including Re-exports)	Imports	Trade Balance
1961:	II	476.3	452.5	+23.8
	III	504.6	497.3	+ 7.3
	IV	517.3	518.9	- 1.6
1962:	I	506.5	516.2	- 9.7
	II	510.4	525.0	-14.6
	III	524.5	552.8	-28.3

Source: Computed from data in Dominion Bureau of Statistics, "Canadian Statistical Review, October, 1962," and the "Canadian Statistical Review Weekly Supplement" for November 14 and November 18, 1962.

U.S. dollar indebtedness rises

Much of the strength of the Canadian dollar clearly reflects recent borrowings of U.S. dollar, either directly in U.S. markets or indirectly through capital inflow in Canadian financial markets. Trade sources show Canadian borrowings in this country amounted to $677 million through November 1962 compared with $148 million in the same period in 1961 and $238 million a year earlier. (See Table 7.)

TABLE 7. Canada: Sales of New Government, Municipal, and Corporation Bonds Payable in U.S. Funds

			Provincial			
Time Period	Total	Gov't.	Direct	Guaranteed	Municipal	Corporation
Jan. - November:						
1962 to Nov. 26	677.2	250.0	15.0	37.0	28.7	296.5
1961 to Nov. 27	148.4	-	-	-	26.4	122.0
1960 to Nov. 28	238.2	-	25.0	52.0	111.1	50.3
January - June:						
1962 to July 9	103.5	-	-	-	1.5	103.0
1961 to July 10	117.4	-	-	-	26.4	91.0
1960 to July 13	238.0	-	25.0	52.0	110.7	50.3

Source: A. E. Ames & Co., "Weekly Bond Sales Summary."

These borrowings include a $250 million placement of Government of Canada bonds with five U.S. insurance companies in October; about half this amount has already been transferred to Canada and the remainder is expected to be shifted in early 1963.

At present, the Canadian Government has outstanding the following direct debt payable in New York:

Maturity	Rate	Issue	Amount
9/1/74	2-3/4	1/1/49	$60,206,000
9/15/75	2-3/4	1/15/50	37,969,000

Canadian provinces and municipalities have also been regular and heavy borrowers in this country and their total indebtedness, though not available, is undoubtedly appreciable.

Canada made a drawing of $300 million in European currencies from the International Monetary Fund in June; this drawing has not yet been repaid. Canada has not borrowed from the International Bank for Reconstruction and Development.

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Recent Economic Developments in Belgium, May-December 1962

Summary

During the period under review, Belgium made further progress in reducing unemployment to only one-third of the early-1959 level. Industrial production picked up sharply during the summer after having increased very little for a year. Retail sales improved markedly, and the rise in wages was accelerated.

Belgium continues to enjoy a nearly complete absence of upward price pressures. The balance of payments yielded a surplus of $80 million in the first half of 1962, and appears to have been about in equilibrium in the months July-November.

The discount rate was reduced 1/4 of 1 per cent in August and again on December 6. These and several previous reductions have brought the rate from 5 per cent in August 1961 to the present 3-1/2 per cent. Official action and increasing ease in the money and capital markets have caused continuing sharp declines in interest rates.

The Belgian Treasury retired another $118 million of its short-term foreign currency debt in the months April-August. At the end of August this debt was $285 million compared with its peak level of $633 million in June 1961.

Unemployment reduced further; output rise accelerates.

Economic activity in the period under review has been at a level which Belgian observers hold to be satisfactory. Unemployment, which not so long ago was a major problem in Belgium, fell further from 49,000 in March to 42,000 in September on a seasonally-adjusted basis. (See Table 1.) The downtrend in unemployment, which dates from early 1959 when the jobless numbered 130,000, has brought the number of unemployed to less than 2 per cent of the active population, a smaller percentage than in 8 of the other OECD countries.

Industrial production, seasonally-adjusted, picked up sharply during the summer after showing very little increase for an entire year. (See Table 1.) There had been only a 1-1/2 per cent rise from the second quarter of 1961 to the second quarter of 1962. Subsequently, output rose in July-August to a level more than 3 per cent higher than in the second quarter. This may be a consequence of a reported upsurge in retail sales in the spring. Significantly higher department store sales beginning in March are shown by the seasonally-adjusted index in Table 1.

TABLE 1. Belgium: Selected Economic Indicators, Seasonally-Adjusted
(monthly average or month)

	Quarter				Month		
	I	II	III	IV	July	Aug.	Sept.
Industrial production (1953 = 100)							
1961	a/ 126	139	137	139			
1962	140	141	--	--	146	145	n.a.
Unemployment (thousands)							
1961	96	90	85	77			
1962	60	44	41	--	42	40	42
Department store sales (1953 = 100)							
1961	145	146	144	143			
1962	146	154	--	--	139	n.a.	n.a.

a/ Production affected by strikes in January.

Sources: OECD (production and unemployment) and National Bank of Belgium (sales).

In recent months, the sectors of industry showing the largest activity increases over a year previous have been building construction and the metal-working industries. In contrast, output in the steel and coal mining industries has lately been running below a year previous; demand for steel has been weak, and coal production is hampered by a continuing shortage of miners. Exports, which had been a strong expansionary force in 1961 and early 1962, did not increase between the first and second quarters (seasonally-adjusted), but in the third quarter were up 2.2 per cent over the second quarter.

Wage rise accelerates; wholesale prices fall.

Retail sales have certainly been helped by the marked gains in the real earnings of labor in Belgium during the period under review. Hourly earnings in industry rose 4 per cent between March and June, compared with 1.4 per cent both in the same period a year previous and in the three intervening quarters. (See Table 2.) To some extent, this rise reflects the tightening labor supply. But in large part it was due to the increases of about 2-1/2 per cent in industrial wage rates in June, when wages were adjusted upward to the sudden rise in the retail index between March and June as a result of the European potato shortage last spring. (See Table 2.) This rise proved to be temporary, and was largely reversed in the summer months, leaving workers with a clear net gain in real wages. Civil servants received a 5 per cent salary increase in August.

TABLE 2. Belgium: Wage and Price Indexes
(1953 = 100)

	March	June	September	December
Hourly earnings in industry				
1961	140	142	144	146
1962	148	154	n.a.	
Wholesale prices				
1961	103.2	102.0	102.1	102.7
1962	104.0	103.8	101.7	
Consumer prices				
1961	110.5	111.1	111.5	111.5
1962	111.7	114.3	112.4	

Sources: National Bank of Belgium (earnings) and OECD (prices).

In contrast with most of her Western European neighbors, Belgium has continued to be free of upward pressure on wholesale prices. The Belgian wholesale price index in fact declined 2 per cent between March and September, because of declining prices of agricultural commodities, and the index in September was slightly lower than a year previous. (See Table 2.) The retail price index rose 0.9 per cent from March to October, when it was 1.3 per cent higher than a year earlier, mainly because not even Belgium has escaped an upward trend in the prices of services at the consumer level.

Favorable balance of payments position.

Belgium had a balance of payments surplus of $80 million in the first half of 1962. (See Table 3.) Changes in official reserves (Table 4) suggest that external transactions were approximately in equilibrium in the months July-November. The first half year results compare favorably with the $158 million deficit in the first half of 1961, but show a smaller surplus than the $164 million surplus in the second half of 1961.

The current-account balance in January-June 1962 was not greatly changed from the two preceding half-year periods, if allowance is made for both accidental and seasonal factors. While there was an $88 million current surplus in the first six months of this year compared with a $46 million deficit in the same period last year, this is largely to be explained by the effect of strikes on exports at the beginning of last year. The small decline in the current surplus between the last half of 1961 and the first half of 1962 was the result of seasonally lower net invisible receipts, and the seasonally-adjusted trade balance was nearly unchanged between the two periods.

Capital movements showed a deficit of $8 million in the first half of 1962, including a net outflow of official capital of $28 million. In this period the Treasury's foreign-currency debt was reduced $148 million, but most of the debt retired was held by Belgian banks. Repayments of foreign-currency debt have the effect of drawing down official reserves. But Belgian banks have used repayments of debt held by them to reduce the foreign indebtedness they incurred initially to purchase the debt. In the first half of 1962, official gross reserves declined $54 million, but the net foreign liabilities of the Belgian banks contracted by $134 million.

TABLE 3. Belgium: Balance of Payments, 1961 and First Half 1962

(In millions of U.S. dollars)

	1961		1962
	First Half	Second Half	First Half
Goods, services, and private transfers	- 46	118	88
Official transfers	--	- 16	--
Official capital	-118	40	-28
Private capital	- 12	22	16
Errors and omissions	18	--	4
Monetary movements a/:	158	-164	-80
Of which:			
National Bank of Belgium	- 42	- 202	62
Commercial banks	166	46	-134

a/ Change in net foreign assets of monetary institutions (- = increase).

Source: National Bank of Belgium and IMF

TABLE 4. Belgium: Official Reserves (Gold and Convertible Currencies)

(In millions of U. S. dollars; end of period)

1960 -	December	1,422
1961 -	June	1,472
	December	1,657
1962 -	June	1,603
	July	1,631
	August	1,625
	September	1,626
	October	1,616
	November	1,607

Sources: IMF and National Bank of Belgium

<u>Interest rates fall further</u>.

There was a continued and sharp downward movement in interest rates in the second and third quarters. Changes in selected interest rates are shown in Table 5. This movement was encouraged by further cuts in the National Bank of Belgium's discount rate and rates on those Treasury certificates still issued under the tap system. Following reductions of 1/4 of 1 per cent in the discount rate in August and December of last year, further slashes of 1/4 of 1 per cent were made this year on January 18, March 22, and August 9. Recently, another reduction of the same amount occurred on December 6. The rate is now 3-1/2 per cent compared to 5 per cent in August 1961.

Apart from the discount rate reductions, the continued downward movement of interest rates has been caused by a fundamental easing of the money and capital markets. While industrial output was scarcely rising in the first six months of this year, bank deposits and money supply were increasing rapidly. Compared with a year earlier, in August money supply was up 8 per cent and commercial bank deposits up 15 per cent. The banking reform of January 1 allowed market forces to exercise a greater role in the determination of interest rates. Among other things, that reform abolished the former fixed relationship between the discount rate on one hand and, on the other, rates on 4-month certificates issued by the Treasury and the Securities Stabilization Fund and rates paid on bank time deposits. These 4-month certificates have been sold at auction since the beginning of this year.

TABLE 5. Belgium: Selected Interest Rates
(end of period)

	1961 Dec.	1962 Mar.	1962 June	1962 Aug.
Discount rate	4.50	4.00	4.00	3.75
Treasury certificates:				
3-month (on tap)	4.00	3.30	3.00	2.90
4-month (at auction from 1/1/62)	4.25	3.50	3.25	3.15
6-month (at auction)	4.70	3.70	3.40	a/ 3.30
12-month (at auction)	4.90	3.85	3.50	a/ 3.38
Bank time deposits:				
1-month	2.40	1.90	1.90	1.70
3-month	3.15	2.75	2.75	2.50
6-month	3.30	2.90	2.90	2.70
Gov't bonds (yield to maturity)				
2-5 yrs. to maturity	5.21	4.63	4.51	4.33
5-20 yrs. to maturity	5.74	5.37	5.21	4.96

a/ September 4

Source: National Bank of Belgium

Foreign-currency debt

The most recent figure for the total debt of the Belgian Government payable in foreign currencies is $823.8 million on July 31, 1962. Of this total, $425.7 million was long-term (over five years), $96.3 million was medium-term (one to five years), and $301.8 million was short-term.1/ Of the long-term debt, $285 million, or thereabouts, was payable in U. S. dollars. Short-term debt in dollars came to $172 million in October 1961, but now may be much smaller. Little if any of the medium-term debt is in dollars. Details are given in the Appendix.

1/ At the end of August the short-term debt was $285 million.

APPENDIX

Foreign Currency Debt of the Belgium Government

I. Long-term debt.

A. U.S. dollar obligations

1. On October 31, 1962, Belgium's outstanding indebtedness to the Eximbank and the IBRD was as follows:

Eximbank	35.2 million
IBRD	57.5 million

2. On June 30, 1962, Belgium's outstanding indebtedness on U.S. government loans other than Eximbank loans was $63.0 million, mostly Marshall Plan loans.

3. Publicly-issued dollar bonds outstanding appear to total approximately $118.6 million. A public issue of $25 million was floated in December 1961 and another of $30 million in March 1962. In addition, other bond issues outstanding totalled $63.6 million on April 30, 1961.

B. Obligations in other currencies

1. At the end of 1961, Belgium still owed $33.2 million equivalent on a 30-year Canadian dollar loan received from the Canadian Government in 1946-47.

2. The remaining non-dollar long-term debt consists of about $118 million of publicly-issued bonds denominated in Swiss francs, Netherlands guilders, Deutsche Marks, and sterling.

II. Medium-term debt.

Most of this debt consists of a $20.7 million equivalent guilder loan obtained from a group of Dutch banks in May 1961, and a $50 million equivalent DM loan obtained from a group of German banks in August 1961.

III. Short-term debt

Substantial portions of the short-term debt in foreign currencies have in the past actually been held by Belgian banks. This debt has been denominated in several foreign currencies, as well as in gold. At the end of October 1961, when the short-term debt totalled $503.6 million, the portion denominated in U.S. dollars was $172 million. Since the total short-term debt at the end of August 1962 had been reduced to $285 million, the portion in U.S. dollars may now be substantially less.

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