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Council and Commission

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(Information)

COUNCIL AND COMMISSION

SIXTEENTH REPORT
ON THE ACTIVITIES OF THE MONETARY COMMITTEE

FOREWORD

The purpose of this report is to give a brief account of the activities of the Monetary Committee during 1974.

During this year the Committee held 15 sessions and the working parties drawn from its own members or set up at its initiative met on many occasions.

At its session of 10 July 1974 the Committee elected its officers. It elected as Chairman Prof. C. Oort, Treasurer-General in the Netherlands Ministry of Finance, and as Vice-Chairmen, Dr. O. Emminger, Vice-President of the Deutsche Bundesbank and Mr C. de Strycker, Vice-Governor of the Banque Nationale de Belgique. Mr J. G. Littler of H.M. Treasury was elected Chairman of the Committee of Alternate Members. In accordance with the Council Decision of 30 April 1972 aligning the dates of renewal of the terms of office of the members of certain committees, the terms of office of the new officers will expire on 31 December 1975. A list of members as at 31 December 1974 is annexed.

The report was adopted as at 31 December 1974.

INTRODUCTION

1. In 1974, world business activity lost a good deal of momentum; this trend was accompanied by a further acceleration of inflation and by balance-of-payments disequilibria of record proportions. The heavy swing in the terms of trade — resulting from the increase in the prices of raw materials and especially from the quadrupling of crude oil prices from November 1973 onwards — contributed to these developments. The disequilibria and inflationary tendencies increased in gravity most of all in those countries which already had run into difficulties before the oil crisis. The new pattern of international payments relations combined with domestic economic difficulties, particularly in deficit countries, posed a serious threat to the free trade and payments arrangements developed since the war.

2. The new economic and financial situation also hampered the process of integration in the Community. Consequently the Community authorities gave priority to reaching agreement on practical action to help Member States in difficulty and to safeguard the degree of integration already achieved

rather than attempting further progress towards economic and monetary union along the lines mapped out in previous years. The rapid reduction of the extreme payments disequilibria of certain member countries and the restoration of the stability of the value of money are among the most important preconditions governing the revival of the integration process in the Community, for without them present strains in the Community cannot be dispelled.

3. This report is divided into four parts. The first chapter reviews international monetary events in 1974, and the second chapter gives an account of joint Community action in the monetary field including progress towards the establishment of economic and monetary union. The third chapter is devoted to a review of the economic and monetary trends in the Community and the fourth summarizes the activities of the Committee's Working Parties.

CHAPTER I

THE FOREIGN EXCHANGE MARKETS

4. The Monetary Committee followed closely developments in the foreign exchange markets. In 1974 international monetary relations were hampered by formidable payments disequilibria. Although internal economic factors were partly to blame in some countries, the position was aggravated by the sudden jump in crude oil prices in late 1973.

5. The currencies of most industrialized countries continued to float throughout the year; the modifications in exchange rate relationships between the major currencies mainly reflected the economic and monetary trends in the various countries. For much of the year, national and international interest rate policies were of particular importance for many currencies: interest rate disparities proved an important factor in capital movements, the potential size of which grew appreciably as a result of the colossal surpluses of the oil-producing countries. Another factor of disturbance which was of some importance for a period around the late summer was uncertainty about the position of some banks and the particular difficulties experienced by some of them as a consequence of over-extension in the foreign exchange markets. This was a relatively short period of unease which was over by the end of the year.

6. The trend in the rate of the US dollar against the currencies within the Community 'snake' illustrates the changes which occurred in exchange rate relationships. At the beginning of the year the improvement in the position of the dollar, which had been observed in the last few weeks of 1973, became more marked despite the fact that, during that period, several central banks in industrialized countries sold dollars in currency support operations. During the second half of January, the dollar rate was being quoted at about 8 % above its nominal parity against the currencies within the Community snake. This was a result of the belief that the higher oil prices would damage the US economy less than the economies of most other industrialized countries.

7. But in the first weeks of 1974, most industrialized countries, in an attempt to facilitate the financing of existing or expected payments deficits, began to relax the measures they had taken to control inward capital movements during the period of the monetary crisis. Most countries introduced measures to facilitate or encourage capital inflows; furthermore, the restrictions on capital outflows were tightened in countries facing particularly serious payments problems. These measures were supported by a high interest rate policy, constituting an important element in the fight against inflation, particularly in the European countries.

8. In the United States, the liberalization of capital movements, and in particular the abolition of all restrictions on the export of capital combined with an interest-rate pattern favouring investment abroad, led to heavy outflows of capital from the end of January 1974 onwards. As a result, there has since been a depreciation in the dollar on the exchanges. After reaching its nominal parity against the currencies within the Community snake on 21 February, it continued to drift downwards; in mid-May the depreciation reached about 10 % against its nominal parity.

9. Thereafter, the scarcity of liquidity on the US money market which was the result of a more restrictive monetary policy, and the prospect of a greater inflow of petro-dollars led to an improvement in the situation, with the dollar, despite fluctuations, gradually strengthening until, in mid-September, it had almost returned to its nominal parity against the currencies within the Community snake.

10. After September, the dollar rate swung downwards again, mainly owing to the marked decline in short-term interest rates in the United States compared with other countries and to the disappointing trend in the trade balance and the unfavourable business situation in the United States. After steadily weakening in the fourth quarter, the dollar had, at the end of the year, almost returned to its lowest 1974 level, namely that recorded in mid-May; its depreciation against the Community snake currencies was in the neighbourhood of 10 %.

11. On 19 January 1974, after consulting the other member countries and the Commission, the French Government decided to discontinue its participation in the Community exchange scheme and temporarily to allow the franc to float independently. The purpose of this step was to forestall speculation and to protect the reserves. At the same time, the French authorities declared their intention to ensure orderly working of the exchange market. The Monetary Committee held a consultation on the French decision. Immediately after this decision, which was underpinned by measures to curb capital outflows and to encourage capital inflows, the value of the franc on the exchanges dropped by some 5 % against the currencies remaining in the snake. In mid-May, the franc touched its lowest level, a drop of almost 14 % as against the Community snake, thereafter staging a gradual recovery; by the end of the year, it was being quoted at 5 to 6 % below the snake currencies.

12. Otherwise, the Community snake operated relatively smoothly; the rates of the participating countries' currencies remained for most of the time comfortably within the authorized margin of 2·25 % and, generally speaking, little intervention in Community currencies was needed. However, it must be pointed out that US dollar interventions by central banks of the snake and the DM interventions by the Federal Reserve Bank of New York, which essentially aimed at moderating fluctuations in the dollar, were also helpful for the stability of the system. There were only two periods of strain: once between the end of March and the last two weeks in May, when the Deutschemark was practically always at the snake's upper limit, with the Belgian franc and the Danish krone taking turns at the other extreme. Faced with this situation, which was largely attributable to speculative capital movements, the Bundesbank was, in accordance with the agreed rules, obliged to support the weakest currencies by taking in about DM 4 000 million of foreign currencies.

13. The second occasion on which the Community's exchange arrangements were strained was between the end of July and the beginning of October, when the Belgian franc and the Dutch guilder were persistently at the snake's upper limit while the Deutschemark was quoted for most of the time at its lower limit. The weakness of the Deutschemark, which, in view of the generally favourable balance of payments situation in Germany, might have seemed surprising, was attributable mainly to interest rate differentials and to the unease caused on international exchange markets by the collapse of a German bank. In order to stabilize exchange rates, the Bundesbank had to sell foreign exchange worth about DM 3 500 million during that period. The reversal of exchange-rate and intervention trends in the snake during the course of the year demonstrated the effectiveness of the Community exchange-rate system.

14. In 1974, the currencies of the countries participating in the snake appreciated, in some cases quite considerably, against almost all other currencies: from 1 January to the end of the year the extent of this appreciation approached 6 % against the French franc, 15 % against the US dollar and the pound sterling and 25 % against the lira and the yen.

CHAPTER II

ECONOMIC AND MONETARY UNION AND OTHER JOINT COMMUNITY ACTION

15. Balance of payments disequilibria, which were already in existence in the Community due to divergent economic trends and policies in the member countries, were rendered much more severe by the energy crisis and presented the Community with exceptionally difficult problems in 1974. The strained situation harboured the danger that individual countries might be tempted to seek

solution to their difficulties through unilateral measures. The main task of the Community institutions was, therefore, to forestall the possibility of protectionist actions or actions distorting competition and to promote joint action to help Member States in difficulty. Progress towards economic and monetary union along the lines mapped out in 1973 remained in suspense, but the Community was able to achieve agreement on a number of practical measures which effectively strengthened its solidarity.

16. After January, only five Community countries, (together with Norway and Sweden) still adhered to the arrangements concluded on 24 April 1972 on the narrowing of intra-Community margins, for the United Kingdom and Ireland had already left the snake on 23 June 1972, Italy had followed suit on 13 February 1973, and France on 19 January 1974.

17. At a meeting on 21 January 1974, the Ministers of Finance and the Governors of the Central Banks of the countries remaining in the snake, (BLEU, Denmark, Germany and the Netherlands) confirmed their resolve to maintain the existing relationships between their currencies within the framework of the 'Basle Agreement', one objective being to facilitate a swift return to the Community snake by the other Member States. They also reached agreement on the principles and procedures for the closer coordination of arrangements for intervention on the exchanges, of foreign exchange control regulations and of monetary and credit policies, with the aim of ensuring the smooth working of the Community exchange scheme.

18. In January 1974, the Commission proposed that the Member States should state their firm intention to refrain 'from any competitive depreciation of their currencies and from any restriction on trade', and hold consultations at Community level on exchange-rate trends, interest rate policy, the use of the international capital markets and the utilization of reserves. This was agreed by Council on 18 February 1974. In addition, the Council stated that the EEC would endeavour to ensure 'that the whole of the international community adopts, in the field of money and trade, policies which would assure stable and orderly relations'. At the same meeting, the Council formally approved various legal instruments for the strengthening of economic and monetary union, on which agreement in principle had already been reached on 17 December 1973 (see Fifteenth annual report on the activities of the Monetary Committee, OJ No C 123, 14. 10. 1974, p. 5). Thus, it renewed in a more systematic, and sometimes stronger form, the arrangements already in existence by taking decisions on: the attainment of a high degree of convergence of the economic policies of Member States, stability, growth and full employment in the Community, and the creation of an Economic Policy Committee; it also invited the member central banks to increase the quotas in the short-term monetary support arrangements.

19. In 1974, the Monetary Committee also dealt with problems arising out of the Italian situation. In February, this country was negotiating with the International Monetary Fund for a stand-by credit agreement. In accordance with the Council Decision of 8 May 1964, consultations were held in the Monetary Committee since Italy proposed to 'have recourse to resources which can be mobilized within the framework of international agreements'. However, it was only on 10 April that the IMF opened a credit line to Italy of 1 000 million SDR. In the meantime, on 18 March the Banca d'Italia, with the agreement of the Committee of Governors of the Central Banks, drew the equivalent of 1 562 500 000 units of account under the short-term monetary support facility which had been made available on a stand-by basis from June 1973. In order to have a better understanding of the Italian situation, the Monetary Committee created a Working Party under the chairmanship of Mr de Strycker. This Working Party held discussions with the Italian authorities in March and drew up a report. The conclusions of this report were contained in the Monetary Committee's Opinion to the Council and the Commission of 5 April.

20. On 29 April, the Italian Government announced that it was introducing emergency measures under Article 109 of the EEC Treaty. The key measure was a requirement to lodge with the Banca d'Italia for a six-month period a non-interest-bearing cash deposit totalling 50 % of the value of specific visible imports. This was mainly intended to scale down domestic liquidity and indirectly to facilitate the restoration of balance of payments equilibrium. The Commission immediately examined Italy's situation, and on 6 May 1974 addressed a recommendation to the Italian Government indicating those re-equilibrating measures which in the Commission's opinion were essential and urgent. On 8 May, it published a Decision authorizing Italy to take these emergency measures within the meaning of Article 108 (3).

21. On 6 July 1974, the Italian Government adopted a comprehensive set of stabilization measures relating to taxation and public service charges; these measures, with a few minor

amendments, were approved by the Italian Parliament in August. Meanwhile the Monetary Committee Working Party chaired by Mr de Strycker held a further series of consultations with the Italian authorities. The short-term monetary support was renewed twice for a period of three months on 18 June and 18 September. On the basis of one of the Working Party's reports, the Monetary Committee prepared an Opinion in November (see Annex I) which led to a recommendation by the Commission and on 18 November 1974 the Council approved a Directive on the granting of medium-term financial assistance to the Italian Republic. The assistance totalled 1 159 200 000 units of account, and is to be paid back in four equal instalments in 1978. The interest rate — 7·5625 % — is an average between the corresponding market financing cost and IMF financing on comparable maturity terms. The United Kingdom, which for balance of payments reasons was unable to take part in the financing of the medium-term assistance, continued to accord to the Banca d'Italia a renewable three-month credit in the amount that it had formerly made available in the short-term support operation. In accordance with Article 9 of the Directive, the Commission, in collaboration with the Monetary Committee, will see that the conditions of economic policy to which the assistance is linked are properly observed.

22. In addition to these Community arrangements, the Banca d'Italia obtained a loan of $ 2 000 million from the Deutsche Bundesbank in return for pledging a part of its gold reserves, valued at market-related prices, as collateral.

23. One of the major preoccupations of the Committee during the whole year has been the monetary and financial implications of the energy crisis, in particular the recycling of the oil-producing countries' expected surpluses. In February, the Committee examined the proposal that the Community should undertake a joint borrowing operation on the international capital markets with the double objective of recycling oil funds and assisting Member States with balance of payments difficulties. In accordance with a request received from the Council at its session of 6 June, at its meeting of 10 and 11 July, it adopted an Opinion on the problems which would be involved in floating a Community loan. In addition, it set up a Working Party of both treasury and central bank representatives, on the basis of whose studies it finally adopted an Opinion to the Council and Commission on 10 October (see Annex II). On the basis of this work, the Council considered the question of Community loans at several sessions and on 21 October 1974 approved a basic Regulation and on 19 December 1974 approved a Regulation implementing the first Regulation.

24. This provided the Community with an instrument enabling it to help towards financing oil deficits. Under the basic Regulation it is the Community which will raise the loan, in one or more operations, either directly from third countries and financial institutions or on the capital markets. Including interest, the total amount of the loans may not exceed $ 3 000 million and their average term must be at least five years. With the proceeds, the Community will grant Member States loans to which will be attached economic policy conditions fixed by the Council in each case.

25. The implementing Regulation lays down the procedure to be followed in the event of a Member State which has received a loan from the Community being unable to raise the necessary foreign exchange to make a payment. In that event, the other Member States undertake to provide finance to enable the Community to continue the servicing and amortization of the loan. Each Member State's share in the refinancing will be determined in line with its short-term monetary support quota. Member States which are themselves in balance of payments difficulties may be exempted from this refinancing subject to the condition that no contributing country will be obliged to provide proportionately more than twice its quota. Countries required to meet the guarantee acquire a claim on the Community. The loan amounts are placed at the disposal of the central bank of the borrowing country, since these loans are intended solely for the financing of balance-of-payments deficits.

26. The Committee was also involved in arriving at a Community position on other recycling proposals made in international fora. In particular, the IMF oil facility for 1974 and later for 1975 as well as the OECD Financial Support Fund were discussed in the Committee on several occasions.

27. The Monetary Committee gave considerable attention during the year to the problem of gold and after a detailed discussion of the problem, the Committee adopted a report to the Council and the Commission at its meeting of 4 and 5 April. This report, together with that of the Committee of Governors, formed the basis for the understanding reached at the informal conference of finance ministers at Zeist on 22 and 23 April 1974. The substance of this understanding was presented by the Chairman of the Monetary Committee to the Committee of Twenty of the IMF at its meeting in June 1974 (see Annex III). The Monetary Committee continued to keep the gold problem under review as part of its preparations for meetings at the international level.

28. The Monetary Committee also frequently discussed other international monetary problems. On a number of these it was able to arrive at a common position which the Community usefully presented in the IMF, Committee of Twenty (Committee for the reform of the international monetary system and associated questions), and the Group of Ten. The principal questions dealt with concerned the value and interest rate of the SDR, the revision of IMF quotas, amendments to the IMF Articles of Agreement and to the General Arrangements to Borrow (GAB), the setting up of the Interim Committee of the Governors of the Fund ,and the particular interests of developing countries.

29. The Monetary Committee discussed and presented written reports on various monetary questions linked to the achievement of economic and monetary union, such as the Community exchange rate system, pooling of reserves and the unit of account. At the Council session of 16 September, the President of Council had presented a memorandum on European monetary revival, in which he highlighted four areas as being suitable for studying the possibility of immediate further progress. These were:

— floating of a Community loan,

— the units of account used by the Community,

— modification of the Community exchange rate system,

— coordinated action on the Euro-markets.

30. In accordance with the Council request to begin work as soon as possible on the latter three items, the Monetary Committee submitted an initial opinion on the unit of account to be used for the European Development Fund and then on the general question of the European unit of account. The work on this problem is still continuing. It also submitted an Opinion on joint floating of Community currencies, and began work on the problem of coordinated action on the Euro-markets.

31. The Committee held consultations and prepared Opinions on the exchange rates used for the conversion of national currencies into units of account for the purpose of the common agricultural policy. These consultations principally concerned the Italian lira, the pound sterling and the Irish pound.

CHAPTER III

ECONOMIC AND MONETARY DEVELOPMENTS IN THE COMMUNITY

32. The Committee held its regular examinations of monetary and financial developments in Member States, with particular emphasis on the monetary policy pursued. During the year, it held such examinations of France, the United Kingdom, Germany and the Netherlands.

33. In 1974, largely because of higher oil prices and — at least in the early part of the year — higher prices of the other main raw materials, the general economic trend in the industrialized countries changed direction: the long period of vigorous growth in the world economy came to an end. World business trends became very uneven — in most countries growth declined and in some countries the GNP actually contracted. The volume of international trade, which had expanded by 15 % in 1973, increased by less than 5 % in 1974, not increasing at all in the fourth quarter. In terms of dollar value, however, growth in 1974 matched the rate for 1973 (37 %), which reflects inflationary tendencies in many parts of the world. The Community's main international trading partners were hard hit: in the United States and Japan, real gross national product declined sharply. The other industrialized countries were affected to differing degrees, but the pace of growth slackened everywhere in the course of the year.

34. The Community countries were not sheltered from the changed world economic climate. For 1974 the growth of real gross domestic product fell by half, from 5·5 % to slightly more than 2 % for the Community as a whole. This overall figure was the net result of an appreciable increase in the first half of the year and a pronounced decline in the second; by the end of the year industrial production was at best marking time, when not actually falling. In 1974, as in 1973, export demand was the most buoyant growth factor, or to be more exact, the least sluggish. After increasing by 12 % in 1973, the volume of exports of the Community as a whole rose by only about 9 % in 1974, and even this figure owed much to an unexpectedly high increase (nearly 50 %) in the

volume of imports of the oil-producing countries. Private consumers' expenditure (volume) in the Community as a whole rose by a mere 1·7 % in 1974, compared with 4·6 % in 1973, despite the rapid increase in incomes in 1974; gross fixed capital formation fell in real terms by 1·3 % in 1974 (+ 4·8 % in 1973). In most of the member countries these two demand components deteriorated almost without interruption throughout the year. The increase in public current expenditure in real terms also slowed down in 1974 but more moderately (3 % as against 3·6 % in 1973).

35. Employment was inevitably affected by the decline in the level of economic activity. During 1974, those countries which previously had suffered very little unemployment also had to cope with this problem. By the end of the year more than 3 % of the labour force in the Community were out of work. In addition, hours worked were reduced in many industries, so that short-time working became widespread. The hardest hit by the energy crisis were industries whose prospects were suddenly clouded by the disappearance of a cheap energy source, the main sufferers being the motor vehicle industry and its suppliers. But in all sectors of activity, the sudden heavy swing in the terms of trade and the climate of increased uncertainty helped to foster expectations of a recession and to bring out cautious attitudes.

36. Inflation was gathering momentum at the end of 1973 and this trend was confirmed in 1974; the upward price movement reached very high levels in almost all the Community countries under the combined effects of the rise in oil prices, the depreciation of certain currencies, the slowdown in productivity gains and, above all, the sharp increase in wage costs. The tendency for excessive growth in money supply which accompanied these phenomena was not reversed in all Member States by sufficiently restrictive monetary and budgetary policies. But the pace of inflation differed considerably from country to country in the Community. The rise in the cost of living index was lowest in Germany (5·9 %); rates were higher in the Netherlands (10·9 %), Luxembourg (11·3 %), France (15·2 %), Denmark 15·3 %) and Belgium (15·7 %), but not as high as in Ireland (17 %), the United Kingdom (19·1 %) and Italy (19·2 %). At the end of the year, however, there was evidence in most member countries that strain was easing.

37. The most obvious effect of the leap in the prices of petroleum products was a sharp deterioration in the current accounts of the industrialized countries. In the United States, the current account, which had achieved a modest surplus in 1973 ($500 million), accumulated a deficit of $1 300 million in 1974 (1); in Japan, the deficit increased considerably from $100 million to $4 500 million between 1973 and 1974. The deterioration was even more marked for the Community as a whole, which showed a deficit of some $13 000 million in 1974, compared with a small surplus in 1973 of $800 million. Beneath this overall deterioration, however, trends differed considerably within the Community, the countries with current-account surpluses before the oil crisis managing to maintain or even increase their surpluses and those with deficits or balanced positions being the hardest hit, as shown in the following table.

(1) These figures and all the others given in this paragraph are OECD estimates.

Current balance of the Community countries (in $ 1 million)

	BLEU	Denmark	Germany	France	Ireland	Italy	Netherlands	United Kingdom
1973	+ 1·4	— 0·5	+ 4·4	— 0·7	— 0·2	— 2·4	+ 1·8	— 2·9
1974	+ 0·5	— 1·0	+ 9·4	— 6·0	— 0·6	— 7·9	+ 1·8	— 9·1

Source: OECD.

38. By the end of 1973, the authorities in most member countries faced with accelerating inflation, had increasingly tightened up economic policy measures. This pattern was maintained and even reinforced in the first half of 1974; but in the second half, the decline in activity and the sharp rise in unemployment prompted most member countries to adopt measures which, if not really reflationary, were designed at least to provide selective support for economic activity and in particular investment, although only Germany had as yet had any real success in combating inflation. Interest rates rose to

record levels in almost all countries. None the less, accelerating inflation meant that in all the countries except Germany the remuneration of savings failed to offset the fall in the value of money. Together with the fact that short-term rates were frequently higher than long-term rates, this helps to explain why investors in these countries were reluctant to place their funds on a long-term basis, and the relatively poor performance of the capital markets.

CHAPTER IV

WORKING PARTIES OF THE MONETARY COMMITTEE

39. The Working Party on Securities Markets continued to examine developments in the capital markets of Member States and in the international capital market and discussed capital market policies. It presented a report on its activities, the conclusions of which were approved by the Monetary Committee (see Annex IV).

40. Having received a report in October 1973 (see fifteenth annual report) from the Working Party on Short-Term Capital Movements, in fulfilment of its original terms of reference, the Committee defined the area of future activities of this Working Party. At its meeting of 4 and 5 April, it approved new terms of reference which instructed the Working Party in the first stage to exchange and examine mutual information on national exchange control measures, in the second stage to reach a consensus on what constitutes a minimum armoury of common instruments and on how the use of such instruments might be concerted and in the third stage to examine the possibility (at the Community level) of a differential application of these instruments as between intra- and extra-Community capital movements. As a first step in the fulfilment of these terms of reference, the Working Party submitted an interim report in December which was approved by the Monetary Committee (see Annex V).

41. At its meeting of 4 and 5 February, the Monetary Committee adopted terms of reference for the Working Party on Harmonization of Monetary Policy Instruments set up jointly with the Committee of Governors in accordance with the resolution of the Council and the representatives of the Governments of the Member States of 22 March 1971 on the achievement by stages of economic and monetary union. After the terms of reference were also approved by the Committee of Governors, the Working Party commenced work in the middle of the year.

LIST OF THE MEMBERS AND THE ALTERNATES OF THE MONETARY COMMITTEE

Chairman	
Dr C. J. Oort (from 10 July 1974)	Thesaurier-generaal bij het Ministerie van Financiën (The Hague)
Vice-Chairmen	
Dr O. Emminger	Vizepräsident der Deutschen Bundesbank (Frankfurt/Main)
Dr C. J. Oort (until 9 July 1974)	Thesaurier-generaal bij het Ministerie van Financiën (The Hague)
M. C. de Strycker (from 10 July 1974)	Vice-gouverneur de la Banque nationale de Belgique (Brussels)
Members	
Mr S. Andersen	Gouverneur, Danmarks Nationalbank (Copenhagen)
Mr J. Balfour (from 25 April 1974)	Bank of England (London)
M. F. Boyer de la Giroday	Director in the Directorate-General for Economic and Financial Affairs — Commission of the European Communities (Brussels)
Mr B. J. Breen	Central Bank of Ireland (Dublin)
M. R. de la Genière (from 24 July 1974)	Sous-gouverneur de la Banque de France (Paris)
M. A. de Lattre (from 28 January 1974 to 23 July 1974)	Sous-gouverneur de la Banque de France (Paris)
M. M. D'Haeze	Directeur général de l'administration de la trésorerie et de la dette publique — Ministère des finances (Brussels)
M. C. de Strycker	Vice-gouverneur de la Banque nationale de Belgique (Brussels)
Mr C. W. Fogarty	H.M. Treasury (London)
M. J.-Y. Haberer	Chef du service des affaires internationales à la direction du trésor — Ministère de l'économie et des finances (Paris)
Mr K. Hansen	Director-General — Det Økonomiske Sekretariat (Copenhagen)
M. C. Lamboray	Directeur adjoint de la Caisse d'épargne de l'État (Luxembourg)
Mr C. W. McMahon (until 24 April 1974)	Director — Bank of England (London)
Prof. G. Miconi	Direttore generale del Tesoro — Ministero del Tesoro (Rome)
Dott. U. Mosca	Director General for Economic and Financial Affairs — Commission of the European Communities (Brussels)
Mr S. F. Murray (until 25 November 1974)	Department of Finance (Dublin)
Mr T. O'Cofaigh (from 26 November 1974)	Department of Finance (Dublin)
Dott. R. Ossola	V. Direttore generale della Banca d'Italia (Rome)
M. J. Schmitz	Conseiller de gouvernement au ministère des finances (Luxembourg)
Drs. A. Szasz	Directeur van de Nederlandsche Bank N.V. (Amsterdam)
Dr H. H. Weber (from 9 January 1974)	Ministerialdirektor — Bundesministerium der Finanzen (Bonn)

Chairmen of the Alternates of the Monetary Committee	
Prof. Dr J. Mertens de Wilmars (until 9 July 1974)	Conseiller économique de la Banque nationale de Belgique (Brussels)
Mr J. G. Littler (from 10 July 1974)	H.M. Treasury (London)
Alternates	
Mr M. J. Balfour (until 24 April 1974)	Bank of England (London)
M. J.-M. Bloch-Lainé	Sous-directeur à la direction du trésor — Ministère de l'économie et des finances (Paris)
Drs. D. H. Boot	Onderdirecteur van de Nederlandsche Bank N.V. (Amsterdam)
Mr H. Dalgaard	Head of Division — Danmarks Nationalbank (Copenhagen)
Drs. G. de Man (until 2 December 1974)	Ministerie van Financiën (The Hague)
M. A. Dondelinger	Commissaire au contrôle des banques (Luxembourg)
Dr W. Flandorffer	Ministerialrat — Bundesministerium für Wirtschaft (Bonn)
Mr F. L. Hall (from 25 April 1975)	Bank of England (London)
Hr. G. Jennemann	Bankdirektor — Deutsche Bundesbank (Frankfurt/Main)
M. H. Koch (until 26 December 1974)	Directeur général des études à la Banque de France (Paris)
M. G. Lefort (from 27 December 1974)	Directeur général des services étrangers de la Banque de France (Paris)
Mr D. Lynch	Department of Finance (Dublin)
Mr D. McCormack	Central Bank of Ireland (Dublin)
Prof. G. Magnifico (from 1 January 1974)	Banca d'Italia
M. J. Mertens de Wilmars	Conseiller économique de la Banque nationale de Belgique (Brussels)
Dr B. Molitor	Director in the Directorate General for Economic and Financial Affairs — Commission of the European Communities (Brussels)
Mr J. E. Nash	Director in the Directorate General for Economic and Financial Affairs — Commission of the European Communities (Brussels)
Dott. S. Palumbo	Dirigente generale al ministero del Tesoro (Rome)
M. M. Schmit	Inspecteur des finances (Luxembourg)
Mr N. Ussing	Head of Division — Det Økonomiske Sekretariat (Copenhagen)
Drs. R. Van Boven (from 3 December 1974)	Ministerie van Financiën (The Hague)
M. J. van Ypersele de Strihou	Chef de cabinet adjoint du ministère des finances — Ministère des finances (Brussels)

Secretariat

M. G. Morelli

M. G. Lermen

Mr A. Chapman

ANNEX I

REPORT TO THE COUNCIL AND THE COMMISSION

(Grant of medium-term financial assistance to Italy)

I. INTRODUCTION

1. Pursuant to the Agreement establishing a system of short-term monetary support between the central banks of the Member States of the EEC, signed on 9 February 1970, and amended on 8 January 1973, short-term monetary support was granted to the Bank of Italy on 28 June 1973 for an amount of 1 562·5 million units of account (US $1 884·9 million). At the same time, as in the case of the mobilization by the Bank of Italy of the support facility on 18 March 1974, the Monetary Committee proceeded to examine the economic and monetary situation in Italy, in accordance with the terms of Article VII of the Agreement establishing a system of monetary support. The conclusions reached by the Monetary Committee were given in a report dated 24 July 1973 (Doc. II/453/73) and in the Opinion of 5 April 1974 (Doc. II/194/74) presented to the Council and the Commission. In view of the fact that the term for which the short-term monetary support was granted expired on 18 September 1974, the Monetary Committee further examined the situation in Italy and adopted, on 11 September 1974, the text of an Opinion to be submitted to the Council and the Commission (Doc. II/496/74). In this document, the Committee expresses the view *inter alia* that the Community should continue to contribute to Italy's financing needs and that such action is a matter of urgency.

2. On the basis of this Opinion, the Council, having noted the decision of the Committee of Governors of the Central Banks to renew the short-term monetary support granted to Italy for three months, requested, at its meeting on 16 September 1974, that the Commission, together with the Monetary Committee and the Committee of Governors of Central Banks, should draw up concrete proposals regarding medium-term financial assistance to Italy.

3. At its meeting on 6 and 7 November 1974, the Monetary Committee carried out a thorough examination of the situation in Italy on the basis of preliminary work by the *ad hoc* Group 'Italy', which met on several occasions in Rome and Brussels under the chairmanship of Mr de Strycker. The conclusions reached by the Monetary Committee are given in the present report.

II. THE ECONOMIC SITUATION IN ITALY AND THE CURRENT OUTLOOK

4. After expanding strongly last year and in the first half of 1974, economic activity is at present tending to weaken. Whilst exports are still expanding very briskly, the trend of domestic demand, especially for investment, is rather hesitant. In seasonally adjusted terms, industrial production actually declined in the period July to August; in relation to the corresponding level for 1973, no more than a slight increase was recorded (not quite 1 % against 18·6 and 8·7 % respectively for the first and second quarters of 1974). The upward movement of prices, however, continued at an extremely rapid pace, with consumer prices in September exceeding by 24·6 % and wholesale prices by 43·7 % the levels reached a year earlier.

5. The weakening of domestic demand, together with the simultaneous expansion of exports, seems to have resulted in an immediate improvement in the current balance of payments position. This latter was slightly in deficit in July-August (Lit 47 000 million) as against a deficit of Lit 2 027 000 million in the first quarter and Lit 2 183 000 million in the second quarter. Furthermore, for the first time in recent years, capital movements showed an upward trend despite the fact that no further loans had been floated on the international financial markets by State-controlled enterprises. Partly as a result of a $ 2 000 million credit (Lit 1 321 000 million) granted to Italy by the Bundesbank, gold and foreign exchange reserves held by the Italian monetary authorities, which amounted to Lit 2 793 000 million in June, rose to Lit 4 521 000 million in September.

6. For the current year the Italian authorities forecast an increase in the GNP of 4 to 4·5 % by volume and 20 % in money terms. Consumer prices are expected to rise by 20 %. The deficit on account of goods and services, which amounted to Lit 1 551 000 million in 1973, will rise to Lit 5 850 000 million in 1974 (see paragraphs 8 and 9).

7. In the event that the current economic weakness continues during the first quarter of next year, the year-to-year growth of the GNP in volume will not exceed 1·5 % in 1975 [1]. A rise of 16 % in consumer prices is forecast, and the total wage bill is expected to rise by the same order of magnitude. Fixed investment at constant prices is expected actually to decline by 1·5 % whilst the other components of domestic demand are likely to expand to only a slight extent. Conversely, exports of goods and services may reasonably be expected to grow rapidly (by 8 % at constant prices). This being the case, the deficit on account of goods and services at constant prices should decline to an appreciable extent such that a deficit of about Lit 3 400 000 million seems a plausible estimate for 1975 (corresponding to about 3 % of GNP in money terms for 1975, against 6 % in 1974).

(1) According to Italian experts, the disappointing trend of growth results from constraints imposed by the balance of payments deficit and the high level of Italy's indebtedness.

The balance of payments

8. Forecasts for the current balance of payments in 1975 (deficit of Lit 3 250 000 million) are based essentially on the assumption of an increase of 6 to 7 % in the volume of world trade. This forecast allows for a slight increase in the share of Italian exports in world trade, as a result of the depreciation of the lira since February 1973, In addition, it seems probable that the weakness of domestic demand will induce Italian businessmen to increase their efforts to penetrate foreign markets.

9. As regards the trade balance (fob figures) in 1975, the Italian authorities expect the oil deficit to stabilize at the level reached in 1974 (Lit 4 700 000 million or $7 200 million at an exchange rate of 1 US $ = Lit 655) (1). This forecast assumes that no change will occur in the quantities and prices of oil products imported in relation to the average for 1974. On the other hand, the non-oil trade balance, still substantially in deficit in 1974 (by Lit 1 600 000 million or $2 400 million), should show a surplus of some Lit 700 000 million next year ($1 100 million). Furthermore, a surplus of the same order of magnitude is predicted for the balance on account of services and current transfers.

10. As regards capital movements, only the yearly capital repayments relating to the off-setting loans (2) can be predicted with certainty; they will amount to $1 000 million in 1975. In round figures, the balance on account of current transactions and servicing the external debt will amount to about $6 000 million next year. Any net capital movements in categories other than those mentioned would, of course, modify this total.

11. As of the end of October, the means available to finance this deficit were as follows:

— gold stocks of about $3 500 million valued at a price of $42·22 per ounce (3).

— foreign exchange reserves, including SDR's, of about $3 400 million.

— $4 000 million of 'swap' credits.

— IMF standby credits of $400 million.

Public finance

12. Treasury receipts on account of central government budget transactions amounted, in the period January to August 1974, to Lit 11 656 000 million and expenditure to Lit 15 133 000 million; levels for the previous year were therefore exceeded by 22·1 and 11·1 % respectively. As a result of the higher rate of growth of receipts, the budget deficit was limited to Lit 3 477 000 million (Lit 4 068 000 million in the period January to August 1973). However, as a result of other treasury transactions (administration of the deposits and loans bank — Cassa Depositi e Prestiti — and autonomous institutions) the deficit on treasury account was higher than in the previous year (Lit 5 921 000 million against Lit 4 292 000 million: it was financed almost entirely by monetary means. According to estimates by the Italian authorities, the treasury deficit will amount to around Lit 8 400 000 million in 1974. This figure is higher than that forecast in September by Lit 400 000 million, due to certain expenses — especially in relation to the State enterprises ENEL and IRI — being brought forward from 1975 to 1974.

13. The balance on account of current transactions by all public authorities has been in deficit since 1971. This deficit amounted to Lit 702 000 million in 1971, Lit 2 076 000 million in 1972 and Lit 3 463 000 million in 1973. For the current year it could amount to about Lit 3 000 000 million. The deficit for the State (Lit 534 000 million in 1971, Lit 951 000 million in 1972 and Lit 2 486 000 million in 1973) will decline to about Lit 1 650 000 million in 1974. This decline is mainly due to direct taxation reforms and to the series of fiscal measures introduced in July.

The expansion of credit

14. For the period 1 April 1974 to 31 March 1975, the Italian authorities have committed themselves to confine the overall expansion of credits to the economy to the total of Lit 22 400 000 million fixed last March during the negotiations of the stand-by credit granted by the IMF.

The overall expansion of credit includes the financing of the treasury deficit (excluding assistance to financial intermediaries), credits granted by Italian investment banks and special financial institutions (4) together with issues of bonds by enterprises and public authorities other than the treasury. Increases in the capital of State-controlled enterprises or issues of shares are not included in this definition.

15. The effective increase in credit during the first five months of the period concerned (April to August 1974) was, on the whole, maintained within the limits laid down in the annual target (for the period April 1974 to March 1975) i.e. Lit 22 400 000 million. The same applies to treasury financing which, in accordance with commitments entered into with the IMF, was not to exceed Lit 8 600 000 million for this period taken as a whole. Credits granted to other public authorities (including the social security organizations) and to enterprises in the period April to August 1974 followed a trend corresponding more or less to the difference (Lit

(1) For the purposes of this report, the oil deficit is defined as the difference between the value of total imports and exports of petroleum products. For comparison, this deficit was Lit 800 000 million in 1973.

(2) These are loans contracted since June 1972 on international financial markets by certain State-controlled enterprises. The proceeds of these loans were frozen almost in their entirety in the Bank of Italy.

(3) Of this stock about 20 % has been given as collateral for a loan of $2 000 million from the Deutsche Bundesbank.

(4) These institutions grant both medium- and long-term credit; they obtain finance by issuing bonds.

13 800 000 million) between the total volume of credit and total treasury financing. This latter figure represents an increase of about 17 %, as against 20 % in 1973.

16. The overall expansion of credit, (see Annex 1 for detailed figures), will not exceed Lit 24 700 000 million in the period 1 April 1975 to 31 March 1976 (1). Taking into account the reduction in liquidity which would arise from such a balance of payments deficit as forecast, this ceiling incorporates an increase in the monetary base of the order of 16·1 % over 1974, whilst the rate of increase 1974 on 1973 should be 16·3 %.

This expansion of credit will allow for the following to be covered:

— Treasury borrowing requirements of Lit 8 000 000 million for 1975.

— The borrowing requirements of other public authorities and enterprises of Lit 16 700 000 million. This borrowing, taking account of internal financial resources of enterprises and the other sources of finance described in Annex 1 should permit investment of about Lit 25 000 000 million to be undertaken. It should be noted that these forecasts include a particularly low growth rate in the financial assets of enterprises, being only 7 to 8 % between 1973 and 1975.

III. GUIDELINES FOR ECONOMIC POLICY

17. The Monetary Committee believes that Italy's balance of payments problems call for action in depth with a view to restructuring the Italian economy. It considers that immediate measures should be taken to reduce the 1975 deficit substantially, whilst longer-term measures should quickly be implemented with a view to eliminating the external disequilibrium completely and repaying any debts contracted.

18. The Italian Government proposes to adopt an economic policy designed to achieve a surplus of at least $1 000 million on account of the non-oil items of the trade balance in 1975.

Immediate measures

19. As regards public finance, the Italian Government should make a special effort to achieve an improvement in the situation during the coming years. In this respect, the deficit on treasury transactions, which will amount to about Lit 8 400 000 million in 1974, will have to be reduced to Lit 8 000 000 million in 1975 (2).

20. The Committee considers that the rate of growth of public expenditure should be limited to 16 % in 1975. This rate, which corresponds to that agreed by the Italian Government, implies a zero increase in real terms. The budget forecasts adopted by Parliament (appropriations basis) exceeded this figure and particular attention must therefore be paid to their implementation in terms of actual receipts and expenditure. To this end, cuts may be necessary in non-productive current expenditure and in non-priority sectors. Furthermore, the Government should act jointly with the other public authorities to limit the latters' expenditure in 1975 by an amount corresponding to that indicated for central-government expenditure. However, in the opinion of the Monetary Committee, a reduction in the budget deficit can only be obtained in the short term by a further increase in receipts.

21. As regards credit policy, the Monetary Committee reaffirms its opinion of 11 September 1974, to the effect that the increase in the total volume of credit granted to public authorities and enterprises should not exceed Lit 22 400 000 million during the 12 months to 31 March 1975. Between 1 April 1975 and 31 March 1976, the increase should not exceed Lit 24 700 000 million. Treasury financing should be conducted in such a way that the resulting monetary creation is compatible with an expansion of credit which is sound enough to ensure that financing is non-inflationary in the medium term.

22. Before the end of 1975, new economic policy guidelines will be fixed for 1976.

Medium-term measures

23. One of the fundamental medium-term problems is to achieve an improvement in the state of public finances. The total budget deficit is of the order of 5 to 6 % of GNP. In particular, the margin between current expenditure and current receipts is a little over 3 % of GNP. The Italian authorities should undertake measures, some of them immediately, with a view to its complete elimination within a period of five years. Furthermore, during this period, monetary financing of treasury borrowing requirements should be progressively and substantially reduced.

24. On the expenditure side, it would be desirable if the authorities could reduce the rate of growth, particularly on account of the semi-public institutions, in accordance with the Draft Law No 1718 currently before Parliament.

25. In transferring tasks from the central administration to the regions, care should be taken that this operation does not involve duplication of work resulting in an unjustifiable increase in expenditure.

(1) Taking account of the forecast rate of inflation, the increase in total credit outstanding (+ 17·8 %), will be practically zero, in real terms, on one year before.

(2) These figures do not include finance granted to financial intermediaries (amounting to Lit 100 000 million in 1974 and Lit 400 000 million in 1975), or the operations for consolidating certain local authority debts (Lit 144 000 million for the eight months to August 1974).

26. As regards receipts, the fiscal and parafiscal share in total national income in Italy is significantly below the Community average due to the relatively low receipts from direct taxes. Measures should be introduced immediately to improve the relative share of direct taxation: in this respect, it is a matter of vital necessity that the struggle against tax evasion should be intensified.

27. The efforts already being made to strengthen the infrastructure of the Italian economy — especially as regards administrative organization — should be intensified. In particular, administrative procedures, which at present seem highly complex besides differing greatly from one department to another, should be simplified; measures to facilitate the mobility of officials between the various departments within the administration should be introduced, whilst at the same time certain tasks could be decentralized as between the central government and the regional authorities. This should make possible a stricter control of the number of personnel employed in public service.

28. To improve the balance of payments position in the medium-term, the Italian authorities should strive to reduce consumption of petroleum products in domestic use. On the other hand, in accordance with Community provisions, measures designed to promote the growth of agricultural production should be introduced. The Italian authorities should ensure the earliest implementation of the Council Directives concerning the modernization of the structure of agricultural production (OJ No L 96 of 23 April 1972).

29. It is important that the Italian authorities should take meaures to adapt the structures of consumption and production to the new situation arising from changes in the international terms of trade. In order to achieve the required changes in industrial production, it will be particularly necessary to modernize the employment services and accelerate the creation of vocational training programmes for workers. Those Community instruments already available (especially the Social Fund) could support the efforts which the Italian authorities will undertake in this field.

30. Measures to encourage saving and influence its pattern are also needed. In this context, for example, consideration might be given to the introduction of a system of savings premiums to assist house purchase and the creation of Italian investment funds.

31. Before 30 June 1975 the Italian Government will present detailed drafts of measures for implementing the actions described in paragraphs 23 to 30. These drafts will be incorporated into an overall view of the situation at the Community level.

IV. THE FINANCIAL CONDITIONS FOR MEDIUM-TERM ASSISTANCE

32. Article 3 of the Council Decision of 22 March 1971 lays down that medium-term financial assistance shall be granted to a Member State in difficulties or seriously threatened with difficulties as regards their balance of payments. The Committee believes that Italy is in the situation envisaged by this Article and thinks that the amount of the assistance should be the same as that of the short-term monetary support, which was provided in dollars, i.e. 1 562 million units of acount ($1 884·9 million).

33. The medium-term financial assistance could be implemented as follows:

- countries with existing or foreseeable difficulties as regards their balance of payments which decline to participate totally or in part in the operation in accordance with the terms of Article 4 of the Council Decision of 22 March 1971, would continue to provide assistance to Italy, to the extent of their quota (or a part of it) in the operation, within the framework of the short-term monetary support with a tacit undertaking to renew this assistance until the date of expiry of the medium-term financial operation;
- the amount to be financed in the medium-term, after deducting the assistance being provided under short-term arrangements, would be divided between the participating countries in proportion to their respective quotas;
- in the event that the short-term monetary support could not be renewed, in whole or in part, right up to the date of expiry of the medium-term financial assistance, a Council Decision would have to determine the methods of arranging the necessary financing.

34. Article 3 (2) of the Council Decision of 22 March 1971 lays down that credits can be granted for two to five years. However, a declaration written into the minutes of the Council meeting specified that 'in order to ensure at the beginning a higher degree of liquidity, it would be advisable to limit credits to a period of two to three years during an initial period of three years maximum following the effective employment of the system'. In view of the fact that the payments falling due in relation to the servicing of external debts already contracted by Italy will be quite heavy in 1976 and 1977, the Committee considers that it would be appropriate to envisage repayment in instalments during 1978. In this way, the effective term of the assistance would be approximately three-and-a-half years.

35. As regards the currency in which the financial assistance is expressed, the Council Decision of 22 March 1971 provides that claims and obligations shall be expressed in terms of units of account defined in weight of gold. The problem is to choose appropriate methods of converting the units of account of the assistance into currencies of payment so that the claims of the creditors and the obligations of the debtor can be defined. To resolve this problem the Monetary Committee considered two possible alternatives:

(a) Under the first alternative, the medium-term financial assistance would be provided by all the participating countries in US dollars and repaid by the debtor country in the same currency. The unit of account would be converted into dollars on the basis of the central rate of the dollar prevailing at the time the assistance is granted; at present one unit of account = \$1·20635.

(b) Under the second alternative, the medium-term financial assistance would be provided by all the participating countries in their respective national currencies and repaid by the debtor country in the same currency. The unit of account would be converted into the different national currencies on the basis of the central rate or market rate of these currencies fixed for the entire term at the time the assistance is granted.

36. A declaration in the minutes specifies that the rate of interest should be half-way between those current on the open market and those applied by the IMF. Since the IMF rate for financial assistance granted for similar terms is 4·875, a single rate could be determined for the whole term of the assistance on the basis of this rate and on current rates on the Euro-dollar market for a comparable term, if the assistance is provided in dollars. Should it be provided in national currencies, it would be necessary to refer to current interest rates for similar terms on the relevant Euro-currency markets or on national markets. A calculation of the rates applicable to various currencies are given in Annex 2.

V. SURVEILLANCE

37. The fulfilment of the economic policy commitments entered into by Italy and the periodic examination of the economic situation of this country should be covered by a regular supervisory procedure carried out jointly by the Commission and the Monetary Committee. In particular, respect for the quantitative economic policy objectives fixed by the Council when the medium-term financial assistance is granted should be subject to surveillance. To this end, the Italian authorities should communicate to the Commission on fixed dates (for example, monthly), certain statistical information concerning the economic, financial and monetary situation. In addition, the Monetary Committee should carry out a thorough examination of the progress of the situation in Italy at regular intervals (for example, every six months).

38. To prevent a proliferation of studies and recommendations, care should be taken to ensure that this surveillance is carried out within the framework of existing Community procedures. To the same end, it would be advisable to establish the necessary contacts with the appropriate departments of the IMF.

39. If, in the course of a study of this kind, or in the light of information provided by the Italian authorities, it should appear that economic trends are liable to diverge from the objectives fixed, the Commission will so inform the competent Community authorities. The same procedure would apply in the event that any revision of the objectives was felt to be necessary.

Annex 1

Overall credit expansion in the economy

(in Lit 1 000 million)

	1974	1975
A. Public institutions (other than those included under B) and enterprises, including the housing sector:		
1. Gross investment	23 550	25 000
2. Capital transfers received by the treasury	— 2 700	— 2 900
3. Variations in financial assets	1 550	2 300
4. Borrowing requirements (1 + 2 + 3)	22 400	24 400
5. Less:		
— issue of securities	700	700
— credits granted by the treasury as financial intermediary	1 500	1 400
— credits from abroad	600	200
— gross saving	5 600	5 400
6. Balance to be financed (a)	14 000	16 700
B. Treasury, deposits and loans bank, autonomous institutions	8 400	8 000
C. Overall credit expansion (A 6 + B)	22 400	24 700

(a) By the investment banks and special credit institutions as well as by the issue of bonds.

Annex 2

Current interest rates in EEC member countries (except Italy), on the Euro-markets and at the IMF for terms of three to four years

(mid-October 1974)

I. **Rates on national markets** (1)	
— *Germany*	
— yield on federal treasury bills with three to four years to maturity	10·04 to 10·33
— yield on medium-term federal treasury bonds	10·40 to 10·60
— *Belgium*	
— five year SNCI and CCB treasury bills	9·75
— three year SNCI and CCB treasury bills	9·25
— *Denmark*	
— yield on mortgage bonds and industrial financing institute bonds (four years to maturity)	13·50 to 14·50
— *France*	
— CNCA three year bonds	8·60
— five year treasury bills	9·02
— *Ireland*	
— yield on treasury bonds with three years to run	12·10 (end June)
— *Luxembourg*	
— three year bearer savings certificates	6·00
— *Netherlands*	
— yield on state bonds with four years to run	9·16
— *United Kingdom*	
— treasury bills with four years to run	9·62
II. **Euro-market rates**	
Euro-dollar	10·50
four year Euro-pound	22·50
III. **IMF rates**	
'oil facility' credits (three to seven year maturities)	7 %
— 'extended fund facility' credits (four to eight year maturities)	Progressive rate according to maturity (4 to 6·5 %)
— interest rate on four year drawings (including the Commission)	4·875 %

(1) Rates on national markets are not strictly comparable, and are often not very representative due to the low volume of operations at the relevant maturities. Further, it should not be forgotten that these rates are the ones most often directly or indirectly controlled.

ANNEX II

OPINION TO THE COUNCIL AND THE COMMISSION

I. COMMUNITY LOANS

At its session of 16 September 1974, the Council in dealing with the question of Community loans, considered the report from the Chairman of the Monetary Committee and from the Committee of Governors and instructed the Community authorities to complete quickly the current technical work within the guidelines laid down in the report submitted by the Chairman of the Monetary Committee. The Chairman of the Council, Mr Fourcade, also asked member governments to indicate their official reactions to the report of the Chairman of the Monetary Committee.

At its meeting of 17 September 1974, the Monetary Committee instructed the joint *ad hoc* group to continue such work as was within its competence and to secure the government reactions which the Chairman of the Council had requested. The joint *ad hoc* group of the Monetary Committee and the Committee of Governors met on 26 September 1974 and 7 October 1974 and considered all the official reactions which had been received. The Monetary Committee, at its meeting of 10 and 11 October 1974, drew up the following opinion on the basis of the government reactions and the report received from the *ad hoc* group.

II. GENERAL CHARACTERISTICS OF THE OPERATION

Bearing in mind the need to recycle the surplus funds of oil-producing countries, the Monetary Committee agreed that the general characteristics of the operation should be the following:

(a) That the Council would prefer not to engage in one massive loan operation, but rather in one or more loans of moderate size.

(b) The loan or loans would not take the form of public bond issues for general subscription, but would be placed with owners of large scale funds — principally in oil-producing countries — and possibly in part with financial intermediaries. In the present situation, loans of seven to ten years maturity would seem to be the most appropriate choice. It was felt that the technique of roll-over credits should be avoided. However, it was noted that the maturities and other characteristics of loans will depend largely on prevailing market conditions at the time of issue.

(c) The decision to issue an external loan would be taken at the initiative of any Member State in need of assistance to meet a balance of payments deficit caused chiefly by the rise in oil prices. The greatest discretion should be maintained with regard to the entire negotiating procedure in respect of each operation in order to avoid disturbances in financial markets.

(d) The Council shall maintain control over the timing and conditions of each loan operation.

III. CHOICE OF BORROWER

The various alternatives with regard to the choice of borrower were again considered. A general consensus was established on the following:

1. The Community should be the borrower.

2. The Council shall authorize each specific borrowing transaction. It would also approve each on-lending operation to the interested Member State or States and determine the economic conditions which would be an integral part of such a loan agreement.

3. (a) The negotiations on the terms of any borrowing operation with the lenders will be conducted under the auspices of the Commission, who will recommend the final conditions to the Council, subject to the advice of the Monetary Committee and the Committee of Governors. Whilst they might need to be preceded by political contacts undertaken by the Commission, these negotiations might, in practice, be conducted at the technical level jointly by the staff of the Commission and of the EIB, who would report to a very limited *ad hoc* working party. This working party would be composed of competent people nominated by the Member States, the Commission and the EIB, and would be responsible for preparing the operation for approval by the Council of Ministers.

   (b) The Commission shall negotiate with the borrowing Member States and recommend the economic conditions on which a proposed loan to a Member State is to be granted. Such conditions shall include the entire monitoring system to be established during the time-span of the loan. Subject to advice from the Monetary Committee and the Commitee of Governors, a Council Decision will then again be necessary.

The Monetary Committee proposes to look into the matter of appointing a managing agent in the near future.

IV. REPAYMENT OF LOANS

1. It is considered that only in extreme cases would a situation arise in which a borrowing Member State would

find it was impossible to meet a loan commitment in foreign exchange. This applies all the more because such a situation could only arise after three or four years following the granting of a loan, during which time considerable monitoring of the situation would have taken place.

2. Upon the Council agreeing to extend a loan to a Member State through Community procedures, each non-borrowing Member State would incur a contingent liability in respect of such a loan. Such contingent liability would be represented by the obligation to provide foreign exchange to the Community to meet one or more maturities or interest payments should the borrowing Member State be unable temporarily to meet its obligations in foreign exchange.

3. It was considered that a system be provided which would fulfil two criteria:

(a) ensure, that at any time, the servicing of the capital and the interest payments of the external debt shall be carried out by the Community;

(b) a ceiling in respect of each operation should be set on the refinancing contingent liability of each Member State.

4. The system would operate in the following way. In the event of inability by a borrowing Member State to meet all or some of its due foreign exchange payments:

(a) Temporary foreign exchange financing would be provided to the Community by each of the other Member States in the proportion which its quota in the existing short-term monetary support system bears to the total quotas of those States (1);

(b) If one or more of these States should be unable (in whole or in part) to take up their share of refinancing owing to balance of payments difficulties and/or a serious deterioration in their foreign exchange reserve positions then, subject to consultation and Community agreement, the remaining States would provide temporary facilities to the Community to cover the shortfall, again in proportion to their respective quotas, but subject to the over-riding limit that no member could be called upon to contribute more than its ceiling.

(c) Should any balance still remain to be financed after stage (b) above, Member States experiencing balance of payments difficulties and/or a deterioration in their reserve positions would still have to cover this balance in proportion to their short-term monetary support system quotas (see 5 (f) below).

(d) The ceiling for each Member State's financing contingent liability would be twice the proportion of its quota in the short-term monetary support system, expressed in percentages.

(e) It should in any case be the general rule that both in the case of original inability to pay by the borrower as well as of temporary exemptions from financing by other Member States all possible external and Community financing arrangements should first be exhausted.

5. The monitoring system should be geared to the pattern of each operation. It is, however, understood that the final rule shall be that the monitoring system during the whole period of the loan will be concerned entirely with verifying the respect by the borrowing Member State of the economic policy conditions which are an integral part of the loan agreement. The following system could be envisaged:

(a) During the grace period of a loan from the Community to a Member State when only interest charges are to be met, six-monthly monitoring of the development of the principal economic indicators, balance of payments trends, and movements in the reserve positions of the debtor State should be carried out.

(b) As the first capital repayment then approaches, a more intensive monitoring system should be operated to ensure that no problems arise with regard to payment on the due date or dates.

(c) Should it appear, however, that difficulties are likely to arise, a special examination of the debtor Member State's position shall take place at an appropriate time before each payment date.

(d) All monitoring under (a), (b) and (c) above will be carried out under the authority of the Commission in collaboration with the Monetary Committee and the Committee of Governors.

(e) During the special examination referred to in (c) above the debtor Member State will be required to demonstrate its inability to meet a payment (in whole or in part). If the special examination indicates that such inability exists, the Commission proposes to the Council to decide affirmatively upon a refinancing arrangement as described in 3 above. If there are serious doubts that such inability exists, the debtor Member State may apply to the Council, who will decide after the Commission has delivered an Opinion and the Monetary Committee and the Committee of Governors have been consulted. The decision of the Council will be taken either on a unanimous vote or qualified majority following its own decision.

(f) Any Member State wishing to be temporarily exempted (in whole or in part) from its refinancing commitments will have to state its position in the course of the same examination as referred to in (c) above, and the same procedure shall apply to its request as is applied to the original debtor State's request. The criteria by which the Community bodies will assess the case of the Member State wishing to be temporarily exempted, in whole or in part, may be less stringent than the criteria to be applied to the original debtor State, taking into account, however, the extent to which other Member States' ceilings are being approached.

(1) Proportions of quotas of Member Countries in the short-term monetary support system:

Germany	22·02 %,	Belgium/Luxembourg	7·34 %,
United Kingdom	22·02 %,	Netherlands	7·34 %,
France	22·02 %,	Denmark	3·30 %,
Italy	14·68 %,	Ireland	1·28 %.

(g) Should the Council agree to a refinancing procedure as described in (e) and (f) above, then it shall be considered that an emergency situation has arisen and all future procedures of monitoring of the original debtor State shall be substantially reinforced until all normal financial relationships have been re-established.

(h) It shall be the general rule that the earliest reimbursement or reinstatement should take place as soon as the relevant Member State's balance of payments and foreign exchange reserve positions have improved sufficiently.

V. FINAL CONSIDERATIONS

1. The Monetary Committee does not consider itself competent to pronounce on the question of whether the Community can undertake such a borrowing operation as described above on the basis of Article 235 of the Treaty of Rome. Neither does it consider itself qualified to answer all questions relating to Community budgetary and accountancy procedures.

2. Considerable discussion has taken place on whether formal recommendations should be made on the currency denomination of a first loan operation. It was, however, felt that this depended on exogenous factors and was a subject best left to the negotiating body.

At the same time it should be pointed out that the denomination of the first loan does not imply that subsequent loans shall be denominated in the same way and in this context the desirability of eventually reaching a Community denomination should be kept in mind.

3. The Monetary Committee believes that borrowing operations by the Community, provided they are not of excessive size, should be realizable. It feels that apart from the engagement of the Community, what would be required would be public statements to the effect that the Council had reached such a decision unanimously and that arrangements had been made internally within the Community to take care of all payment contingencies.

ANNEX III

STATEMENT OF THE CHAIRMAN OF THE MONETARY COMMITTEE TO THE COMMITTEE OF TWENTY

I have been asked to report on an informal discussion — and I emphasize the word *informal* discussion — which the Ministers of Finance of the EEC have held on April 22 and 23 at Zeist on the subject of gold.

Before I report to you on the outcome of the discussion I would like to make clear that it has resulted neither in a formal decision on the part of the EEC countries nor even in a firm proposal to be made in a wider international context. What came out of Zeist was a consensus on certain substantive propositions that are to be further explored before they are submitted to one of the coming meetings of the Council of Ministers of the EEC. If at a later stage the Council reaches agreement on a certain position, the further procedure could be that the European Community formulates a formal *proposal* on how to deal with the problem of gold in the period before the reform of the international monetary system.

In Zeist, Ministers have agreed on two general propositions. First, they have re-asserted that the SDR should become the principal reserve asset in the future system, and that arrangements for gold in the interim period should not be inconsistent with that goal. Second, they have agreed that such interim arrangements should enable monetary authorities to effectively utilize the monetary gold stocks as instruments of international settlement.

There was a consensus among Ministers that an increase of the official gold price, although it might serve the second objective, would be inconsistent with the first. In order to mobilize monetary gold as an international reserve asset, they have agreed that:

1. Monetary authorities should be permitted to buy and to sell gold among themselves at a market related price and to sell and buy on the free market. The monetary authorities would have complete freedom to buy or to sell gold, and would have no obligation whatever to enter into any particular transaction.

2. Certain delegations are of the opinion that gold transactions with the free market should not, over a certain period of time, lead to a net increase of the combined official gold stocks.

3. In order to apply these principles, various practical solutions can be envisaged. Two were mentioned in particular. One is that monetary authorities periodically fix a minimum and a maximum price beyond which they would not respectively sell or buy on the market. The other consists in creating a buffer stock to be managed by an agent who would be charged by the monetary authorities to sell or buy on the market such as to ensure orderly conditions on the free market for gold.

4. These arrangements would be adopted provisionally and would be reviewed in the light of experience attained after, say, a year.

In concluding, Mr Chairman, I would like to emphasize once more that what I have just said is not a proposal by the EEC, but a report on an interim-stage in the discussions. Ministers have permitted us to make this report in order to inform you as early as possible of the direction in which a consensus among the EEC countries is emerging. They expect deputies to interpret the status of the information in the light of what I have just said.

ANNEX IV

PRELIMINARY DRAFT REPORT OF THE WORKING PARTY ON SECURITIES MARKETS

General survey

During the greatest part of the year all capital markets, national and international, were affected by important upheavals in international capital movements as a result of the oil price increase: rates of inflation which reached levels never before recorded in peacetime, huge balance of payments surpluses accruing to the oil-producing countries, and equivalent deficits incurred by the oil-consuming countries. The immediate consequences on the capital markets was a rapid and continuous rise in interest rates, particularly short-term rates, which often exceeded those on long-term bonds, over the first 10 months of the year.

In these circumstances, there was a shortage of capital flowing to the market as lenders, in the face of inflation, preferred to stay liquid, accompanied by an extreme reluctance on the part of borrowers to issue long-term loans at high rates of interest.

The 'abnormal' structure of interest-rates, with short-term rates higher than long-term rates for long periods (the rate on six-month dollars at one point rising to 14 %) produced a market preference on the part of lenders for short-term investments. This is demonstrated by the extremely low volume of medium- and long-term bond issues in most countries, and the similarly large volume of Euro-currency bank loans (roll-over credits) accorded.

A further device which was resorted to by financial operators in an attempt to revive the markets was the use of floating rate issues even for bond loans, based on a previously chosen six-month average (usually the London inter-bank rate) with a premium ('spread') which varied according to the quality of the borrower and the length of the loan. However, even with the additional safeguard of a guaranteed minimum rate, the improvement in the markets was not significant.

Only towards the end of the fourth quarter were there signs of a 'normalization' on the markets, with a recovery in the volume of bond issues and a reduction in the level of interest rates.

The trend in interest rates was not identical in all Member States, some countries reaching a peak earlier than others, with an ensuing decline towards the end of the year. In addition, the extent of the increase differed considerably between countries, such that the interest rate gap became even wider. In general, those countries with the lowest increases also peaked earlier, Germany 10·9 % in October and France 12 % in June. Countries with the highest increases either have not yet reached a peak or only in December (UK and Ireland over 17 % on long-term bonds) although in these last, short-term interest rates have remained well below long-term rates, the slope of the yield curve being at times unusually steep.

The volume of issues varied considerably between countries. In most, there was a reduction in the amount raised. In France, Italy and the UK the reduction was quite serious. In others, despite a fall in the first nine months, the fourth quarter result was sufficient to provide a small increase over 1973 (Denmark).

The share markets in all countries were affected by the prevailing economic situation and the general uncertainty. In all countries there was a fall in the share index during the year, but the extent of the fall and the degree of recovery towards the end of the year differed considerably. In Germany the fall in the share price index was least over the year as a whole, it having recovered in the fourth quarter to rise almost back to its end-December 1973 level. There were also three countries which experienced a rise in the index during the first part of the year. In Germany and the Netherlands this was due to a premature belief that the initial effects of the oil crisis were over and the recession would not be so serious. When it became clear that the world economic situation was in fact worsening, then the index underwent the downturn to the third quarter. In Italy, the rise in the index in the first quarter (up 16 points between January and April) was due to a belief that the purchase of equities was a hedge against inflation. When subsequent events proved otherwise, the index underwent a substantial fall over the rest of the year. In the UK, Ireland and Belgium, the trend was a continuous downward one. In France the fall was continuous, but a certain recovery was noted during the fourth quarter.

National markets

In *Germany,* the markets were very depressed in the first three quarters, but after the Bundesbank took measures in October easing the restrictive credit policy, the situation improved considerably with the expectation by investors that there would be a fall in interest rates. The distinctive change from the previous year has been the general reluctance of private households to invest in long-term bonds as a result of growing economic uncertainty, and thus concentrating activity on the bond market in the hands of the banks. Another feature has been the shortening of the maturities of new issues (five to seven years).

In the first quarter there was a lack of activity combined with a fall in prices and a rise in yields. This was accompanied by a strong tendency on the part of the public to acquire short-term liquid assets rather than long-term paper. This market situation did not change fundamentally in the following months. Following the measures to ease liquidity at the end of October, the markets recovered strongly in the fourth quarter, and the final volume of net issues for the year 1974 as a whole at DM 26 700 million corresponded approximately to the volume in 1973 at DM 26 800 million.

At the beginning of the second quarter, the Bundesbank carried out interventions to restrain the rise in interest rates, since a further rise was considered unacceptable for economic reasons, but bond yields on the secondary market increased further to reach 10·9 % in June, and then stabilized at around this level until October. The measures announced by the Bundesbank on 24 October ushered in a period of falling yields which ended the year at 9·4 %.

The volume of foreign DM issues was very low during the first half of the year, as the differential between yields on these bonds and yields on domestic bonds narrowed, and during May and June, even reversed. During the second half of the year, the market gathered momentum following a widening of yield differentials, and although the gap narrowed again during the third quarter, there was a strong recovery in the fourth quarter with issues of DM 643 million and the yield at about 1 % above that on domestic bonds. The total volume of issues was about one-quarter that of the previous year with DM 637 million compared with DM 2 571 million in 1973.

The share markets also had an unsatisfactory year, although the extent of the fall was less than that of other centres. The share price index fell from 127 in January to 106 at the beginning of October, its lowest level since October 1967, but towards the end of the year the mood became more confident and the index was almost back to its level of a year earlier. The volume of share issues (at market prices) was virtually identical to that achieved in 1973.

In *France,* for the major part of the year, results were generally unsatisfactory, due to some very bad results for the year as a whole, and to a complete interruption for five weeks during July and August. The total volume of gross issues was about one-third down on that of 1973 at FF 22 550 million compared with FF 34 640 million the previous year. For the first three quarters in particular, results were sharply below those for the previous year.

On the side of the issuers, the market was characterized by an almost total absence of public enterprises in the first three quarters, and of financial institutions in the second and third quarters, who, in view of conditions on the domestic markets, preferred to have recourse to the international markets. They were encouraged in this by the authorities principally because of the weakness of the domestic market and secondarily for balance of payments reasons. This absence was to the benefit of private enterprises who thus accounted for a major part of activity during this period, and achieved a total volume of FF 8 170 million for the year as a whole. The recovery of activity in the fourth quarter allowed the reappearance of the financial institutions and public enterprises on the domestic bond market.

The movement of yields also reflected the trends on the bond market, as well as those on the international markets. From the beginning of the year until June yields rose rapidly from 9·4 to 11·3 for public issuers (for private issuers rates were about 0·5 % higher). During the third quarter they were stable at around 11·5, with a slight but regular fall from the end of the quarter on until the reappearance of minor tensions during the fourth quarter. At the end of the year, the gross yield rates on the secondary market were 11·21 for public securities and 11·9 for private sector securities, compared with 10·21 and 10·47 respectively at the beginning of the year. Nominal rates followed the trends on the secondary market, ending the year at 11·3 % (public sector) and 12 % (private sector), a rise of 1·9 and 2·4 points respectively.

Share issues were slightly up on 1973 in volume, despite a very low level of activity in the third quarter. This was compensated for by a reasonable level of issues in the second quarter (in contrast to a rather low volume of bond issues in that quarter) and by a substantial recovery in the fourth quarter, in line with most other centres. The share price index reflects the extent to which the Paris Bourse shared the world-wide slump in stock market activity, declining by about 40 points between January and September, but recovering slightly to end the year about 30 points down at 59 from 92.

Developments on the *Italian* bond market have been heavily influenced by the tax reforms which came into force on 1 January, by a restrictive credit policy and by the trend of inflation. Public demand for bonds was extremely weak throughout the year. The acceleration of inflation, the expectation of higher interest rates, and the appearance of a gap between short-term and long-term rates have all provided incentives to investors to prefer more liquid forms of investments. There were very few new issues in the first three quarters of the year, and the total net volume, at Lit 5 173 000 million was about 50 % down on that for 1973 (Lit 10 476 000 million). This was achieved only because a large number of issues were made in the last quarter (Lit 4 525 000 million). Recourse to the international markets, at Lit 1 855 000 million, almost reached the 1973 level of Lit 1 900 000 million, despite being concentrated in the first half of the year. The sharp fall in the volume of domestic issues which occurred in the first quarter was almost totally due to a concentration of issues in the last quarter of 1973 in order to avoid increased tax burdens for bonds issued after 1 January 1974 following the fiscal reforms which came into effect on that date. The markets continued to function at a very low level although measures were taken to attract private capital to the market, such as variable rates, shortening of maturities and premature redemption clauses. Under these conditions, almost the total amount of each loan was taken up by the banking system, partly due to the prolongation of measures requiring credit institutions to invest a certain percentage of their funds in bonds.

Yields have followed a rising trend over the year, from about 7·5 % in January and February to 11 % in June, rising further to around 12 % in October and ending the year at 12·7 % in December. This increase in yields, accompanied by an interest rate structure where short-term rates have consistently been above medium- and long-term rates has also contributed to the high liquidity preference of the public.

The volume of share issues declined even more than the volume of bond issues, with an amount less than one-third that attained in 1973 (Lit 620 000 million against Lit 1 983 000 million).

The share price index rose steadily until April, rising from 169 to 185, then falling to 115 at the end of the year as uncertainties on economic developments and the profit possibilities of firms made investors reluctant.

In the *United Kingdom*, uncertainty created by two general elections and three budgets unsettled the markets throughout the year, although there were periods during which the markets remained quite firm.

The volume of net issues fell substantially. At the beginning of the year, while prices dropped and yields rose, sizeable sales of medium- and long-dated government stocks were made, and a new medium-dated treasury tap stock was issued. This situation continued into the second quarter when substantial sales of stock were again made and a new long-dated and a new short-dated tap stock were issued, despite an easing of the market during May and June. During the third quarter, the markets fluctuated under the influence of various economic developments and only one new stock was issued, although the prices of all gilt-edged stocks rose over the period as a whole. The market was firm throughout September, but thereafter turned very weak, the general election in October and the budget in November doing little to disperse the feeling of uncertainty, and although there was a slight recovery at the end of November, demand for stocks remained low.

The trend of yields over the year as a whole was in the upward direction, along with that of most interest rates. Yields on long-dated government stocks began the year at around 13 %, rose to around 14 % in March and up to 16 % in October, ending the year at over 17 %, although short-term yields remained in the range 12 to 13 %.

The interest rate structure was 'normal' with short-term rates lower than long-term rates throughout the whole year.

The equities market had a very bad year, the share price index falling continuously until 11 December when it reached 150·4, its lowest level for 20 years. At the end of the year it stood at 161·4, a fall of 70 % from its May 1972 'high' of 543·6 and a fall of 51 % during 1974, compared with a fall of 33 % in 1973.

Activity was extremely depressed throughout the year, particularly in the first three quarters, although the final volume of new issues, at £136 million was not seriously down on the result for 1973 (£162 million). This relatively favourable result is due to the fact that one issue made in the fourth quarter accounts for nearly half the total.

Events on the *Irish* capital market closely followed those on the UK capital markets.

Demand for Irish Government stocks was fairly strong and steady throughout the year, and new tranches of existing stocks at various maturities were issued in every quarter. These general trends, however sizeable, mask fluctuations in actual sales of stock over the year. The first quarter began well, but became weak later as prices of long-dated stock fell, and the net result for the whole quarter was well down on the same quarter the previous year. The market remained fairly steady throughout the second, quarter, prices then falling slightly in July and August from the end-June levels to produce very buoyant sales for these months. This trend did not, however, continue, and for the rest of the year prices of medium- and long-dated stocks fell continuously, under the influence of apprehensions over the future trend of interest rates which had risen sharply to 15·25 % in October, to 17 % in November (for long-dated stocks). This trend eased off in December, and new tranches of stock were issued to meet the re-appearing demand for stock.

Yield rates and interest rates closely followed those in the UK, the trend over the year being in the upward direction. At the beginning of the year long-term interest rates were still rising from the levels of the previous year, and in March yields ranged from 12·5 to 14 %. During the second quarter, the spread widened, however, yields on short- and medium- dated stocks falling, while those on long-dated stocks rose to give a range of 12 to 14·5 % at end-June. This remained stable until the fourth quarter, when long-term interest rates climbed even higher with yields between 12 and 15·5 % in October, rising to between 13 and 17 % at the end of the year.

Since the Irish and UK stock exchanges are now merged, trends follow a similar pattern, and as in the UK, the share price index fell continuously during the year from 234 to 119.

In the *Netherlands*, capital markets have produced a distinctly better performance in terms of total borrowing than in 1973: Fl 3 715 million against Fl 1 938 million for public issues. The net amount of privately placed loans increased from Fl 11 100 million in 1973 to Fl 12 500 million in 1974. Details on gross flows are not available; the Bank voor Nederlandsche Gemeenten placed loans with a maturity of five years and more to a total amount of Fl 3 160 million (1973: Fl 2 515 million).

Demand for capital has been quite buoyant throughout the period, particularly from public institutions, and from non-banking concerns in the private sector. Issues were not always easy to place, however, and to meet the distinct preference on the part of household investors for short-term bonds the maturities of bond issues had to be shortened. The private placement of 25 year bonds became quite difficult, even with successive increases in interest rates. However, there was a marked recovery during the fourth quarter caused by expectations that long-term rates had reached their peak. This manifested itself in very active markets for both public issues and privately placed bonds.

In accordance with international interest rate trends and persisting inflation, long term interest rates continued to rise over the first seven months of the year, thus continuing the trend which had already manifested itself in the latter months of 1973. In the early period this was reinforced by the reluctance of institutional investors to invest at prevailing rates on a long-term basis, and by large demand for capital, particularly from public authorities. By April they had risen to over 10 %, then to 11·5 % for 25-year loans in July, with yields on the secondary market following suit, rising from 9·01 in December 1973 to reach a high of about 10·4 in August. Thereafter, there was an easing of rates and towards the end of the year the decline in rates gathered momentum with yields down to 9·1 % in December (a fall of 1·3 points).

The increase in the gap observed in the first quarters between yields on private placements and yields on bonds as a result of growing interest from foreigners in guilder bonds was followed in the last months by a reduction in this gap, with rates on private placements falling by about 1·6 %.

With effect from 1 February, the closed bond (or 'O'-guilder) circuit was abolished, and after the second quarter there was great demand from foreigners for guilder investments in the form of fixed interest guilder bonds as well as in short-term guilder notes. After having come to a virtual standstill in the first quarter, issue activity resumed in the second and third quarters with about Fl 300 million in each quarter, increasing to Fl 400 million in the fourth quarter.

The share market, traditionally unimportant as a source of funds, also produced a lower result than in 1973, and the share price index fell from 108 to 88 over the period.

In *Denmark*, as a result of the dominating role of tap issues by the mortgage credit institutions in the bond market, trends in this market are reflected by the movement of prices and yields on the secondary market, following changes in the demand for and the supply of capital, especially for construction purposes.

Over the year as a whole, the volume of issues stabilized at the high level attained after the considerable year on year increases from 1970 to 1973. The total of gross issues was only slightly higher than in 1973.

In the first half of the year, however, the bond markets were under heavy pressure: accelerating inflation, tight liquidity in the banking system and the economy as a result of the restrictive credit policy pursued by the monetary authorities all combined to produce a fall in bond prices despite considerable purchases by the national bank. The average yield of all bonds in circulation rose from 14 % in January to 15·3 % in March and to an all-time high of 17·7 % at the beginning of August.

At the end of August, however, there was a sharp reversal of the market situation with a decline in rates both on long-term bonds and in the money market, reflecting a drop in new housing starts, as well as an improvement in the liquidity position of the banks, who recommenced purchasing after having been net sellers of bonds in the second quarter and the national bank became a net seller again. By the end of September, yields had fallen to below 16 %. Prices continued to rise over the fourth quarter and by the end of the period yields had fallen to 14·5 %. Foreign purchases of Danish kroner bonds, regulated by a quota system, were modest during the year, and during the first nine months sales only slightly exceeded repatriations. As from 1 December, foreign purchases of Danish bonds were completely liberalized.

The volume of share issues was modest throughout the year. The share price index exhibited a downward trend to November, from 188 to 133, but recovered slightly in December to 147.

Placing of issues on the *Belgian* capital markets was slightly more difficult in 1974 than in 1973, particularly in the second and third quarters, although the total volume of gross issues reached FB 273 000 million compared with FB 267 000 million the year before. But there was a reduction in the net volume of issues (FB 134 000 million against FB 143 000 million in 1973), which can be explained by a considerable increase in the amounts devoted by the State to contractual amortizations and to both final and intermediate redemptions, the net volume of tap issues being, however, distinctly higher.

During the first half of the year, the State had recourse to the market on two occasions. Although the placing of the February loan was fairly easy, the loan in May did not have the same success. However, after an improvement in the terms of loans and an increase in the interest rate to 10 % (1 % over that of the May loan) for a loan in September, which was placed very easily, the market was more receptive in the fourth quarter.

Over the first eight months of the year, interest rates rose continuously, but in September there was a certain stabilization which continued to the end of the year. Secondary market yields for public issues which had begun the year at 7·92 rose to 9·26 in September, but declined again to 9 in December, while those on private issues rose from 8·5 to 11·9 in October, declining to 11 in December. Nominal rates on public issues reached a maximum of 10 % in September and remained there until the end of the year.

The share market had a reasonably successful year, the total volume of new issues in the first nine months being higher than that recorded in 1973, but activity was low in the fourth quarter, so that the total for the year as a whole was lower than in both 1972 and 1973.

The share price index followed the same trend as in most countries, falling by 35 points over the year, from 164 at end-December 1973 to 129 at end-December 1974.

In view of the large margin between money market interest rates and long-term interest rates, the *Luxembourg* authorities decided not to permit any issues on to the calendar during the first nine months of the year, neither domestic issues, nor conventional foreign issues.

In August, the banks increased their terms for medium- and long-term placings, which was followed by a fall in money market rates, and brought an end to this period of tight money. As a result, the authorities admitted a 'test' issue by the ECSC, in October. This was followed by a slightly larger EIB loan in November and a Council of Europe loan in December, to produce a total volume of issues of Lfrs 1 100 million compared with Lfrs 2 700 million in 1973.

Although this low amount was easily absorbed by the market, the authorities insisted that the initially decided ceilings be strictly observed in order to leave disposable capital free to reactivate the secondary market.

Yields on the secondary market remained fairly stable over the year, reaching a high point at the end of the third quarter, and declining thereafter.

International bond markets

Major changes in world financial flows and in the balance of payments of most trading countries as a result of the oil price rise and the consequent surpluses of the oil producing countries as well as deficits for most oil importing countries seriously affected the *international bond markets* during the period.

Over the first nine months of the year, investors showed a marked tendency to prefer short-term liquid investments. This is apparent from the large amount of roll-over credits accorded to the detriment of conventional bond issues. In fact, the volume of roll-over credits (syndicated bank loans in Euro-currencies) accorded is inversely related to the volume of bond issues. During the first two quarters of the year, the ratio of roll-over credits to bond issues was 17 and 26 respectively. In the third quarter this had fallen to 15 and in the fourth quarter, as the bond market recovered, the amount of roll-over credits was only three times that of bond issues. The total amount was about $30 000 million, an increase of 30 % over 1973, but compared with a 400 % increase in 1973 over 1972.

The general malaise on the bond markets: low volume of issues, increasing interest rates, and shorter maturities can be largely attributed to continued monetary instability, investors being reluctant to invest in long-term bonds at a time when yields on long-term bonds compared unfavourably with rates of inflation. An additional factor, however, must be the marked liquidity preference on the part of investors from the oil-producing countries combined with the delay between the capital being received by the oil-producing countries and their recycling it back to the bond markets, in the place of industrialized countries which had previously been the major source of funds. The significant improvement which occurred in the fourth quarter can be largely attributed to the fact that voluntary recycling of capital via the private long-term bond market was getting under way, combined with the policy of lower interest rates being pursued by the authorities on the national markets to encourage demand.

The volume of issues fell appreciably over the first three quarters of the year. From 1 204 million EUR in the last quarter of 1973, it dropped to 504 million EUR in the first quarter, and to a 10-year low of 249 million EUR in the third quarter as a result of the factors decribed above. In the fourth quarter there was a strong recovery to 1 169 million EUR as conditions improved to produce a total of 2 300 million EUR, which while not as low as had been expected was still barely half the volume recorded in 1973. The decline affected all the currencies of issue except the guilder and the unit of account.

A breakdown by currencies of issue shows an increase in the percentages for the dollar (53 from 46 % of total volume), the guilder and the unit of account (12 from 4 % and 9 from 3 % respectively) to the detriment of the others. In contrast to the previous year was the decline in Swiss francs (down from 15 to 11 %) and in DM (25 to 10 %). During the second quarter of the year, issues in DM virtually disappeared.

Issues in units of account and 'EURCO' increased considerably, but issues in EURCO were not particularly successful. This was attributed to the fact that this formula may be too complex for most investors to understand.

There were some changes in the pattern of debtor countries over the past year. The EEC share remained the same, but within it some substantial shifts took place. Far fewer UK borrowers floated loans, but more French and Dutch borrowers came into the markets. The share of US and non-EEC international organizations decreased, but that of the rest of the world went up.

Interest rates on the international capital markets were seriously affected by events on the money markets and the changes in financial flows. An increasing tendency this year was for loans to carry a variable rate, based on the LIBOR (London Inter-Bank Offer Rate) and an additional 'spread' the rate of which varies according to the length of the loan and the quality of the borrower. This last was an attempt to overcome the uncertainty and lack of confidence prevailing in the market.

Interest rates on dollar issues as measured by yields on the secondary market reflected both the degree of international confidence in the dollar, internal political events in the US and the ability of the US to deal with the financial implications of the energy crisis, as well as international trends. Beginning the year at around 8·5 %, by June they had risen to 10 % and reached a high of 12 % in October. Thereafter, in line with the recovery on the markets, interest rates on dollar issues fell slightly to 11·25 % at the end of the year.

With the exception of the period May to June, yields on DM international bond issues were continually above those of internal issues. Despite this yield gap, demand for DM international issues was weak until the autumn. However, towards the end of 1974 the volume of DM foreign issues increased sharply which can be explained partly by the return of confidence following the success of the stabilization policy pursued by the German authorities, and partly by the change in the behaviour of investors from oil-producing countries who began to undertake longer term investments and at the same time choosing to diversify the range of currencies in which they invest. Furthermore, it seems that issuers do not expect a significant revaluation of the DM in relation to their own currencies during the life of these loans.

The market for international bonds denominated in Swiss francs, where interest rates are traditionally at a low level by comparison with other currencies of issue, was seriously affected this year. At 6·5 % at the end of 1973, the level of yields had risen to around 8·5 to 9 % at the end of the second quarter. Despite a closing of the markets by the Swiss authorities, it was eventually admitted that the pressure on rates was too great, and the markets were re-opened with rates for new issues at 8 % in July and then drifting upwards to end the year at 8·25 to 8·75 %.

Some changes occurred in the bond market policies pursued by the member countries. In Germany, sales to non-residents of domestic bonds with more than four years maturity were authorized again at the end of January. In September, the cash deposit requirement for credits taken up abroad by residents was finally lifted, although its rate had already been lowered. In the Netherlands, in accordance with arrangements with other 'snake' countries to relax restrictions on capital inflows, the 'O'-guilder circuit was abolished in March. A new law affecting the control of the stock exchanges and of stock issuing companies was introduced in Italy in June.

The Working Party continued its examination of the problems involved in protecting the holders of fixed interest securities from loss in real value and has discussed several aspects of the problem in detail, particularly the experiences of individual Member States in applying such measures.

With regard to the problem of coordination and integration of capital markets, the Committee exchanged regular information on developments in Member States, and has begun its analysis of the obstacles which currently exist to the free movement of bonds and other securities. To this end, it has commenced work on the revision and up-dating of its 1970 report on 'bond market policy in the Member States of the EEC', to include the three new Member States. The Working Party completed its studies of capital market structures this year when two meetings were devoted primarily to an examination of the Irish and Danish capital markets respectively.

LIST OF THE MEMBERS OF THE WORKING PARTY ON SECURITIES MARKETS

Chairman:	M. D'Haeze, Directeur général de l'administration de la trésorerie et de la dette publique, Brussels.
GERMANY	Dr. K. Andreas, Leiter der Hauptabteilung Kredit, Deutsche Bundesbank, Frankfurt/Main.
	Ministerialrat Dr. G. Levermann, Bundesministerium der Finanzen, Bonn.
	Regierungsdirektor D. Thorand, Bundesministerium der Finanzen, Bonn.
	Regierungsdirektor H. Stoller, Bundesministerium für Wirtschaft, Bonn (from 1 January 1974).
BELGIUM	F. Junius, Banque nationale de Belgique, Brussels.
	E. Kestens, Inspecteur général au Ministère des finances, Brussels.
	M. Esselens, Inspecteur général à l'administration de la trésorerie, Brussels.
DENMARK	J. Kjaer, Kontorchef, Danmarks Nationalbank, Copenhagen (until 31 December 1974).
	H. Olsen, Fuldmaegtig, Handelsministeriet, Copenhagen.
FRANCE	Y. Berger, conseiller auprès du gouverneur de la Banque de France, Paris.
	J. M. Bloch-Lainé, Sous-directeur à la direction du trésor, Ministère de l'économie et des finances, Paris.
	J. de La Motte de Broöns, Direction du trésor, ministère de l'économie et des finances, Paris.
	Mrs L. Beauvais, Banque de France, Paris.
IRELAND	C. O'Carra, Department of Finance, Dublin.
	M. Coffey, Central Bank of Ireland, Dublin.
ITALY	Dott. B. Bianchi, Servizio studi, Banca d'Italia, Rome.
	Dott. G. Monterastelli, Condirettore centrale, Banca d'Italia, Rome.
	Dott. V. Platino, Ispettore capo del Tesoro, direzione generale del Tesoro, Ministero del Tesoro, Rome.
LUXEMBOURG	A. Dondelinger, Commissaire au contrôle des banques, Luxembourg.
	E. Israel, Directeur à la Banque Internationale à Luxembourg.
	Mrs. P. Weides-Schaeffer, Conseiller adjoint au Commissariat au contrôle des banques, Luxembourg.
NETHERLANDS	Drs. M. M. Keyzer, Nederlandsche Bank N.V., Amsterdam.
	Drs. P. C. Timmerman, Onderdirecteur van de Nederlandsche Bank N.V., Amsterdam.
	Drs. J. Grooters, Directeur binnenlands geldwezen, Ministerie van Financiën, The Hague.

UNITED KINGDOM	J. M. Bridgeman, Treasury Chambers, London (from 1 January until 30 April 1975).
	H. S. Lee, Treasury Chambers, London (from 1 May 1974).
	D. A. C. Nendick, Cashiers Department, Bank of England, London (until 31 December 1974).
COMMISSION OF THE EUROPEAN COMMUNITIES	J. E. Nash, Director for Monetary Matters in the Directorate-General for Economic and Financial Affairs of the Commission of the European Communities, Brussels.
	A. Kees, Head of Division, Directorate-General for Economic and Financial Affairs, Commission of the European Communities, Brussels.
	P. Ohlmann, Head of Division, Directorate-General for Economic and Financial Affairs, Commission of the European Communities, Brussels.
	M. Zucker, Directorate-General for Economic and Financial Affairs, Commission of the European Communities, Brussels.
SECRETARIAT	G. Morelli, Secretary of the Monetary Committee, Brussels.
	G. Lermen, Brussels.
	A. Chapman, Brussels.

ANNEX V

INTERIM REPORT BY THE WORKING PARTY ON SHORT-TERM CAPITAL MOVEMENTS

Introduction

Since 9 October 1973, when it submitted its first report to the Monetary Committee, the Working Party has held three meetings. Pursuant to the new instructions received from the Committee on 16 April 1974, the Working Party gave priority, in the first stage, to collecting information on restrictions on capital movements adopted by Member States. In the experts' opinion, this emphasis was justified by the fact that in the period under review (October 1973 to end-December 1974) profound changes took place in international economic and monetary relations, some of which will have long-term effects that are difficult to judge.

Chapter I discusses the most significant factors behind the changes in the volume and direction of capital movements, and behind the measures taken by Member States; it also includes a summary of modifications introduced in the method of the various instruments. Chapter II describes the measures adopted by the authorities in each individual country.

CHAPTER I

The most significant factors affecting capital movements and their control — changes in the method of application of the instruments

A. *Events leading to the Member States modifying their capital movement restrictions*

In the period under review, profound changes took place in international economic and monetary relations, causing Member States to modify their capital movement restrictions.

The following factors are worth noting:

— the dollar was firm until September 1974, which was due partly to the fact that oil payments are generally made in dollars, and partly to the restrictive monetary policy followed by the United States during the majority of the period. Since then, the easing of American monetary policy and the small flow of petro-dollars into the American banking system during the last quarter of 1974 exerted downward pressure on the dollar;

— all Member States were expecting a sharp deterioration in their current accounts either in the form of reduced surpluses or in the form of an increased deficit, with the deterioration mainly attributable to the rise in the prices of imported primary products, particularly oil;

— in the majority of Member States, the authorities initially pursued restrictive monetary policies which resulted in an increase in short-term interest rates. As a result, interest rate differentials between the various international markets were considerably reduced. From Autumn 1974 on, in most Member States monetary policy was eased gently; due to a considerable parallelism between the national measures, interest rate differentials between the countries did not increase;

— despite the fact that virtually all currencies were floating, there were substantial official interventions on foreign exchange markets to maintain exchange rates at acceptable levels;

— the countries which experienced sharp deteriorations in their current account position used foreign currency borrowing primarily to maintain the level of their official reserves.

These factors brought about profound changes in the volume and direction of short-term capital movements:

— at the beginning of 1974 the pattern of speculative capital flows changed as a result of the recovery of the dollar in relation to European currencies; however, the later reversal of the trend in the dollar reinforced the attraction of investments in European currencies;

— the volume of capital flows induced by interest rate differentials declined, as a result of the converging trends of short-term interest rates on the money markets in Europe and the United States, and also of credit restrictions;

— floating currencies made foreign exchange speculation more dangerous than under the system of fixed exchange rates.

B. *Changes in the objectives of the measures taken*

As a result of the factors described above, restrictions on capital movements in most Member States lost some significance. With the direction of short-term capital flows reversed at the beginning of the period under review, many restrictions on capital inflows no longer served any essential purpose. Furthermore, the almost universal adoption of floating exchange rates, together with concerted interventions by central banks in Europe and the United States, made it possible to absorb without serious difficulty such disruptive capital movements as continued to occur.

C. *The changes seen from a Community point of view*

The measures taken by Member States, although varying in scope, were in the same direction: easing of restrictions on capital inflows, and/or tightening of restrictions on capital outflows.

Because of this, there was even some degree of 'harmonization', without eliminating the differences between the policies followed by Member States: while some became more liberal and eased restrictions on capital inflows, others became more 'interventionist' and tightened restrictions on capital outflows.

The changes in restrictions on capital movements of Member States did not lead to any distinction being made between movements originating inside the Community and movements from outside; further, considerable divergences still existed as regards the instruments employed.

In the table below an 'X' in the appropriate column indicates the Member States which during the period under review eased restrictions on capital inflows and/or introduced or tightened restrictions on capital outflows.

Country	Restrictions on capital inflows eased	Restrictions on capital outflows tightened
Germany	X	
Belgium	X	
Denmark	X	
France	X	X
Ireland		X
Italy		X
Luxembourg	X	
Netherlands	X	
United Kingdom	X	X

D. *The principal instruments introduced, abolished or modified*

(a) *Two-tier foreign exchange markets*

The two-tier market was abolished in both France and Italy. In *France* this move was made in order to enable the supply of borrowed foreign exchange to balance importers' demand for foreign exchange on a unified market. Maintenance of the two-tier market would have meant a weak official and a strong financial franc, thus discouraging capital inflows.

In *Italy*, the system was abolished partly because of its complexity and partly because of the insignificant volume of transactions on the free market since the introduction of the requirements on residents to lodge an interest-free deposit equivalent to 50 % of the value of foreign investments, and since the decision that all commercial loans had to be obtained through the regulated market.

(b) *Limited split of the foreign exchange markets*

In the *Netherlands*, the 'closed circuit' system was abolished after the authorities noted a decline in the preference of non-residents for fixed-interest paper denominated in guilders.

In the *United Kingdom*, rules on the compulsory use of either the investment currency market or the official market were modified in order to channel certain foreign exchange inflows into the official market.

In *Ireland*, analagous modifications were implemented in view of the free movement of capital which exists between the United Kingdom and this country.

c) *Regulations governing non-residents' deposits*

— the negative interest rates on non-residents' convertible franc deposits were suspended in Belgium and Luxembourg; then abolished in Belgium;

— the ban on the payment of interest on non-residents' sight deposits in national currency was suspended in France; in Belgium and in Luxembourg where it was limited to convertible accounts, it was suspended, then abolished;

— the ban on the building-up, by non-residents, of time deposits in convertible accounts and on the payment of interest on all convertible accounts was suspended and later abolished in Belgium and Luxembourg.

(d) *Regulations governing residents' foreign borrowing not linked to commercial transactions*

In *Germany*, authorization was no longer required for foreign loans contracted by residents after 1 February 1974, and for the transfer of claims on residents to non-residents after 15 September 1974. The 'Bardepot' was abolished with effect from 1 October 1974.

In *France,* the ceiling for foreign currency borrowing abroad by residents was considerably raised.

In the *Netherlands,* the rules on loans between affiliated companies were eased.

In *Denmark,* the rules on long-term loans raised abroad, the proceeds from which are used in Denmark, were modified.

(e) *Regulations governing the external positions of commercial banks*

In *Belgium,* ceilings on the banks' debit positions were relaxed, but ceilings on credit positions introduced.

In *Italy,* banks cannot have a net external debit position greater than that as at the evening of 19 July 1974.

(f) *Fixing of special compulsory reserve ratios on banks' liabilities to non-residents*

The compulsory minimum reserves against banks' outstanding short-term liabilities in national currency were abolished in France. In Belgium and Luxembourg an identical measure was taken for the sector covered by the regulations.

Compulsory minimum reserves against changes in banks' oustanding short-term liabilities in national currency (in the sector covered by the regulations) were removed in Belgium and Luxembourg.

In Germany, compulsory reserves against the increase in banks liabilities to non-residents were abolished with effect from 1 January 1974.

(g) *Regulations governing leads and lags*

Provisions concerning time limits for payment for imports and exports were amended in several countries to make inflows of capital easier (Belgium and Luxembourg), or make outflows more difficult (France). In Germany, with the lifting of the 'Bardepot', these rules no longer served any purpose.

(h) *Purchase of national securities by non-residents*

Restrictions were removed in *Germany,* except for fixed interest securities maturing in less than four years.

In *Denmark,* non-residents were authorized to purchase fixed interest Danish bonds which are denominated in Danish kroner and dealt with on stock exchanges.

(i) *Interest-free deposits on certain imports*

Deposits of this kind were introduced in Italy, the principal objective being to reduce the liquidity in the economy.

(j) *Restrictions on foreign spending by residents*

Restrictions of this kind were introduced by Italy to curb exports of capital.

(k) *Restrictions on exports of capital for direct investment abroad*

In March 1974, the United Kingdom authorities withdrew a previous relaxation of the controls on exports for direct investment by United Kingdom residents in other countries of the EEC.

(l) *Limitation of forward currency purchase*

In France, the possibilities for residents to engage in forward currency purchase were considerably reduced.

(m) *Prohibition on lending to non-residents*

In France, the authorities introduced a measure prohibiting the granting of loans in FF to non-residents.

CHAPTER II

The major modifications to restrictions on capital movements in Member States

In this chapter, a summary is given of the major changes, specifying the instruments abolished or newly introduced and the related objectives.

1. **Germany**

Most restrictions on capital inflows were progressively lifted. The renewed strength of the dollar, together with the tendency for interest rate levels to converge reduced the danger of capital inflows triggered by speculative considerations or by interest rate differentials. Furthermore, with the cost of imported products going up, it was thought desirable to allow the DM to appreciate in order to minimize the effects on domestic price levels. There were also outflows of capital, which were, however, followed by inflows of capital at the end of the year.

Since the abolition of the cash deposit requirement (in October 1974), the only remaining restrictions concern payment of interest on non-residents' deposits and the purchase by non-residents of money market paper and securities with a remaining life of less than four years. Minimum reserves against the increase in the banks' liabilities to non-residents were abolished. On the other hand, the compulsory reserves against total outstanding liabilities are still applicable. This ratio, incidentally, is still fixed at a higher level than that applying to residents' deposits.

2. **Belgium**

In view of the oil crisis and the expected balance of payments deficit, restrictions on capital inflows were progressively removed and rules were introduced on the credit position of the banks.

The following provisions were suspended:

— negative and zero interest rates on non-residents' convertible accounts;

— compulsory reserves against the outstanding volume of and changes in these accounts.

A ceiling on banks' creditor positions in foreign currencies on the regulated market was, however, introduced.

Provisions concerning time limits for commercial payments were changed in order to lighten the controls on advance payment for exports (leads) and deferred payments for imports (lags).

3. **Denmark**

In December 1973 the rules concerning incoming financial credits were tightened in order to prevent circumvention of domestic credit restrictions. Thereafter authorization was only granted for loans used to finance fixed investment by the borrowing company itself.

In September 1974, primarily in order to stimulate investment and to reduce unemployment, these rules were eased. It is expected that inflows of capital will also contribute towards financing a growing deficit of the balance of payments.

Since 1 December 1974 non-residents have been authorized to purchase fixed interest Danish bonds denominated in Danish kroner and dealt with on stock exchanges.

4. **Ireland**

Because of the free movement of capital between the United Kingdom and Ireland, this latter country took measures analagous to those introduced in the United Kingdom with regard to:

— the proceeds from disinvestments in non-EEC countries;

— the proceeds of the sale of overseas sterling area securities;

— outward direct investment in the overseas sterling area;

— the acquisition of personal property outside the scheduled territories.

5. **France**

The speculation against the franc at the end of 1973 and the beginning of 1974 led the French authorities — following a substantial loss of foreign exchange — to temporarily suspend the application of the narrower margins agreement. Subsequently, the rise in oil product prices helped to cause a deterioration of the balance of payments, and the deficit was met by borrowing abroad. This situation prompted the authorities both to abolish restrictions on capital inflows and to curb capital outflows.

The measures taken included:

— abolition of the two-tier foreign exchange market;

— relaxation of the restrictions applying to foreign loans raised by residents;

— suspension of:

  — the ban on the payment of interest on non-residents' accounts,

  — the obligation to maintain reserves against these accounts;

— introduction of:

  — restrictions on forward purchases of foreign exchange

  — a ban on French franc loans to non-residents,

  — a six-month limit on the time allowed for payment for exports.

6. **Italy**

In view of the widening balance of payments deficit the authorities gradually tightened the restrictions on exports of capital and introduced restrictions concerning payment for imports and on foreign spending by residents.

The two-tier foreign exchange market was abolished since it no longer served any purpose.

In detail:

— restrictions were placed on the import of Italian bank noted;

— an interest-free deposit of 50 % had to be lodged in respect of imports of certain types of goods;

— restrictions were placed on expenditure by residents travelling abroad.

In addition, limits were imposed on banks' net debit positions (19 July 1974).

7. **Luxembourg**

With the danger of speculative inflows of foreign exchange receding more and more, measures introduced earlier to curb capital inflows were suspended:

— the compulsory reserve ratio against non-residents' convertible accounts was reduced to zero;

— the special commission payable on credit balances in non-residents' convertible accounts was similarly reduced to zero.

Modifications to the rules on the banks' credit position in foreign currencies on the regulated market and on leads and lags are identical to those described under 'Belgium'.

8. **Netherlands**

After the revaluation of the guilder in September 1973 and after the declaration of the oil-boycott, expectations concerning the long-term perspectives of the balance of payments encouraged the authorities to liberalize progressively existing restrictions on inflow of capital. International preference for fixed-interest guilder securities had disappeared:

— authorization policy as regards incoming intercompany financial credits with a maturity of five years and more has been eased;

— the 'O' guilder circuit has been abolished.

9. **United Kingdom**

In view of the balance of payments situation which was in deficit already before the increase in oil prices, existing exchange control policies have been tightened in order to encourage inflows and to reduce outflows of capital:

— rules concerning borrowing abroad by residents for domestic use have been relaxed;

— financing rules for outward direct investment in the EEC and in the overseas sterling area were brought into line with those for the rest of the world by precluding the use of official exchange for the most part;

— rules concerning repatriation of profits, disinvestment proceeds from direct investments abroad and sales by residents of foreign currency securities have been tightened.