Commentary

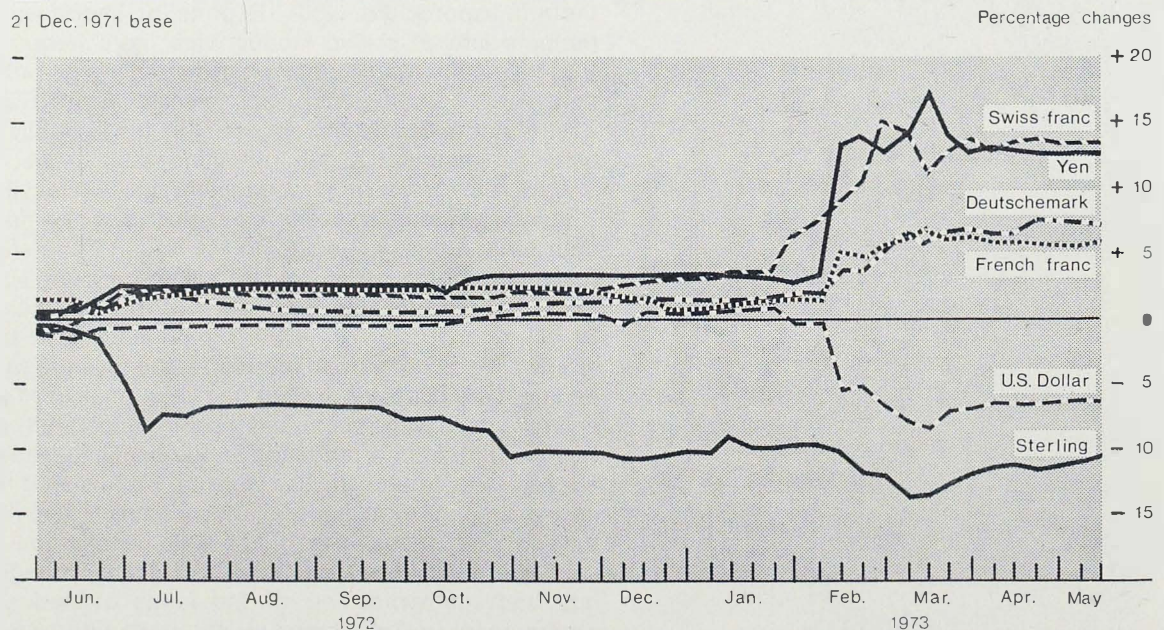
The international currency crisis overshadowed other events in the first half of the period – February to April – generally covered by this Commentary. Sterling remained floating and was little affected at the time, though the effective realignment of currencies will inevitably have repercussions on the pattern of trade and payments. A rapid rise in commodity prices was particularly unwelcome in relation to the Government's statutory policy to counter inflation. The second stage of these arrangements came into effect for incomes on 1st April and for prices on 29th April; the first stage was largely successful, but fresh food prices – which could not be controlled – rose very fast. Economic activity continued to recover strongly, but it was still dominated by the consumer boom, with investment only beginning to recover, though exports did well. Reports of shortages of components and of skilled labour were more frequent. In the Budget, on 6th March, an unprecedentedly large public sector borrowing requirement was forecast for 1973/74. On 21st May the Chancellor announced cuts in public expenditure programmes, mainly affecting later years. To help finance the borrowing requirement the Chancellor in his Budget announced several measures to make government debt more attractive, including the issue of two stocks with unusual features. The initial reaction of the gilt-edged market to the financing problem was to mark prices down; however, about this time the prolonged rise in short-term interest rates began to be reversed – the revenue season was ending, certificates of deposit had been made less attractive, and excessive wage claims were being successfully resisted – and in April, after a reduction in the banks' base rates, gilt-edged prices improved. The external trade deficit reached a new peak in March: imports appear to have been bunched, the longer-term benefits to the volume of trade from the sterling depreciation last June had scarcely begun to be felt, and the worsening of the terms of trade was still pronounced. In April, however, the trade figures were more encouraging, and confirmed that the March figures had been subject to erratic influences. The money stock still rose substantially over the period as a whole. In March and April, there were signs of easing in the expansion of bank lending. The building societies came under heavy pressure from borrowing and from withdrawals, but their position began to recover strongly in April.

The international currency crisis

Foreign exchange markets in February and much of March were dominated by further crises of confidence, the first over the post-Smithsonian rate structure and the second over the U.S. dollar. The introduction of the Italian two-tier market in January (the repercussions of which led to the floating of the Swiss franc), the publication of the 1972 U.S. trade deficit of over $6 billion, and the problem of controlling the rise in domestic U.S. prices had concentrated the markets' attention on the apparent lack of improvement in

the position of the dollar since the Smithsonian realignment at the end of 1971. Moreover, it appeared at times in the following weeks that the crisis was being fed and magnified by inappropriate and untimely statements from both sides of the Atlantic. At all events, from the beginning of February the dollar was heavily sold, at once moving to its support point in the main Continental centres; and in the first two days of the month more than $1 billion of support was given by central banks. Over the week-end 3rd-4th February, the West German authorities took further measures to deter capital inflows; but these provided a temporary lull only, and by the 6th the dollar was again being sold on a massive scale. In the four days 6th-9th February, support purchases by central banks amounted to $6 billion, bringing the total

Effective changes in exchange rates[a]



The effective rate for sterling has fallen only a little since October, apart from a temporary decline after the U.S. dollar devaluation in February.

a Each line reptesents the appreciation/depreciation of a currency against all other major currencies, based on the position at 21 December 1971.

support since the floating of the Swiss franc on 23rd January to more than $8½ billion; over two thirds of these dollars had moved into Western Germany and a sizable share into Japan. Over the week-end 10th-11th February, the finance ministers of the countries most involved held urgent discussions. The talks culminated on the 12th – when the London market was closed and the European and Japanese central banks withdrew from the markets – in agreement that the dollar would be devalued by 10% against gold, that most major currencies would not follow, and that the yen would be allowed to float. The Italian authorities announced that the two-tier market for the lira would be continued, but

that the commercial lira, like the financial lira, would be allowed to float, thus further reducing the number of members maintaining their currencies within the 2¼% 'snake' of the Community's narrow margins scheme.[1] Sweden and Finland devalued their currencies by some 5% against gold.

After the shock of this further devaluation of the dollar, markets were slow to accept the consequences of the realignment of rates. Even so, the dollar moved gradually to its new ceiling in Western Germany, and in the period up to 21st February the Deutsche Bundesbank were able to sell about $1 billion. But the reflux of dollars was short-lived. On the 22nd there was another abrupt change of sentiment. Tension in the Middle East had risen; there had been increasing speculation about the possibility of a joint European float; the Swiss franc was still appreciating despite the Swiss authorities' announcement that they would intervene to influence the rate before they re-established a fixed parity; the price of gold was at record heights; and statements by U.S. government spokesmen were taken to imply that further measures might be necessary. As a result, the dollar fell back sharply, and by the opening of business on 23rd February was again at its support point in the main Continental centres. However, when it became known that European central banks were supporting the dollar at their buying limits and that the markets' fears about the imminence of a joint float were unfounded, there was a temporary improvement in sentiment, which was reinforced during the next few days by the news of a reduction in the U.S. trade deficit and of an increase to 5½% in Federal Reserve discount rates.

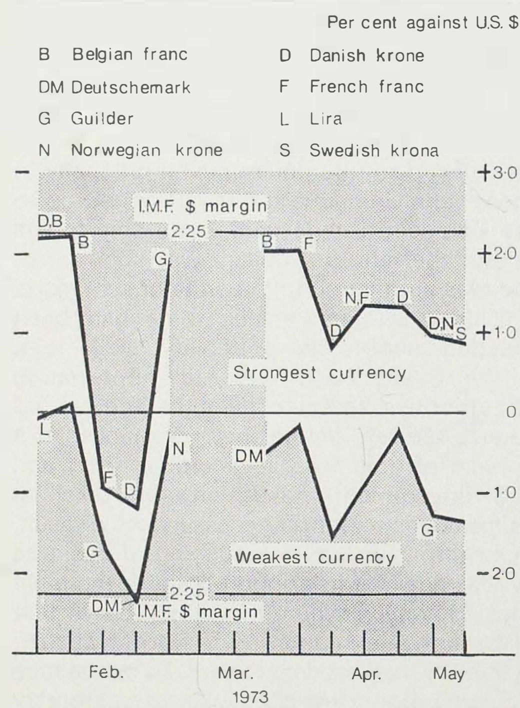
The markets' doubts about the durability of the existing exchange structure soon returned, however, aggravated by impatience over the inevitably painstaking progress being made on international monetary reform. Following fresh rumours about a joint European approach to the dollar problem – which was again interpreted to mean a unified float – the dollar fell back to its floor at the end of February. On 1st March, sales of dollars were on an unprecedented scale, and purchases by European central banks were much bigger than on any single day during previous crises: total official purchases amounted to some $3·6 billion, and over two thirds of the inflow was absorbed by Western Germany.

Both the February and March upheavals were due mainly to lack of confidence in the U.S. dollar. The volume of funds which moved and their speed of movement demonstrated the increased involvement of three major groups: multinational companies with mainly U.S. dollar budgets but large overseas interests; large internationally-orientated commercial banks managing their own and their customers' investments; and a number of central banks in various parts of the world.

In view of the unsettled international currency situation, the London market, in common with markets in other major centres, was formally closed on 2nd March until further notice. This meant that central banks were no longer supporting the dollar and that most currencies were

1 June 1972 *Bulletin*, page 169.

The E.E.C. 'snake'[a]



The markets reopened on 19 March with the members of the E.E.C. scheme floating jointly against the dollar. The 'snake' in fact subsequently moved to the centre of the former dollar support points.

a Tuesday closing rates. Based in February on deviations from nominal dollar parities then in force, and from 19 March on the dollar equivalents of central rates in terms of SDRs.

effectively floating, commercial banks being free to continue to deal for themselves and for their customers. Further urgent consultations were instituted between the finance ministers of the nations most concerned. Following a meeting in Brussels over the week-end of 10th-11th March and a subsequent conference in Paris, a settlement was announced: the markets would formally reopen on 19th March; the deutschemark would be revalued by 3% against gold (and therefore against most other currencies); six E.E.C. countries (Belgium, Denmark, France, Luxembourg, Netherlands, and Western Germany) would maintain the $2\frac{1}{4}$% spread among their own currencies, but would no longer maintain margins for the U.S. dollar; the Austrian schilling would be revalued against gold by $2\frac{1}{4}$%; and the United Kingdom, the Republic of Ireland, and Italy would continue independently to let their currencies float. At about this time, Belgium, France, the Netherlands and Sweden also all tightened their exchange controls to discourage inflows of funds. On 16th March, the Swedish authorities announced that, although Sweden was not in the Community, they would maintain the exchange rate of the krona within the $2\frac{1}{4}$% Community band; and, when markets were reopened on the 19th, the Norwegians announced that they would do likewise.

Markets reopened cautiously – while they were formally closed, the dollar had mostly moved back within the margins established in February. However, there was no sign of any substantial unwinding of the speculative positions in deutschemarks which had been taken up earlier, though the deutschemark was generally around the bottom of the 'snake'; and the dollar remained basically weak against both the European bloc and the Swiss franc. Only in Tokyo was there any real improvement in the dollar and any reflux of funds, the Bank of Japan selling sizable amounts of dollars to keep the yen about 16% above its old parity. On the Continent the 'snake' was at its maximum width for most of the remainder of the period to the end of April, with the French, Belgian and Scandinavian currencies at or near the top, and at first the deutschemark and then the guilder at the bottom. The Swiss franc generally ranged between 18% and 20% above its old central rate. At the end of April, the market rates in terms of the U.S. dollar of the principal currencies, compared with their post-Smithsonian position, had moved as follows:

Percentage changes against U.S. dollar
(end-December 1971 to end-April 1973)

Sterling	− 2·5
Belgian franc	+11·0
French franc	+14·2
Deutschemark	+15·2
Guilder	+ 9·9
Lira	+ 0·5
Swedish krona	+ 7·4
Swiss franc	+20·8
Yen	+18·7

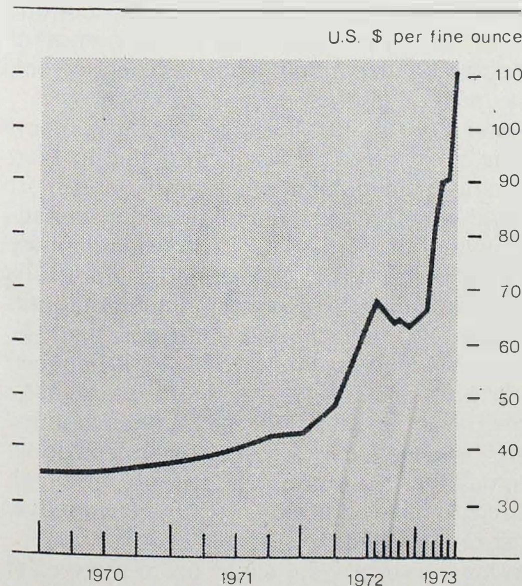
Sterling

Because sterling was floating independently, the reserves were able to be largely insulated from the impact of these upheavals. The exchange rate moved often, but never very dramatically. It had been steady around U.S. \$2·35 throughout most of January but, following the pressure on the dollar at the beginning of February, it rose at times above \$2·39 despite some official smoothing operations. When markets reopened on 13th February after the devaluation of the dollar, the pound was initially quoted at \$2·50 but soon fell back to \$2·42½. Thereafter, with little intervention from the authorities, the rate fluctuated as sentiment about the dollar changed. It ranged between \$2·42½ and \$2·50, before almost touching \$2·52 in New York on 1st March when European central banks announced that they were withdrawing from the markets.

During the first few days of March sterling fluctuated mostly between \$2·46 and \$2·49. The likelihood of sterling joining a Community float was widely debated. The Government's views on the essential conditions at that time for the successful inclusion of the pound in a unified float were set out by the Chancellor of the Exchequer in his Budget speech on 6th March. They included the concept of unlimited support to make the system proof against short-term capital flows of the magnitude recently experienced. As this did not prove acceptable, the Government decided that it was not practicable in the circumstances for the United Kingdom to join a common float on the basis of the conditions embodied in the Community's scheme. Studies will, however, continue to be pursued with a view to developing arrangements which would bring forward the time when this system could be joined by the United Kingdom, the Republic of Ireland, and Italy.

After foreign exchange markets were reopened on 19th March, the sterling rate was initially around \$2·45. It later strengthened – no doubt because interest rates in London remained high and also in response to periodic demands for sterling for oil royalty and tax payments – and ended the period at \$2·4895.

London gold price[a]



After the devaluation of the dollar in February, the gold price rose to new heights, steadying at around \$90 throughout April, before rising rapidly once more in May.

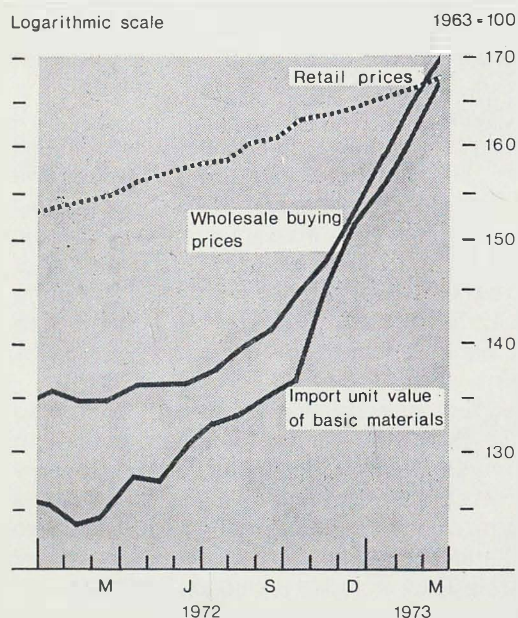
a Last working days (ending mid-May)

The gold market

The pressure on the dollar led to very active conditions in the London gold market in February, and the price rose well beyond previous peaks. Before and immediately after the dollar devaluation the price was very firm between U.S. \$65 and \$70 per fine ounce; but a tendency to mark up the price as a reflex response to the devaluation soon drove it above the \$70 mark. This rise in turn quickly attracted more buyers into the market and led some potential sellers (though not the South Africans) to hold off, and the price forged further ahead, to touch \$94 outside the fixing on 23rd February. It subsequently fell back a little to \$86, before exchange markets were formally closed on 2nd March.

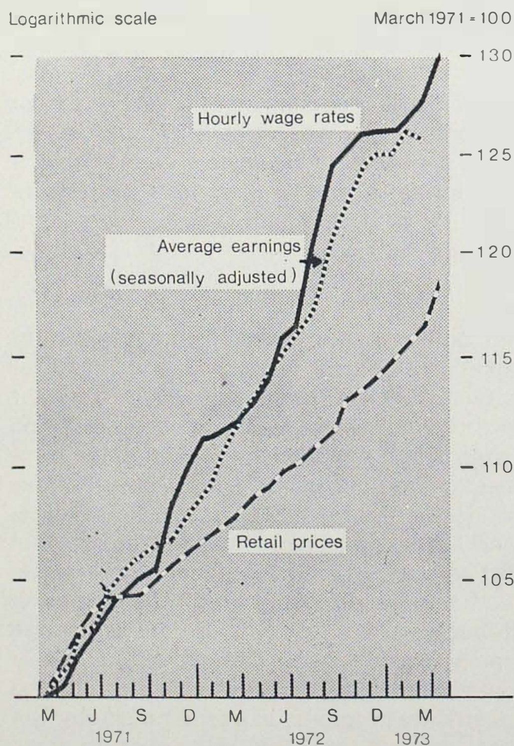
Throughout most of March the market was quieter and less affected by the uncertainty in foreign exchange markets; the price fluctuated between \$80 and \$86. However, towards the end of the month, increased demand, coinciding with the publication of a forecast that the market price could reach

Retail, wholesale and import prices



Pressure on wholesale prices from the cost of imported materials continues to threaten the future stability of retail prices.

Wages, earnings and prices



Although earnings have grown less than prices since the standstill, over the year as a whole they were still well ahead.

$100 or more, provoked a very sharp rise. The price at the fixing reached a new record of $91·50 on the morning of 27th March – as little as two years earlier it had been below $40. Throughout April, the price remained firm around $90–91, and ended the period at $90·72. From 8th May, the price began to rise once more, soon very rapidly, reaching $111 at the morning fixing on 16th May, but thereafter falling back for a while.

Costs and prices

In the domestic economy, the struggle with inflation continued to overshadow other events and to colour assessments of the outlook. The path of wages and prices during the three months to the end of April shows clearly how the Government's standstill moderated the pace of internally generated inflation. During February and March wage rates rose very little; in April they rose sharply after a backlog of settlements caught by the standstill came into effect. Retail prices, too, apart from food, were fairly steady during the standstill, despite a very rapid rise in the cost of imported materials.

Pressures from rising import prices were indeed the most urgent cause for concern. Commodity prices have generally been rising since the last months of 1971; most have advanced particularly strongly since the middle of 1972, especially during the first quarter of this year. However, in April, some prices fell back and others showed signs of moderating their pace, and rises are generally expected to be more gentle from now on. Although the rises to British buyers have owed a substantial amount to the depreciation of sterling since last June, the greater part has resulted from higher world prices. The supply of several major commodities has been hit by natural disaster or crop deficiency, particularly in wheat, cocoa and, more recently, cotton; and rising demand for other commodities, the output of which cannot rapidly be expanded, such as beef, wool, copper and tin, has pushed up their prices too.

Although by the end of April the worst increases in import prices seemed to be over, the earlier rises continued to exert considerable pressure on manufacturers' margins and most had yet to work their way through to retail prices. Manufacturers' wholesale buying prices rose by 6% between January and April following a rise of nearly 10% during the previous three months, whereas their selling prices, which could not be raised without official approval, rose by little more than 1%. Meanwhile, the retail price index went up by 3·2% between January and April. Most of the rise was again due directly to food prices, which went up by 5·3% over the three months. The standstill largely succeeded in holding other prices down – the index for items other than food rose by 2·4%, of which about a third appears to have been a result of the changeover to value added tax on 1st April.

Pressures from labour costs were slight up to the end of March, when the standstill on pay terminated; some deferred increases in wage rates then occurred, and the April index was some 2% higher than in March. Average earnings were also increasing as expanding industrial activity generated more overtime working. The Government's stand against claims in excess of their formula was successful in April.

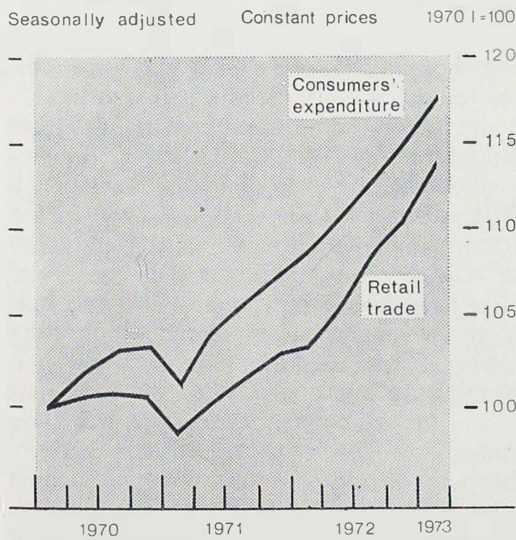
In the longer perspective of the past year or so, it can be seen that earnings are still well ahead of prices.

Expenditure and output

Economic activity expanded strongly in the three months. While consumer spending – now joined by exports – continued to surge ahead, output accelerated on a broadening base, and particularly encouraging signs of expansion in engineering began to emerge. Less happily, reports of supply bottlenecks became more frequent.

Preliminary estimates put the volume of personal consumption in the March quarter, after seasonal adjustment, at $2\frac{1}{2}\%$ above the December quarter, itself about $2\frac{1}{4}\%$ above the September quarter. Retail sales through the shops rose by as much as 3%, compared with $1\frac{1}{2}\%$ in the previous quarter. Much of the extra sales may be explained as anticipating the introduction of value added tax, very heavy buying on this account being widely reported by leading retailers, and certainly sales in April were much less heavy. It is too early to say that the growth of personal spending has more than temporarily eased, especially as the pattern has been affected by the changes in taxation.

Personal spending



Personal spending, particularly through the shops, accelerated in the first quarter (when some buyers may have anticipated the introduction of value added tax).

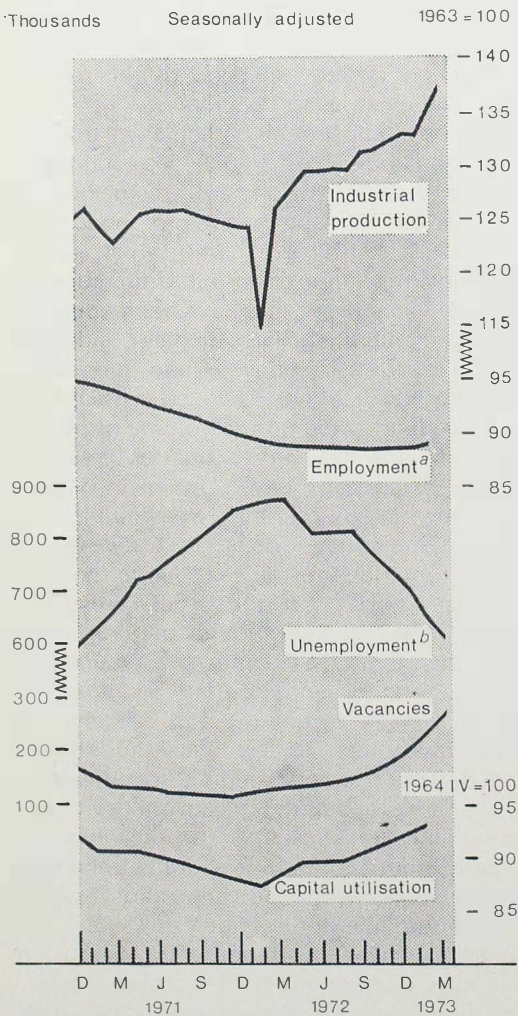
The volume of exports has grown particularly strongly, but investment demand has been much less buoyant, though generally strengthening. At long last, restocking by industry seems to have begun, following a prolonged run-down for most of the last two years, during which stocks became exceptionally low in relation to output. Undercurrents of optimism about fixed investment, too, have been apparent in reports from industry, including the latest survey conducted by the Confederation of British Industry, and there was clearly an upturn in the first quarter. However, a great deal of leeway remains to be made up, and the volume of manufacturing investment in the December quarter was the smallest for five years. A lag between an upturn in output, such as the present one, and an upturn in investment is only to be expected, and in some areas increases in investment will not come through until later in the year. None the less, the reports from industry strongly suggest that investment spending is widely on the increase, though perhaps more to replace machinery than to increase capacity. Certainly the volume of new orders and of output in the engineering industry has risen sharply in recent months. Meanwhile, one particular area of investment, housing, has undoubtedly been buoyant; the difficulty which building societies met in attracting funds to finance their mortgage advances was not reflected in housebuilding statistics. Private housing starts were erratic in the early months of the year but the trend was firmly upwards. Also, public sector housing starts revived somewhat after a subdued time during much of 1972.

In general, the picture was one of strengthening expansion spread fairly widely across the economy. Industrial production in the March quarter is estimated to have risen, after seasonal adjustment, by about $2\frac{1}{4}\%$, considerably faster than the $1\frac{1}{2}\%$ recorded in the December quarter. The expansion lay in manufacturing production, within which the most encouraging feature was a rise of 5% in engineering. The figures have thus confirmed the broadening of industrial

activity from consumer goods towards capital goods and support the belief that a wider range of investment spending is beginning to be undertaken. This will certainly prove necessary if the growth of output is to be long sustained. Already reports of bottlenecks in the supply of components are becoming more widespread, besides the problems caused by disputes in the steel industry, which cut back supplies to some parts of industry. At the same time, shortages of skilled and semi-skilled labour were reported in several parts of the country. The relative pressure of demand compared with previous cycles is, however, difficult to measure, and these problems may stem in part from the sheer speed of expansion rather than from a true lack of resources.

The accompanying chart contrasts the path of output with various indicators of the growing pressure on resources. These are not easy to reconcile in close detail. Productive capacity is still widely under-used, but perhaps by less than the figures suggest. According to the Bank's index,[1] utilisation rose again in the first quarter, but the index remains quite low at 93·0 (last quarter 1964=100). However, the estimate of capital stock underlying the index is based by the Central Statistical Office on normal 'retirements' and, after several years of low utilisation, much of the apparent spare capacity may in fact have been scrapped sooner than usual. In contrast, by mid-May reported adult vacancies had risen to the highest figure since the seasonally adjusted series began in 1958. But this indicator may well overstate the growth in demand for, as noted in the last *Bulletin*, registration has been made more thorough over the past year or so. Next, the figures for employment are subject to heavy revision each year and so these too cannot be relied on for a current picture. Finally, even the unemployment figures present some difficulties of interpretation. Such developments as the growth of redundancy payments, better welfare benefits, more frequent changes of job, and possibly more widespread registration by married women wanting jobs, suggest that for a similar degree of labour shortage there might be more registered as unemployed than in earlier periods. At all events, in these months, the fall in unemployment lost a little of its momentum. In mid-May, the estimated number of unemployed stood at just under 600,000 after seasonal adjustment, or 2·6% of total employees, and 60,000 less than at the February count. Over the previous three months the total had fallen by nearly 100,000, an exceptionally fast rate.

Output and the use of resources



As the expansion of output has strengthened, the degree of slack in the economy has been substantially reduced, though the indicators do not provide a fully consistent picture.

a Index of production industries.
b Excluding school-leavers and adult students.

The Budget

Against this background of rapid, but still ill-balanced recovery, the Budget, which this year was presented unusually early on 6th March, had to steer a course between excessive expansion on the one hand and damage to the nascent revival in investment on the other. In fact, the forecast published with the Budget envisaged that output in the eighteen months to the middle of 1974 would rise at an annual rate of slightly over 5%. It was estimated that the resources would be available to achieve this, but the impact of any shortages of components and skilled labour

1 See the introductory article in the December 1971 *Bulletin*, page 490.

will have to be watched very carefully. Moreover, strong home demand has already brought about high imports; and production bottlenecks could only prolong this situation and at the same time enable fewer goods to be released for export. The Chancellor stressed that his estimates were necessarily subject to many uncertainties and therefore he would not hesitate to act at any time in whatever direction the economy might require on expenditure, on taxation or on monetary policy.

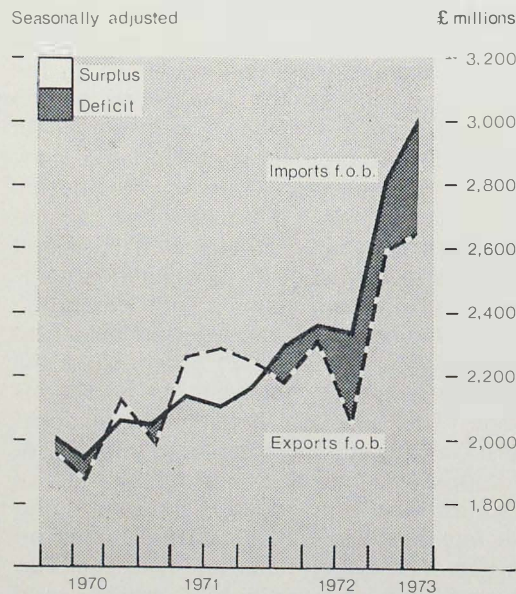
The Chancellor announced new cuts in tax revenue in the financial year 1973/74 of about £120 million, mostly attributable to the zero-rating of confectionery and children's clothing under value added tax. The major changes in taxation affecting 1973/74 had already been outlined last year: these were the introduction of value added tax, of a unified system of direct taxation on personal incomes, and of an 'imputation' system of corporation tax. The net costs of these changes, and of the continued rapid growth in public expenditure, raised the public sector's estimated borrowing requirement to around £4,420 million, compared with an estimated out-turn for 1972/73 of £2,855 million. Within the estimates, the once for all effect of the changeover to value added tax accounts for a loss of revenue this year of some £800 million. In May, the Chancellor announced cuts in spending programmes which would reduce the growth of public expenditure in the years ahead, and including reductions in the current year of about £100 million.

The Chancellor's Budget proposals included some important innovations to help attract the finance for this massive borrowing requirement. Bearing in mind that much of last year's already substantial requirement was met from the sterling proceeds of the loss of reserves when the pound came under pressure in June, the burden on domestic sources in financing the requirement this year is great indeed: if there were no external finance this year, domestic sources would need to provide about three times as much as in 1972/73. The possible expansionary consequences for the money stock were recognised by the Chancellor, but he hoped largely to avoid these by making government debt more attractive. One of his more important proposals concerned the issue of two new government stocks with unusual features, designed to attract funds from outside the banking system, to some extent from the personal sector direct and also from financial intermediaries such as insurance companies and pension funds through which a large proportion of personal savings is channelled. These issues are described later in the Commentary. A further direct approach to the personal saver was made through increasing the attractions of national savings. The limit on holdings of national savings certificates was raised, the total prize money for premium savings bonds was increased, and a new issue of British savings bonds was announced. The new bond carries an interest rate of 8½%, with a tax-free bonus on maturity after five years of 3%. Much of the potential expansion of liquidity stemming from the taxation changes would accrue to the company sector, particularly the extra £800 million estimated to be retained in the private sector this year on the changeover to value added tax. To mop up

some of this excess, and to provide some public sector competition for certificates of deposit, the Chancellor announced a new tax deposit account into which companies may place funds, at a competitive rate of interest, against future corporation tax liabilities. At the same time, capital gains by industrial and commercial companies and by personal holders on sales of sterling certificates of deposit before maturity were made liable to tax, thereby removing an anomaly which had impaired the competition of the public sector with the banks for company funds. The extent to which all these measures will attract the necessary finance remains to be seen: the immediate reaction in the markets was understandably to expect a further rise in interest rates, but sizable sales of gilt-edged stock were made in April.

The Chancellor also announced that certain public bodies would again be allowed exchange cover facilities for foreign currency borrowing (generally limited to borrowing in U.S. dollars). Many local authorities and public corporations showed a quick interest, and several issues have already been made. Around £500 million, and perhaps considerably more, of their borrowing requirements is likely to be financed in this way. This borrowing has, of course, no net effect on the public sector's overall borrowing requirement: public sector income and expenditure are unchanged. But the central government's position as set out in Table 1 of the statistical annex can be affected in either of two ways. If, on the one hand, the foreign currency borrowing replaces loans from the central government, the Government's borrowing requirement (net balance) is thereby reduced. But the reduction affects the Government's external transactions only, and its domestic borrowing is unchanged: this is because it has to borrow an equivalent amount of sterling to pay to the public bodies out of the Exchange Equalisation Account in exchange for foreign currency surrendered. If, on the other hand, the public bodies choose to borrow less in sterling from domestic sources outside the public sector, the Government's total borrowing requirement (net balance) is unchanged, but its domestic borrowing requirement is greater by virtue of the need to finance the inflow of foreign exchange into the reserves.

Balance of U.K. visible trade



Adverse movements in the terms of trade in the first quarter outweighed improvements in the volume of trade.

Balance of payments

The deficit on the current account of the balance of payments which emerged in the second half of 1972 grew further in the first quarter of 1973. Largely because of higher world commodity prices, the depreciation of the sterling exchange rate, and growing industrial activity, the visible trade deficit increased, after seasonal adjustment, from some £230 million in the fourth quarter to about £350 million; and, as there was a fall in the surplus on invisible account as well, the deficit on current account widened from under £50 million to some £200 million. But the balance of trade in volume terms improved distinctly on the second half of last year.

Imports and exports at current prices were respectively 16% and 13½% above the average for the second half of 1972. The terms of trade, which had already become

markedly less favourable during the latter part of 1972 as sterling depreciated against other currencies, worsened further. Import prices rose on average by about 10% over the quarter, compared with an average increase of about 5% a quarter in the previous six months. The latest rises stemmed partly from some further effects of the depreciation of sterling and increasingly from the effects of higher world prices for a wide range of raw materials and foods. The average increase in export prices, on the other hand, was only some 3% in the quarter, much the same as in the earlier period. In volume terms, however, the trade balance became decidedly more favourable : although imports, partly in response to increased demand for industrial materials for restocking, grew by some 8% against an average rise of under 6% a quarter in the second half of 1972, exports, which had then grown only very slowly, now grew by over 10%. Exports were helped by more encouraging conditions in a number of overseas markets and by fewer industrial disputes at home, although strikes (particularly in the motor industry) in the latter part of the quarter no doubt contributed to the very large trade deficit in March. Exports may also have begun to derive some benefit from an improvement in price competitiveness with industrial countries against whose currencies sterling has depreciated.

The invisibles account in the first quarter included payments to the European Community budget, and these, and other government payments, largely account for the fall in net earnings.

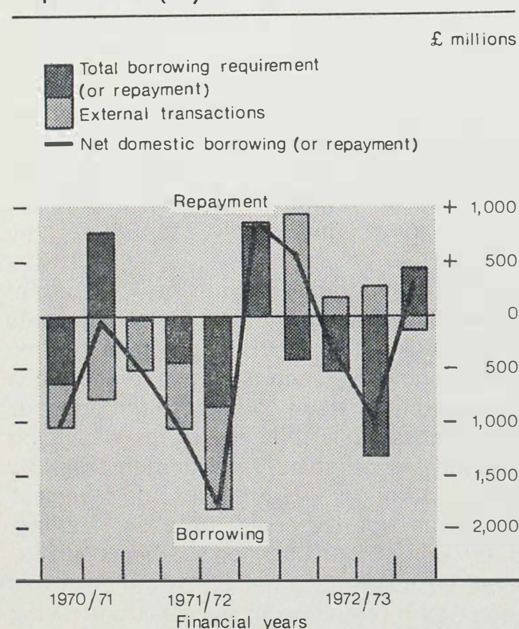
In contrast to the unfavourable movements on current account, transactions elsewhere in the balance of payments created a sizable inflow of funds. As in the previous quarter, identified investment and other capital flows produced a moderate net inflow, and, in marked contrast to the previous quarter, unidentified transactions reflected in the balancing item were also highly favourable. The identified inflow was broadly accounted for by a further rise in overseas sterling countries' exchange reserves held in sterling, which increased by some £200 million. Other overseas sterling holdings fell by nearly £40 million overall, but this was more than offset by a reduction in overseas borrowing in sterling from U.K. banks. The banks' net borrowing in foreign currency from overseas rose only slightly, but they continued to lend more in foreign currencies to their domestic customers. The demand was still mainly for investment abroad, although, because outward portfolio investment fell from the very high rates recorded in 1972, this was less than in previous quarters. The banks also lent about £40 million in U.S. dollars to public sector bodies under the exchange cover scheme announced in the Budget. The balancing item, representing errors and omissions elsewhere in the accounts, swung from a large negative figure (an outflow) in the fourth quarter to a similarly large positive one. Some unidentified inflow of funds is normal during this quarter for tax payment purposes, and there was probably also some reversal of the leading of import payments and lagging of export payments noted during the fourth quarter. The bunching of imports in March may also have contributed, by disturbing the normal relationship between the physical

movement of goods as recorded in the trade figures and settlements in respect of those goods.

The net currency inflow in the March quarter amounted to nearly £70 million (including £46 million in U.S. dollars borrowed by public bodies); it was all credited to the reserves. At the end of March the reserves stood at £2,085 million valued at \$2·89524, the rate that results from the pound's existing gold parity and the new gold parity for the dollar which the United States' authorities intend to declare to the International Monetary Fund.

By the end of April, forty-six out of sixty-one countries and authorities participating in the sterling guarantee agreements had been paid a total of £52 million in settlement of the claims arising from the activation of the guarantees last autumn. About £8 million remained to be paid.

Central government's borrowing requirement (—)



The revenue-gathering quarter saw a smaller surplus than usual to repay debt, but the borrowing requirement for the year as a whole was less than foreseen in the 1972 Budget.

Central government finance

During the March quarter, the main revenue-gathering season, the central government was able to repay around £430 million of borrowed funds and reduce its borrowing in the financial year as a whole to some £1,830 million. This was significantly less than forecast in the 1972 Budget but some £1,300 million greater than in 1971/72. In the course of the quarter, external transactions, including accruals to the exchange reserves, cost over £150 million, leaving nearly £280 million to be repaid to domestic sectors. In fact, domestic holders outside the banking sector provided a further £295 million – purchases of gilt-edged stock, a rise in holdings of notes and coin, and a further flow into national savings comfortably outweighed the seasonal surrender of tax reserve certificates. But as the Issue Department, in the course of its day-to-day operations, acquired over £270 million of local authority debt and commercial bills, only about £300 million was available to reduce the Government's indebtedness to the banking sector. This was in marked contrast to the corresponding quarter last year when about £1,200 million was repaid. Banks' holdings of Treasury bills fell in the latest quarter by £215 million.

Taking the financial year as a whole, much of the total borrowing requirement was met by external finance; about £1,250 million came from this source, largely the sterling proceeds of the loss of reserves in June. Domestic borrowing was thus no more than £575 million. Holders outside the banking sector in fact provided nearly £1,200 million: they bought nearly £500 million of gilt-edged stocks, the growth in the note issue brought in £420 million, and national savings increased by just over £400 million. As the Issue Department bought nearly £300 million of local authority debt and commercial bills, government debt in the hands of the banking sector fell by only £320 million. The banks ran down their holdings of gilt-edged by £975 million, but contributed some £730 million indirectly through Special Deposits.

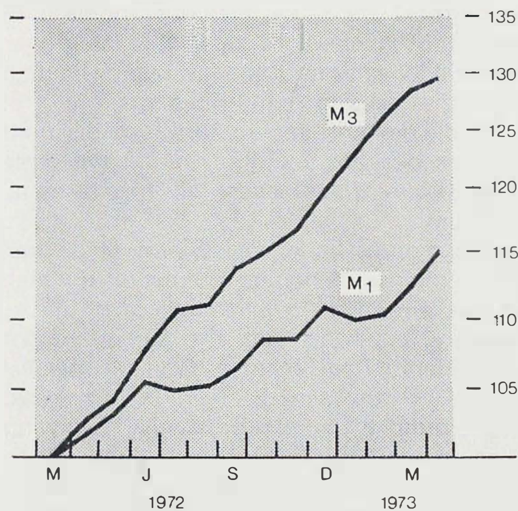
Money stock

Over the three months to mid-April, the money stock, however measured, again grew substantially, though the growth recorded by the different measures fluctuated widely from month to month. During this period, the broadly defined

Money stock

Seasonally adjusted March 1972 = 100

Logarithmic scale



The money stock continued to grow strongly in the three months to April, but showed signs of slowing.

category, M_3, grew by $5\frac{1}{2}\%$ after seasonal adjustment and the narrowly defined category, M_1, by $4\frac{1}{2}\%$; these increases compare with $6\frac{3}{4}\%$ and $1\frac{1}{2}\%$ respectively in the previous three months.

Considered as an indicator of monetary conditions, the growth of M_3 was exaggerated in the early part of the period. The banks continued to bid aggressively for funds to buy reserve assets and so protect their reserve ratios. As short-term rates rose sharply, those who could borrow from the banks at the best rates were able (as at times in the summer of 1972) to draw on their overdraft facilities and invest in term deposits and sterling certificates of deposit – a 'merry-go-round' process which inflated both sides of the banks' balance sheets. The decision announced in the Budget that capital gains on new certificates of deposit would no longer be tax free and the introduction of the tax deposit account are likely to reduce the relative attractiveness of sterling certificates of deposit. Many were in fact sold before the Budget in anticipation of the closure of the loophole. Altogether in the two months to mid-April, domestic holdings of certificates outside the banking system fell by £370 million. The relative attraction of term deposits was reduced by the fall in short-term interest rates, which led to further unwinding of the earlier positions.

The rate of growth of bank lending in sterling to the private sector was slower: during the three months to mid-April, the total rose, after seasonal adjustment, by £930 million compared with £1,580 million in the previous three months. But this lending still contributed more to the expansion of the money stock than did the provision of bank finance to the public sector. Allowing for seasonal factors, the public sector's borrowing requirement will have been substantial, but net sales of government debt to the general public were sizable too.

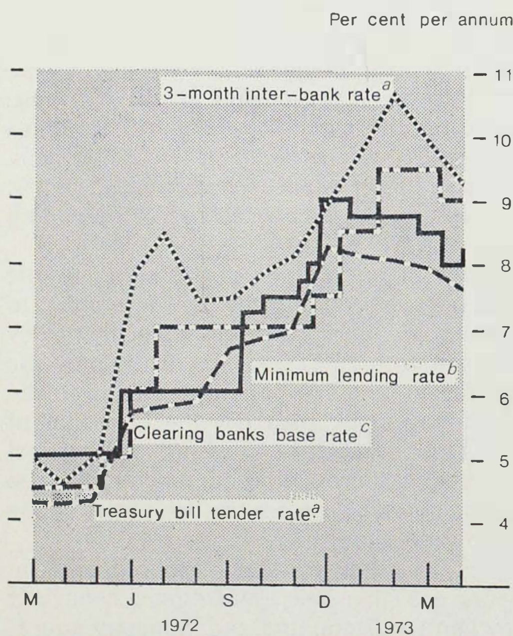
Whereas statistics of interest rates – though only in nominal terms – are available daily, and erratic behaviour on a particular day can be discounted, the monetary aggregates provide snapshots only once in the middle of each month (and once more at the end of each quarter); and it is never easy at the time to judge whether such a snapshot is providing a true or a distorted picture of the current scene. The general difficulty of using either M_1 or M_3 as a reliable indicator was touched on in the last *Bulletin*; it is further discussed in a speech by the Deputy Governor which is reprinted on page 193.

Short-term interest rates

In Continental Europe none of the central banks of the major nations altered their discount rate during the period February to April. However domestic interest rates in these countries provided a poor guide to the rates available on foreign funds. As the international currency crisis developed, a number of countries tightened their exchange controls in order to discourage foreign inflows. Belgium, the Netherlands and Switzerland all applied negative interest rates to increases in foreign-owned deposits above specified levels; and France, Sweden and Western Germany imposed heavy reserve requirements on banks which took more foreign deposits.

In the United States, the period saw a steady rise in interest rates. Following the devaluation of the dollar, Federal Reserve discount rates were raised by ½% to 5½%, the second such increase this year. This move brought the rates more into line with other domestic short-term interest rates, which had risen further since the previous increase in January. However, the increase in discount rates was interpreted as the signal for a rise in U.S. banks' prime lending rates. There were further rises in prime rates at the end of March and in the middle of April; and on 23rd April discount rates were in turn raised again, to 5¾%. During the three months, the yield on 91-day U.S. Treasury bills rose by some ½% to 6 5/16% per annum.

Short-term interest rates in London



Short-term interest rates at last fell back slightly during the period to the end of April, and not just because the revenue-gathering season was over.

a Last Friday of month.
b Bank rate before 13 October 1972.
c Changes are recorded when a majority of the big four London clearing banks have moved to a new rate.

At home, the three months under review saw first a halt and then a reversal in the rise of sterling interest rates which had commenced last autumn. As explained later in the Commentary, Treasury bill yields at the beginning of February were considerably lower than rates in parallel sterling markets; they were already below their peak, and they remained around 8% until April when, following the general decline in sterling interest rates, they fell to 7½% by the middle of the month. By contrast, inter-bank sterling rates were at first bid up very sharply, and the rate on three months' inter-bank deposits rose steadily from 10% at the beginning of February to nearly 11% immediately before the Budget. Then the rate jumped to 12% because of the acute shortage of funds in the parallel markets as holders of sterling certificates of deposit sold in advance of the Budget. However, the Budget action then helped to prick the bubble; the main revenue-gathering season was ending, and interest rates quickly eased, encouraged by the operations of the Bank. By the end of April, the three-month rate was under 9½%.

The cost of forward cover fluctuated widely during this time, the discount on three months' sterling ranging from 4 3/16% per annum at its greatest, around the middle of March, to 1¾% at its lowest, towards the end of April. The movements generally mirrored or magnified the differences between sterling deposit rates and euro-dollar rates, influenced by changing sentiment about the U.S. dollar. Immediately before the dollar devaluation on 12th February, euro-dollar rates were bid up sharply; the three-month rate rose to 7⅝% and the discount on three months' sterling fell to 3%. As sentiment moved temporarily in favour of the dollar for the first few days after the devaluation, forward discounts on sterling widened again. This movement was soon reversed; and then on 1st March, as the dollar came under very heavy pressure, the three-month discount fell sharply, reaching 2 13/16% before markets were closed. At the same time, the three-month euro-dollar rate rose briefly to 9 7/16%. During the formal closure of the markets, when euro-dollar rates eased, there was a widespread expectation that Britain would be under pressure to join a unified E.E.C. float, and forward discounts widened again. They narrowed from the middle of March as euro-dollar rates rose and sterling deposit rates fell. Over the period as a whole, the covered interest differential on three months' inter-bank sterling against euro-dollars mainly ranged

around 1% against sterling. However, in mid-February, when sterling interest rates rose sharply, there was a small intrinsic premium in favour of sterling at one time. The three-month deposit rate for euro-dollars ended the period at $8\frac{1}{4}$%, compared with $6\frac{5}{8}$% at the end of January.

Bill markets

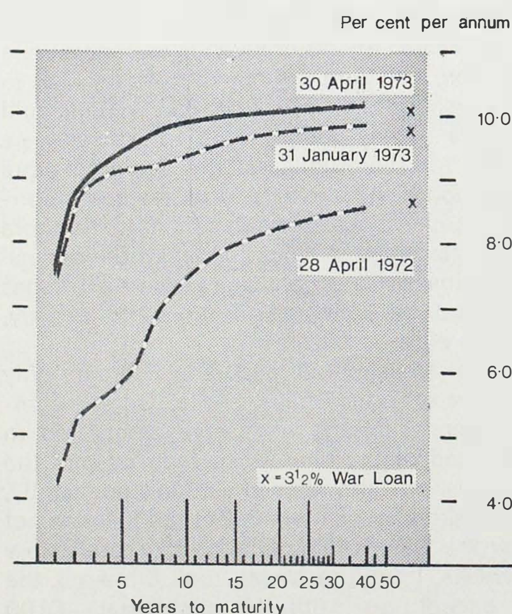
The period from the beginning of February to 9th March as usual saw the peak of the revenue-collecting season. During this time the Bank helped the market by buying bills or lending money nearly every day. Much of the assistance was on a large scale, and the Bank bought eligible bank bills as well as Treasury bills and local authority bills. The Bank lent funds in each of the five weeks, but always just overnight, preferring on these occasions – when the shortages were technical or were expected to be immediately reversed – to lend to the market rather than to take scarce assets off them unnecessarily. From 12th March until 4th April conditions were very different. Government disbursements were well in excess of revenue and there were no other major factors affecting the market. Money was in surplus on many days, and during this period the Bank sold bills on as many days as they bought them – the sales were generally fairly large and the purchases light. From 4th April to the end of the month, government disbursements continued to exceed revenue, sometimes substantially; but there were very heavy official sales of stock following the miners' vote on 4th April against strike action. Quite severe shortages of funds emerged, and the Bank again bought bills heavily, including more bank bills.

At each of the four Treasury bill tenders in February only £60 million bills were on offer. These small offerings, combined with the general shortage of reserve assets, led to quite a strong demand at the tenders so that, despite the general tendency for short-term rates to harden significantly, the average rate fell slightly each week. But the fall was not sufficient to lower the Bank's minimum lending rate below $8\frac{3}{4}$%. For a few weeks, from 2nd March until 6th April, the offerings were, except on 16th March, larger – £100 million to £140 million. The average rate now rose for two tenders, but bills remained scarce and the decline soon recommenced – and generally more quickly. On 23rd March the fall was just sufficient to lower the minimum lending rate from $8\frac{3}{4}$% to $8\frac{1}{2}$%. On 13th April, when the offering was back to £60 million, demand was particularly strong, and the fall in the average rate of over $\frac{3}{8}$% was sufficient to lower the minimum lending rate to 8%. However, the authorities did not wish to see rates falling too precipitately, and the discount houses were made to borrow that afternoon for six days at the existing rate of $8\frac{1}{2}$%. As a result, bids at the tender on Thursday, 19th April, were generally lowered and by enough to lift the minimum lending rate to $8\frac{1}{4}$%. The average rate was unchanged at the last tender before the end of the month.

The gilt-edged market

The gilt-edged market was fairly quiet for much of February, overshadowed by concern about industrial disputes and the

Time/yield curves of British government stocks[a]



Yields changed little between 31 January and 6 March, but after the Budget yields on medium and longer-dated stocks rose sharply, falling back only slightly before the end of the month.

a The lines measure the nominal rate of interest which a stock at each maturity should bear if issued at par. The curve runs from the shortest-dated stock with a life of more than one year to the longest-dated stock. The construction of the curve is discussed in an article in the December 1972 *Bulletin*, page 467.

problems of inflation. On 6th March, the Budget announcement of a borrowing requirement of record size, and of novel measures to finance it, brought sharp falls through fears that the financing of the deficit would lead to rises in interest rates. Falls were particularly steep at the short end. The new measures included the issue of two unusual stocks on 14th March. First, £1,000 million 9% Treasury Convertible Stock 1980 was offered at £99·50 per £100 nominal, convertible at the holder's option in 1980 into 9% Conversion Stock 2000 at a rate of £110 nominal for each £100 of the original stock. This is the first government issue in fifty years for which specific conversion terms, available at the holder's option, have been announced at the time of issue. (The last, in 1921, was 5½% Treasury Bonds 1929.) Second, £400 million 3% Treasury Stock 1979 was offered at £75, the lowest initial issue price for a government stock since at least 1925 (when three tranches of 3½% Conversion Loan 1961 or after were offered at nearly as low prices, the lowest at £76 : 5*s*). Another short-dated stock, £600 million 9% Treasury Stock 1978, was issued on 23rd March at £98·75 to replace the previous short tap stock, 6¼% Treasury Stock 1977, which was exhausted on 19th March.

By then, the market had steadied, and early in April it strengthened noticeably as the settlement of the miners' pay claim encouraged optimism for the outcome of the Government's counter-inflationary measures. Sentiment was helped at this time by a reduction in the clearing banks' base rates. The fall in the Bank's minimum lending rate by ½% to 8% on 13th April further strengthened the market, though it weakened again for a while after disappointing trade figures were announced on the 18th. Both short and long-dated stocks were in demand during the month, particularly the conventional tap stocks – 9% Treasury Stock 1978 (which was exhausted early in May) and 9½% Treasury Loan 1999. To begin with, there was little demand for the two new stocks announced in the Budget.

During the March quarter, the authorities sold nearly £200 million more stock than they bought or redeemed. Sales of stocks with over fifteen years to maturity totalled some £330 million and of stock with between one and five years to maturity over £340 million. By contrast, the authorities on balance bought some £120 million of stocks with between five and fifteen years to maturity; and they bought or redeemed some £360 million of maturing or near-maturing stocks. One stock was redeemed in the quarter, 6¾% Exchequer Stock 1973, of which £138 million remained to be redeemed from the market out of a total issue of £700 million.

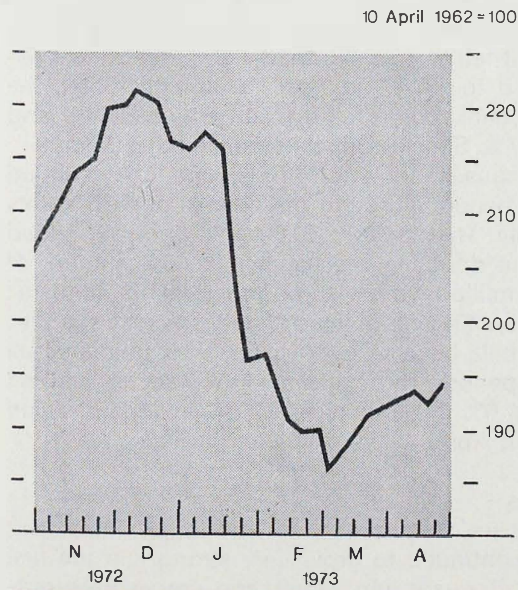
Local authority stocks

In order to facilitate the flow of new issues of local authority stocks to the market, the Bank decided, in consultation with representatives of the local authorities, to introduce new arrangements for the granting of timing consent. These took effect from the end of April.

Applications for timing consent will be considered only from local authorities which declare a firm intention of

making a stock issue in the near future. Having been allocated a date, an authority will be expected to stick to it unless market conditions justify a postponement. In the past, an authority wishing to make a stock issue was placed in a queue, and, on reaching the top, was then invited to make the issue; if it then chose not to do so, it was put back to the bottom. However, the queue had grown so big that in recent years authorities could wait up to five years before reaching the top, by which time many of them had made alternative arrangements.

Industrial share prices[a]



Share prices recovered slightly after the Budget.

a F.T.-Actuaries (500) share price index: Wednesdays.

Equity and debenture markets

Turnover in the equity market was small for most of the three months, though the market brightened from time to time at particularly good items of news. After the sharp falls in January, prices recovered a little in early February, but they soon eased. They reached a low point just after the Budget in early March. Thereafter, for most of March and April prices moved only slowly, though the general tendency was upward. The F.T.-Actuaries industrial (500) share price index stood at 194 at the end of April, slightly lower than at the end of January, having fallen to 184 at its lowest on 9th March.

New issues were few. Some £40 million of equity finance was raised in the three months (a half by financial companies), compared with about £60 million in the previous three months and with nearly £350 million in the second quarter of 1972. The queue of prospective borrowers continued to shorten over the period.

The debenture market was as dull as the equity market. After a slight rise in February, yields increased sharply in March, before falling a little in April. By the end of April, yields on first-class high-coupon debentures were nearly 10½%, about ½% more than at the end of January. Less than £20 million was raised by companies on fixed interest stocks in the three months.

Net sales of unit trust units during February to April amounted to £63 million, about £10 million less than in the previous three months. Net sales in April fell to £17 million; apart from in September, this was the smallest monthly inflow for a year.

Banks and discount houses

The private sector's sterling bank deposits increased distinctly less quickly in the three months to mid-April than in the previous three months. The slowing began with the sales of sterling certificates of deposit before the Budget. The sector's foreign currency deposits also increased a little less than in the previous period. Overseas sterling deposits were little changed over the period as a whole.

After a very large increase in sterling advances in the month to mid-February, the expansion of lending slowed markedly during the remainder of the period. Both the increase and the subsequent slackening reflected the 'merry-go-round' process mentioned earlier. Manufacturing companies seem to have been heavily involved in this, as shown by the development of their borrowing over the three months. Borrowing by construction companies grew fairly

strongly during the period as a whole, but that by persons and property companies showed signs of slowing down. The banks lent much less in foreign currencies to their domestic customers in March and April, after several months in which they had lent unusually large amounts, mostly for portfolio investment abroad.

The banks, and particularly the London clearing banks, at first continued to sell gilt-edged stocks in order to maintain the expansion of their lending, and by the middle of March their holdings were exceptionally small. In April, however, they bought stocks very heavily.

The banks' eligible liabilities rose by some £1,090 million during the period, but their reserve assets by less than £100 million. As a result, their combined reserve ratio was generally under pressure, especially early on: from 14·6% in mid-January, it fell to 13·6% in mid-February, but subsequently recovered to 14·4% in April. Within the total, the London clearing banks' ratio fell from 14·9% to 13·5%, and then rose to 14·7%. Special Deposits remained at 3%.

The discount houses' borrowed funds were little changed in total over the period, although the pattern of their assets changed markedly. They bought £150 million of gilt-edged stocks, more than doubling the historically low amount of just over £100 million which they had held in January; their holdings of sterling certificates of deposits rose sharply; but as Treasury bills became very scarce their holdings fell throughout the period. The houses' public sector lending ratio fell from 54·0% in January to 51·8% in March, rising again to 56·0% in April.

Finance houses

The finance houses' hire purchase and other instalment credit business continued to grow very strongly in the first quarter: in both January and March the rise in debt outstanding, after seasonal adjustment, was over £50 million, an exceptionally large amount. The total increase for the first quarter of some £130 million was well above the previous record of around £100 million in the preceding quarter.

Holdings of reserve assets by the eleven houses observing a minimum reserve ratio of 10% went up substantially in the two months to mid-March, and their combined ratio rose from 10·9% to 13·4%. However, much of this was owing to the acquisition of extra reserve assets by Forward Trust prior to its recognition as a bank in March.[1] In the middle of April, the combined ratio for the ten remaining houses was down to 10·5%. The change in the number of reporting houses also accounts for the apparent fall in eligible liabilities in the month to mid-April, after two months of strong rises.

A typical rate of interest offered by finance houses on three-month deposits rose from 10% in early February to 11¼% in March, much in line with the general trend of short-term rates. Thereafter, finance house rates, like other rates, eased, and they had fallen to around 9½% by the end of April. The Finance Houses Association's base rate, which is calculated monthly from the average three-month inter-bank rate during the previous two months, rose

1 A bank is required to observe a ratio of 12½% against eligible liabilities which include net borrowing from other banks.

rapidly from 9% on 1st February to 10% on 1st March and 11% on 1st April, but then fell back to 10½% on 1st May.

Under stage two of the Government's counter-inflationary policy, the finance houses' hire purchase and credit sale business is subject to the same arrangements for allowable costs and similar restrictions on net profit margins as other companies. Under the arrangements, the houses are permitted to pass on in increased hire purchase charges any increases in their interest costs. Such increases had not been permitted under stage one of the policy.

Building societies

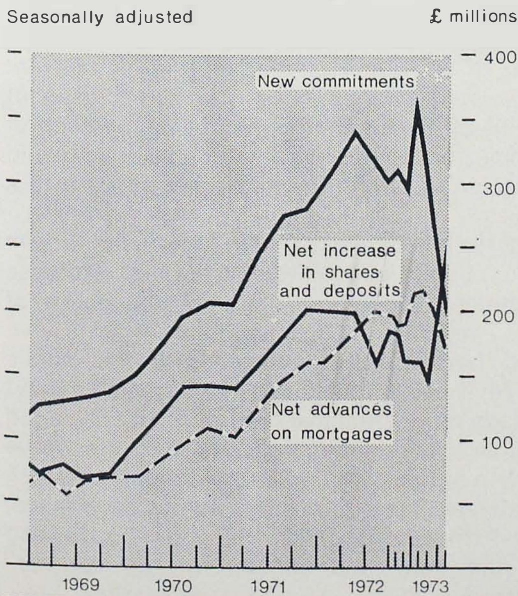
The climate of rising interest rates which persisted until early April seriously impaired prospects for the building societies' liquidity, even though the Building Societies Association recommended an exceptional sequence of increases in deposit rates in order to attract funds.

A rise agreed in January came into effect on 1st February, only four months after the previous rise. The new rate was then worth over 9% to the standard rate tax payer (though due to be cut to about 8% on 6th April under the unified tax arrangements confirmed in the Budget). But the net inflow into the societies fell to a rate about 10% below the monthly average for the December quarter, partly because some personal spending in February and March before the start of value added tax seems to have been financed by withdrawals from building societies. The societies, however, had to meet the very large mortgage commitments they had undertaken in earlier months, and by the end of February their liquid assets had on average run down, after seasonal adjustment, to 15·1% of total assets, compared with 16·9% six months earlier and as much as 18·8% a year earlier. Then national savings instruments were given added attractions in the Budget on 6th March. These circumstances prompted the association on 16th March to recommend a fresh increase in the share rate from 5·6% to 6·3% to take effect on 1st April: the new figure was equivalent to 9·0% grossed up at the new basic rate of income tax. Two large societies, as well as some of the smaller ones, in fact offered their depositors higher rates than this. A decision on the recommended mortgage rate – which was then 8·5% – was deferred, although a number of smaller societies found it necessary to increase this rate also.

The situation continued to worsen during March, and the net inflow of funds fell by a further 10%, reducing the combined liquidity ratio to 14·4%, its lowest since June 1965, though still well above the required minimum of 7·5%. At the same time, the societies entered into many fewer commitments to lend: allowing for seasonal factors, these were over 15% less in value than in February, and commitments in February too had been worth about 15% less than in January. The recent phase of liberal lending had now had to give way to greater selectivity towards mortgage applications.

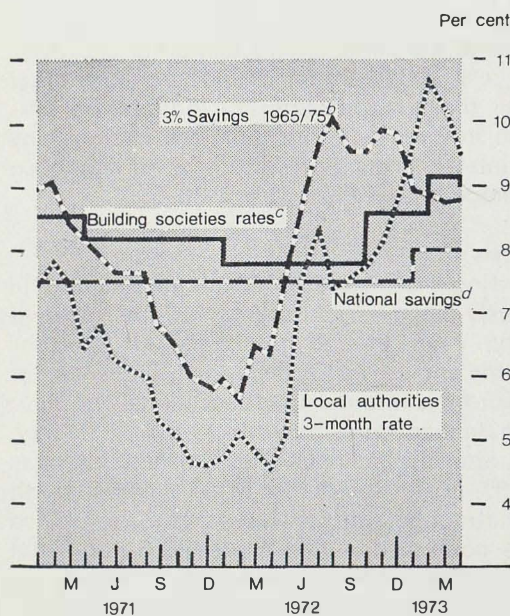
On 4th April the association recommended yet another increase in the share rate, to 6·75% on 1st May, equivalent to 9·64% grossed up at the basic rate of tax. At the same time, the association announced a rise in their recommended

Building society funds



New commitments fell sharply as advances on mortgage outstripped the inflow of funds.

Comparative interest rates[a]



The climate of persistently rising interest rates moved the Building Societies Association to recommend an unprecedented series of increases in deposit rates in order to attract funds.

a Last working day of month.

b Net redemption yield grossed up at standard/basic rate of income tax.

c Recommended rate grossed up at standard rate of income tax, 38·75% until 6 April 1973 and thereafter at the basic rate of 30%.

d National Savings Bank investment account, nominal deposit rate. (National savings certificates, if held for four years, now yield 8·19% grossed up at the basic rate of tax.)

mortgage rate from 8·5% to 9·5%. They would have raised it to 10%, but the Government made available an exceptional 'bridging grant' to help borrowers. This is to run for three months only at a cost of about £15 million and will be found from within the Department of the Environment's existing expenditure programme. The new deposit rates, and the effect of the general easing of interest rates, succeeded in stimulating a much greater net inflow into the societies in April; at the same time their lending on mortgage, which had fallen a little during February and March from the record amount lent in January, fell more sharply, as did the volume of their new commitments; and their combined liquidity ratio rose a little, to 14·6%.

Industrial management and the institutional investor

As described in the June 1972 *Bulletin*, page 178, a working party was asked to examine a possible structure and method of operation of a central organisation through which institutional investors would help stimulate action to improve efficiency in industrial and commercial companies. The report of the working party was reprinted in the last issue of the *Bulletin*. Thereafter discussions continued among the bodies directly concerned as to how the new arrangements would function. As a result of these discussions, the Bank announced on 16th April that the British Insurance Association had now agreed to join the existing member associations to form a new body, to be called the Institutional Shareholders' Committee. The text of the Bank's announcement is reprinted on page 148.

Conclusion

The economy has grown rapidly this year; under-used resources have allowed this expansion to take place without overheating and should continue to do so for some time. The Chancellor estimated in the Budget that the resources were available to support continued growth at 5% per annum for a further year or so. Some current reports of incipient shortages probably spring from temporary lags in adjustment to the higher levels of output; but signs of the approach of capacity limitations, should they at any time appear, would call for prompt action to bring the rate of growth back to a sustainable level.

Looking ahead, the Chancellor acted in May to reduce the rate of increase in public expenditure, releasing resources for greater investment, for exports, and for the needs of consumers.

The estimated borrowing requirement for the public sector in 1973/74 is exceptionally large, but government debt has been made more attractive, and sales of gilt-edged stock to the public have generally gone well since the Budget. The growth of bank lending and of the money stock has begun to moderate. Short-term interest rates have eased, but whether long-term rates can follow depends – as does so much else – on the continued success of the counter-inflationary measures.

Largely, no doubt, as a result of the decision to allow the sterling exchange rate to fluctuate, there was no great

movement of funds into or out of sterling during the international exchange upheavals in February and March. But a floating rate provides no simple antidote to a deficit in the balance of payments current account, because the immediate effects of a depreciation of the currency are to worsen the balance of payments through the terms of trade and to increase inflationary pressures. This has been the experience of the United Kingdom since June of last year, though the effects have been exacerbated by sharp rises in the world prices of many commodities. These mostly appear now to be slowing; and, as the longer-term benefits to the volume of trade of the depreciation in June 1972 accrue, the balance of trade should improve, as indeed it did in April.

The latest realignment of the world's currencies will undoubtedly contribute towards a better balance of world trade in the years ahead, though the effects are bound to take time to develop. The benefits of the previous realignment in December 1971 scarcely had time to begin to appear before being called in question by the markets. An enormous problem for international monetary reform is posed by the great and rapidly growing weight of liquid funds which can nowadays be moved at speed between one international market and another. Progress in reform is bound to be difficult, but agreed arrangements are clearly important if world trade is to be free to develop its full potential. In the meantime, most major currencies are floating, some jointly in the main European block and others independently; the experience so far with these arrangements suggests that they are not so vulnerable to crises of confidence as the previous system had become.