

**EUROPEAN ECONOMIC COMMUNITY**

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**THE INSTRUMENTS OF MONETARY POLICY  
IN THE COUNTRIES  
OF THE EUROPEAN ECONOMIC COMMUNITY**

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## FOREWORD

*This study of the instruments of monetary policy in the Member States of the European Economic Community is the outcome of a joint undertaking by the national monetary authorities and the Directorate General for monetary and financial problems in the Commission of the European Economic Community.*

*It was originally required by the Monetary Committee and the Commission for their own purposes. The Committee has used it during the past year as a basic document in detailed discussions of the nature, use and effectiveness of instruments of monetary policy. In the course of these discussions it was suggested that the studies should be published and made available to wider circles interested in problems of Common Market monetary policy.*

*Our thanks are due to the Commission of the Economic Community for taking up the Monetary Committee's suggestion and making this publication possible.*

JONKHEER MR. E. VAN LENNEP

*Chairman of the Monetary Committee  
of the European Economic Community*





## MAIN CONTENTS

<b>Part one</b>		
	THE INSTRUMENTS OF MONETARY POLICY IN THE COUNTRIES OF THE EUROPEAN ECONOMIC COMMUNITY	7
<b>Part two</b>		
	THE INSTRUMENTS OF MONETARY POLICY IN THE FEDERAL REPUBLIC OF GERMANY	53
<b>Part three</b>		
	THE INSTRUMENTS OF MONETARY POLICY IN FRANCE	103
<b>Part four</b>		
	THE INSTRUMENTS OF MONETARY POLICY IN ITALY	153
<b>Part five</b>		
	THE INSTRUMENTS OF MONETARY POLICY IN BELGIUM	181
<b>Part six</b>		
	THE INSTRUMENTS OF MONETARY POLICY IN THE NETHER- LANDS	215
<b>Part seven</b>		
	THE INSTRUMENTS OF MONETARY POLICY IN LUXEMBOURG	251



**Part one**

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## CONTENTS

<b>Introductory remarks</b>	<b>11</b>
<b>I. Basic facts of monetary policy</b>	
Chapter 1: The institutional framework of monetary policy	13
Chapter 2: The structural conditions of monetary policy	22
<b>II. The principal instruments of monetary policy</b>	
Chapter 3: Refinancing policy	29
Chapter 4: Open-market operations	36
Chapter 5: Minimum reserve policy	41
<b>III. The financing of the public sector and its influence on the liquidity of the economy and of the banks</b>	<b>48</b>

## TABLE

<b>1 – Liquidity of the economy in member countries in 1960</b>	<b>23</b>
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## INTRODUCTORY REMARKS

1. From the outset the Monetary Committee's regular studies of the monetary and financial situation in the Member States have shown how necessary it is to have a careful analysis made of the means of action available to the Central Banks and the other monetary authorities: discount policy, minimum reserve requirements, open-market operations and also the possibility of influencing the liquidity of the economy and the banks as a result of the financing of the public sector. The significance of these weapons in the Member States was not always very clear, and in any case the circumstances in which they were used were not sufficiently known.

2. A full understanding of monetary policy in the member countries presupposes a precise knowledge of these monetary instruments – often differing in conception – of their use in an institutional and structural framework varying from country to country and, finally, of their efficacy. It is particularly important for the Monetary Committee to possess such knowledge, when it has to discharge the duty, entrusted to it by the Treaty, of advising the Council or the Commission of the European Economic Community on these matters. In general the views expressed by the Committee already contain the main features of eventual recommendations of the two Community institutions to the Member States; such recommendations have a proportionately greater practical value the more they can take into account the special situation and the monetary policy powers of the respective Member State.

3. In the course of its work the Monetary Committee has become increasingly conscious of the need for a systematic description of the instruments of monetary policy in the Member States, of the way in which they are applied and of their efficacy. The responsible monetary authorities in the Member States and the services of the Commission have closely co-operated in making studies of the instruments of monetary policy in the Member States, which were completed by a comparative survey. Each of them was thoroughly discussed by the Monetary Committee.

The extensive knowledge gained in this way will make it easier to align the instruments and methods of monetary policy in the various countries. The discussions of the Committee give its members a chance to acquaint themselves with the experience of their partners in respect to certain instruments of monetary policy and put forward suggestions for the improvement of their own monetary policy. Thus, the introduction of a system of minimum reserve requirements in Belgium, at the beginning of 1962, and the improvement of this instrument in



France, may, in this respect, be considered as progress in the achievement of which the work of the Committee had some part.

4. Instruments of monetary policy appear on the whole to be more comparable now than in the early days of the Common Market. It is true that the conditions under which they are applied are quite different: the behaviour of individuals, groups and institutions which participate in monetary transactions is not the same; the banking systems are not entirely comparable and finally the general dissimilarity in the structure of the economies also has some importance. The differences are reflected, for instance, in greater or lesser interdependence between the various member countries and the rest of the world. In view of these structural differences one cannot expect – even considering the process already begun of improving comparability of their monetary instruments – a complete harmonization of policies in this field. Nor does the stipulation in the Treaty of Rome – that monetary policies must be co-ordinated to the full extent necessary for the functioning of the Common Market – imply such a degree of harmonization. Nevertheless, the instruments of policy must be perfected and the arrangements by which they are applied must be worked out in such a way as to attain the common aim of a co-ordinated monetary policy, i.e. an economic expansion which does not jeopardize the internal and external stability of the currencies.

# I. BASIC FACTS OF MONETARY POLICY

## CHAPTER 1

### THE INSTITUTIONAL FRAMEWORK OF MONETARY POLICY

5. In this study the term "monetary policy" will be understood to denote the means available to the monetary authorities to influence the liquidity of the economy, in particular by acting on bank liquidity.

The responsibility for monetary policy in the Member States of the EEC with the exception of Luxembourg, which has no Central Bank of its own and is a special case by reason of its membership of the Belgo-Luxembourg Economic Union, is vested by virtue of the respective laws in the Central Bank, in varying degree from state to state. In some member countries the State, however, has also assigned certain powers in the field of monetary policy to other official institutions or to the government itself or has even taken the final responsibility for monetary policy, but has at least provided for its own participation in decisions on monetary policy.

Besides this, there is a factual limitation on the powers of the Central Banks: governments, that is to say, exert an influence on monetary trends by their debt-management policy and by the placing of their liquid funds. In fact, this policy is generally the reflection of a co-ordination - varying, however, in degree from State to State - between the competent public bodies and the Central Bank.

6. It is perhaps not always precisely possible to determine the scope of government intervention in monetary policy or, conversely, the degree of autonomy of the Central Banks. The existing legislation governing relations between government and Central Bank give only an imperfect picture of these relations, which are often very complex. In practice the government, where it has very strong powers to participate or even to intervene in this field, might not always avail itself of its authority. Conversely, where these legal provisions give to the Central Bank a very far-reaching autonomy, the government may still insist on its views being taken into account. These legal provisions, therefore, come into play only in the event of sharp conflict, whilst the day-to-day conduct of monetary policy and of collaboration between Government and Central Bank tends to depend on the personalities engaged.

The following is a brief description of relations between Government and Central Bank in so far as they are laid down by laws and regulations.

7. In the *Federal Republic of Germany* the Deutsche Bundesbank is empowered by the Act of 1957 to fix interest and discount rates as well as minimum reserve ratios within prescribed limits, and to determine the principles governing its credit and open-market operations. In the exercise of these powers the Bundesbank is independent of instructions of the Federal Government. It is, however, required to support the general economic policy of the Federal Government at least as far as this obligation is consonant with its special task, which is briefly defined in the Act as the "safeguarding of the currency" (die Währung zu sichern).

The 1957 Act also goes into some detail on co-operation between the Government and the Central Bank.

a) The Bundesbank has to advise the Federal Government of matters of primary importance in the field of monetary policy and upon request furnish information to the Federal Government.

b) The members of the Federal Government are entitled to take part in the deliberations of the Central Bank Council. They have no vote, but may propose motions. At their request the taking of a decision is deferred, but for not more than two weeks.

c) The Federal Government invites the President of the Deutsche Bundesbank to participate in its deliberations on matters of importance in the field of monetary policy.

The 1957 Act contains no other provisions concerning the relation between Government and Central Bank. In particular, it provides for no appeal or arbitration authority in the event of disagreement.

The wide institutional autonomy of the Bundesbank is supplemented by the personal independence of the members of the Central Bank Council (Zentralbankrat), the highest body of the Bundesbank. This Council consists of the President and Vice-President of the Deutsche Bundesbank, the other members (at present seven in number) of the Board of Managers of the Bundesbank and of the eleven Presidents of the Länder Central Banks (Landeszentralbanken). These are the Main Offices (Hauptstellen) of the Bundesbank in the Länder, the Hanseatic cities and West Berlin. The members of the Board (Direktorium) are proposed by the Federal Government; the Presidents of the Länder Central Banks by the Bundesrat (the Upper House of Parliament, consisting of representatives of the Länder Governments) on nominations from the competent Länder authorities. All are appointed for a period of eight years by the President of the Federal Republic. The President of the Deutsche Bundesbank, who is chairman of the Board of Management, also presides over the Central Bank Council, which as a general rule meets fortnightly.

8. In *France* the institutional framework of monetary policy is determined by the Act of 2 December 1945 on the nationalization of the Banque de France and the major banks (*grandes banques*) and on the organization of the credit system. This Act was superimposed on the laws, decrees and conventions which formerly defined the status of the Banque de France. It set up a "Conseil national du crédit" (National Credit Council) whose task is to decide on the general lines of credit policy and to study ways of adapting it to the economic development of the country. The Government, the National Credit Council and the Banque de France thus share responsibility in monetary matters.

The Governor of the Banque de France is appointed for an indefinite period by a decree of the Council of Ministers meeting under the chairmanship of the President of the Republic. The Governor is assisted by two deputy governors, appointed in the same way, and he presides over the General Council of the Bank which includes the following :

- i) seven members are appointed by the Minister of Finance to represent general interests (labour, industry, agriculture, etc.);
- ii) four members who are *ex officio* members in their capacity as General Managers of the leading specialized credit institutions in the public sector;
- iii) one member is elected by the personnel of the Bank. Two auditors, who are senior officials in the Ministry of Finance, attend the meetings of the General Council in an advisory capacity.

The Banque de France fixes among other things the rates and conditions applying to rediscounting and open-market operations. Since the beginning of 1961 it has also been responsible for fixing, within limits authorized by the Conseil national du crédit, the minimum reserve ratio (*coefficient de trésorerie*).

The Conseil national du crédit is presided over by the Minister of Finance and Economic Affairs, the Governor of the Banque de France being *ex officio* Vice-President. The 43 members of this Council include eleven representatives of the borrowers, eight of workers' organizations, eight of the Ministries responsible for economic matters, eight of finance and banking institutions and, finally, eight members exercising or having exercised managerial functions in public or semi-public credit institutions. Secretarial services for the Council are provided by a special department of the Banque de France, it is the Governor of the Bank who almost invariably takes the chair at meetings. The Conseil national du crédit makes proposals, renders opinions or formulates recommendations for transmission to the responsible Ministers. But its main functions are to take "decisions of a general nature" (*décisions de caractère général*) concerning the regulation of banking activities (minimum reserve ratios), scale of bank rates and charges, regulations on hire purchase credits, etc.).

The control of the banking and allied professions is the responsibility of the Commission de contrôle des banques, which is also presided over by the

Governor of the Banque de France. If we further take into consideration that the latter is also chairman of the Comité des Bourses de valeurs (Stock Exchange Committee), which has authority over the capital market, we see the importance of his role and the action which he can take in widely differing fields, in close liaison with the Minister of Finance, who is himself represented at all levels in the machinery just described.

9. In *Italy* powers in the matter of monetary policy have been vested to a large extent in the Comitato Interministeriale per il credito e il risparmio (Inter-ministerial Committee for Credit and Savings). The powers of the Central Bank in this field must be considered as derived or delegated functions.

The Comitato Interministeriale – established in 1947 – is under the chairmanship of the Minister of the Treasury, and includes the Ministers of Public Works, Agriculture, Industry and Trade, External Trade and the Budget. The Governor of the Banca d'Italia takes part in the Committee's meetings.

This Committee determines monetary policy and has wide powers of supervision over the banks. Its decisions are carried out by the Ministry of the Treasury and by the Banca d'Italia which is under the control of that Ministry. The Minister has power to change Bank rate and this he does in practice on the proposal of the Governor of the Central Bank.

The Banca d'Italia is directed by a Consiglio superiore (Council) whose role is similar to that of a Board of Directors and which consists of the Governor and of twelve members appointed by the general meeting of shareholders. These are principally the savings banks (holders of 59% of the Bank's capital), other credit institutions and pension funds and insurance companies. The Council appoints the Governor, the General Manager (representing the Governor) and the Deputy General Manager, who make up the managing board of the Bank. These appointments must be confirmed by decree of the President of the Republic. The Consiglio superiore is not competent in the field of monetary policy, which is, as mentioned above, the responsibility of the Comitato Interministeriale to which the Governor of the Banca d'Italia belongs. The administration of the Bank is kept quite separate from the exercise of monetary powers.

10. In the *Netherlands*, the Nederlandsche Bank (a joint-stock company wholly owned by the State) has the task, under the Act of 1948, "to regulate the value of the Netherlands monetary unit in such a way as is deemed most conducive to the welfare of the country and to keep its value as stable as possible".

Powers in monetary matters are vested in the Board of Managers of the Bank, which consists of the President and the Secretary together with at least three and at most five Managers. Members of the Board of Managers are appointed for seven years by the Crown on nomination by a joint meeting of the Board of Managers and the Board of Directors (Raad van commissarissen). They are also suspended or dismissed by the Crown (see also the last paragraph of this

section). The Bankraad (Bank Council) is another body responsible for monetary policy. It has 17 members and is presided over by a Royal Commissioner who exercises Government supervision over the Bank and who may participate in an advisory capacity at meetings of the Board of Directors and at joint meetings. Four members of the Bank Council are appointed by the Board of Directors from among its own members and twelve are appointed for four years by the Crown on nomination by the business and labour organizations in such a way that trade (including transport), industry and agriculture are represented by two members each and labour, financial and banking circles by three members each.

Meetings of the Bank Council which take place at least six times annually are attended in an advisory capacity by the Board of Managers of the Bank, the Treasurer-General and representatives of the Ministries of Economics, Agriculture and Social Affairs. At the meetings the President of the Bank reports on economic and financial developments and on the Bank's policy. The Bank Council is entitled to give its advice to the Minister of Finance in matters which are of importance for guiding the Bank's policy, and the Minister of Finance may request its opinion, after consulting the Board of Managers.

When he considers it necessary for the co-ordination of monetary and financial policy, the Finance Minister may give instructions to the Board of Managers after consulting the Bank Council. Nevertheless, the Board of Managers may within three days submit its objections to the Crown, which then examines the ministerial directives. If these are confirmed, the Board's objections and the decisions of the Crown are published in the "Nederlandse Staatscourant" provided such publication is not contrary to the interests of the State. Members of the Board of Managers failing to apply directives of the Finance Minister which have not given rise to any objections or have been confirmed by the Crown may be removed from office after consultation with the Council of State.

11. In *Belgium* powers in the field of monetary policy are to some extent decentralized. The Banque nationale de Belgique, which is a joint stock company with half of its capital held by the State, is chiefly competent for discount policy, fixing the rediscount conditions and the minimum reserve ratio (coefficient de réserve monétaire). This ratio is fixed by the Commission bancaire (Banking Commission), but on the proposal of the Banque nationale de Belgique. Open-market operations are the responsibility of a special body, the "Fonds des rentes" (Government Stock Equalization Account).

The Banque nationale is directed by a Governor and administered by the Managing Board which is presided over by the Governor; it is assisted by the Conseil de régence (Council of Regents). The Governor is appointed by the King for five years; the Managers – at least three and not more than six – are likewise appointed by the King for a period of six years, on a proposal of the Conseil de régence.

The Managing Board conducts all business which is not the preserve of the Conseil de régence. In case of urgency the Managing Board may change the rates for discount and advances on securities but must refer the matter to the Conseil de régence at its next meeting.

The Conseil de régence meets at least once weekly. It consists of the Governor, the managers and ten regents. The regents are elected by the general meeting of shareholders for three years. Two of them are chosen on a proposal of the most representative labour organizations and three are proposed by the most representative organizations of industry, trade and agriculture. Two regents are selected from the management of public finance institutions. The remaining three are nominated by the Minister of Finance. The Conseil de régence discusses general questions concerning the Bank, the monetary situation and the economic development of the country. It fixes the rates and conditions for discount, advances on securities and loans. However, the Governor of the Bank may suspend execution of the decisions of the Conseil de régence; in such cases he has to submit the decisions to the Conseil général (General Council), which for that purpose is called together at short notice. The Conseil général consists of the members of the Conseil de régence and the eight to ten members of the collège de censeurs (Auditing Board) and is presided over by the Governor.

Finally, the Finance Minister exercises control over all the Bank's operations through the intermediary of a Government commissioner, appointed by the King, who has a right of suspensive veto in respect of any measure contrary to law or to the "interests of the State" and who may attend the meetings of the various bodies of the Bank in a consultative capacity.

Beside the Banque nationale de Belgique there are further institutions with powers in respect to monetary policy. The Fonds des rentes has already been mentioned. Next to it the Institut de réescompte et de garantie (Rediscount and Guarantee Institute) influences the money market. Finally, there is the Commission bancaire (Banking Commission) which, in addition to its functions in supervising the banks and issues of securities on the capital market, administers the system of the so-called bank cover ratios (coefficients bancaires). But beginning in 1962 this regulation has been replaced by a conventional system of minimum reserve requirements.

The decentralization of responsibilities in respect to monetary policy is modified by the fact that the Banque nationale de Belgique, as the principal authority responsible for monetary policy, is represented and can express its opinion in all these institutions. Thus, the Fonds des rentes is jointly administered by the Treasury and the Bank. The Institut de réescompte et de garantie is directed by a Comité de direction (Board of directors) with responsibilities for daily transactions consisting of a Chairman and seven members who are appointed by the King and may be dismissed by him. Four of these members are chosen from a list which includes three candidates nominated by the general meeting of shareholders (banks and financial institutions) for each seat to be

filled. It is customary that the chairman and two members of the Comité de direction are from the Banque nationale. The operations of the Institute are supervised by a Government Commissioner who has a right of veto at all meetings of the Comité de direction.

The most important decisions of the Commission bancaire – in particular those relating to the former regulations on the bank cover ratio – are subject to ministerial approval. Under the new system of minimum reserve requirements this approval is only required when the rate of these reserves is raised by more than three points in the course of any 30-day period.

12. *Luxembourg* has no Central Bank. Under agreements between Luxembourg and Belgium the circulation of Luxembourg notes and coins is limited to a symbolical amount of 300 million francs. Belgian notes and coin are also legal tender in the Grand Duchy.

Luxembourg's sovereignty in monetary matters extends only to fixing the parity of its currency. A public institution, the Caisse d'épargne de l'Etat (State Savings Bank), exerts a considerable influence on the movement of credit in Luxembourg. It acts as bank of the State and accepts deposits expressed in Luxembourg francs; as far as possible it grants credits only to borrowers residing in the Grand Duchy; its liquidity surpluses are invested preferably in readily negotiable money market paper in Belgium. The business of the Bank is as large as that of all the other banks in the Grand Duchy put together.

Deposits with the Caisse d'épargne de l'Etat are guaranteed by the State, which supervises the Bank's activities. The Caisse d'épargne de l'Etat is controlled by a commissioner, appointed by ministerial decree, who can attend meetings both of the Board of Directors and of the Managing Board. It is also supervised by the commissariat for the control of banks.

The Caisse d'épargne de l'Etat has a Board of Directors consisting of the Director, the Deputy-Director, both appointed by Grand-Ducal Decree, and a maximum of five other directors appointed by ministerial decree. These include the Honorary Director of the establishment, a representative of the Chamber of Commerce, one of the Chamber of Handicrafts and one of the National Labour Office. The Board of Directors fixes the interest rate and credit conditions, assumes responsibility for the investment policy of the Bank and supervises the work of the management.

It is to be noted that decisions of the Board of Directors submitted for ministerial approval become effective despite any objection by the Ministry if the Board, after deliberating, confirms its previous attitude. Nevertheless, the Government has the right to dissolve the Board of Directors.

The Managing Board which at present is composed of three members appointed by ministerial decree, in addition to the Director and Deputy Director,



decides as to the acceptance or rejection of individual applications for credits or loans and is responsible for all the business of management which is not especially reserved to the Board of Directors.

To sum up :

- i) the powers of the Caisse d'épargne de l'Etat in the sphere of monetary policy apply only to deposit money ;
- ii) the monetary policy followed by this autonomous public establishment is laid down by the Government subject to the above reservations ;
- iii) the operations of the Caisse d'épargne de l'Etat are under the direct control of the Government represented by a supervising Commissioner.

13. Apart from their powers in the sphere of monetary policy in the strict sense of the term, the central banks of all the Member States have wide powers in the field of *banking policy, supervision and control*. From the monetary point of view the scope of these responsibilities goes beyond the mere supervision of liquidity and solvency, particularly in those countries where monetary policy makes use of selective methods and where the bank's supervisory authorities also have to fix interest rates for debtors and creditors.

These powers are particularly extensive in the case of the Banca d'Italia and the Banque de France. In *Italy* the Central Bank is alone responsible for the execution of decisions taken by the authorities controlling banks, i.e. the Comitato interministeriale per il credito e il risparmio (Interministerial Committee for Credit and Savings) and the Minister of the Treasury; to this end it has available extensive machinery and in fact exercises very wide responsibilities.

In the same way the *Banque de France* gives executory force to the decisions taken by the Conseil national du crédit whether these be of a general or individual nature, and helps to implement these decisions and those of the Commission de contrôle des banques (Banking Control Commission) which, as pointed out above, is presided over by the Governor of the Banque de France. In *Italy* the powers of the authorities dealing with monetary policy and the supervision of banking also extend to long-term credit establishments. In *France* the specialized establishments are under the direct supervision of the State. But it goes without saying that despite this difference in structure these establishments must be able to adapt their operations to the requirements of general economic policy.

In the *Federal Republic of Germany*, the Law on the Credit System (Gesetz über das Kreditwesen) which came into force at the beginning of 1962 expressly provides for co-operation between the Federal Supervisory Office on the Credit System (Bundesaufsichtsamt für das Kreditwesen) and the Deutsche Bundesbank, which has powers of its own in certain fields of banking control, in particular as regards the granting of large credits. Before submitting its proposals for the

appointment of the Chairman of this Office to the President of the Federal Republic the Federal Government must consult the Central Bank. The Federal Supervisory Office issues regulations concerning solvency and liquidity only by agreement with the bank of issue. When the Federal Ministry of Economics or the Federal Supervisory Office on the Credit System prescribes terms for granting credits or accepting deposits, these regulations may not be promulgated without consultation with the Bundesbank. The terms must be such as to reinforce the credit policy measures taken by the Bank.

In *Belgium*, the Banque nationale de Belgique has a representative on the Commission bancaire which is the body exercising powers of superintendence and control over the banks. It also places its technical resources at the disposal of this Commission, in this way acting as does the Banque de France vis-à-vis the Conseil national du crédit or the Banca d'Italia vis-à-vis the Comitato interministeriale. At the request of the Commission bancaire the Bank carries out enquiries and gives its opinion, for instance to the Commission when this body is fixing maximum interest rates for certain classes of credit which it is competent to determine.

In the *Netherlands*, powers of supervision and control over the banks are exercised by the Central Bank itself.

The 1956 law on the credit system confers on the Bank fairly wide powers which it may use to discharge the functions assigned to it in its statutes. These powers include the right to consult the bankers' association and conclude agreements with them when it considers that the situation is shaping in such a way as to impair the accomplishment of its task. It was thus that the Nederlandsche Bank put into operation its system of minimum reserves, which is not provided for in the law on the Central Bank.

## CHAPTER 2

### THE STRUCTURAL CONDITIONS OF MONETARY POLICY

14. The methods and efficacy of monetary policy are determined in varying degrees in the Member States by the structure of the national economy in general and of the banking system in particular. Here we indicate only the main structural data.

15. *The volume of payments transactions with foreign countries* is an important factor in monetary policy. If we take as a rough frame of reference the relation between exports and services supplied, on the one hand, and the gross national product on the other, we obtain for the different States of the European Economic Community in 1960 the following figures (as percentages of the gross national product):

Luxembourg <sup>1</sup>	80
Netherlands	50
Belgium	34
Germany FR <sup>2</sup>	25
Italy	16
France	15

Such considerable differences cannot fail to influence the extent to which the national economies are dependent on the world economic situation. With the almost complete liberalization of trade and services, the return to convertibility and the sweeping relaxation of restrictions on capital movements, relations with foreign countries have tended to develop more widely in all the Community States, particularly Italy and France, i.e. the two countries which were formerly the most sheltered against fluctuations of the economic situation in other countries.

Doubtless, the foreign trade and payments transactions of France and Italy are still small (in relation to the national product) compared with those of the Netherlands, Belgium and Luxembourg, and their responsible authorities can influence economic trends by monetary measures with less heed to their rapid repercussions on external trade. Furthermore, certain restrictions still imposed, particularly on short-term capital movements, make Italy and France less

<sup>1</sup> In 1959

<sup>2</sup> Excluding Berlin and Saar.

sensitive to international capital movements of this sort than Federal Germany, the Netherlands, Belgium and Luxembourg. The policy on interest rates in France and Italy allows more latitude, and they are largely allowed to find their own level. It would seem, however, that in recent times this relative autonomy vis-à-vis the trend of interest rates abroad has tended to disappear, the more so as the banks in all Member States except France are allowed to hold balances in foreign currency and invest on foreign money markets, and they do so on a considerable scale.

16. The habits of the investing public, particularly as regards liquidity, form another structural factor which monetary policy must take into account. Here again we have only a rough basis of comparison. We may get some idea of the diverse structure by comparing the relationship in the different Member States between the liquid assets of households, non-banking undertakings and public authorities, on the one hand, and the gross national product, on the other. The breakdown of these liquid assets varies from country to country and it is in itself an important structural factor in monetary policy.

Table 1

LIQUIDITY OF THE ECONOMY IN MEMBER COUNTRIES  
IN 1960

Country	Primary liquidity as % of GNP	Currency in circulation as % of primary liquidity	Secondary liquidity as % of GNP
Germany FR	18	41	25
Belgium	36	56	25
France	34	42	21
Italy	37	36	30
Luxembourg	43 <sup>1</sup>	41 <sup>1</sup>	41
Netherlands	27	45	38

<sup>1</sup> Including Belgian notes and coin circulating on Luxembourg territory (estimated).

If we consider the most liquid portion of this "liquidity of the economy", i.e. currency in circulation and sight deposits (primary liquidity) the situation is as follows in the different countries.

In the *Federal Republic of Germany*, the ratio of primary liquidity to the gross national product is very low (18%) and has remained remarkably stable on the whole since 1950. In the Netherlands it reached 27% in 1960 after wide

fluctuations, with a predominantly downward trend, since 1950. In France, Belgium, Italy and Luxembourg the ratio in 1960 was respectively 34%, 36%, 37% and 43%; it had risen from 1950 onwards in France, Italy and Luxembourg – with more marked variations in the first of these three countries – and had fallen off in Belgium since the same date.

The share of *currency in circulation* in "primary liquidity" (which is a pointer to the growing requirements of the banks for liquidity to finance the increase in the note and coin circulation in an expanding economy) also varies greatly from country to country; the Federal Republic of Germany, Luxembourg, France and the Netherlands with 41%, 41%, 42% and 45% respectively in 1960 show roughly equal rates but the percentage is definitely lower in Italy (36%) and appreciably higher in Belgium, where it reached 56%.

The volume and composition of "*secondary liquidity*" – sometimes called "liquid savings" in France – also show very wide differences in the various Member States. In France, the Netherlands and to a lesser extent in Italy and Luxembourg, households and enterprises hold short-term securities of the State and other public authorities, which in the case of France represent a third of the volume of secondary liquidity, in addition to their savings deposits and fixed deposits. In Federal Germany and Belgium personal savings and cash surpluses of firms are not to any great extent invested in this liquid form. For this reason secondary liquidity in these countries consists almost exclusively of time deposits and savings deposits with banks and savings banks.

For reasons of a statistical and terminological nature any comparison of the ratio between secondary liquidity and the gross national product in the Member States can only be made with reservations, since secondary liquidity is not everywhere defined in the same way. Thus, in the Netherlands the statistics of secondary liquidity, for reasons pertaining to the nature of the institutions, omit deposits administered by the savings banks. If these deposits are added to facilitate comparison and to take into account the fact that savings deposits – despite their capital character – are essentially liquid investment for their holders, the situation in the Community countries may be summed up as follows :

In 1960, the countries with the lowest ratio of secondary liquidity, of varying composition, to gross national product were France (21%), Federal Germany (25%) and Belgium (25%). In Italy, the ratio was 30%, in the Netherlands 38% and in Luxembourg 41%. In recent years it has steadily increased in all the Member States, with the Federal Republic of Germany in the van; in that country the 1948 currency reform radically curtailed monetary assets and new resources were in the first instance kept in the most liquid form possible. It is not intended to analyse the causes of the structural differences noted and the trend in the various Member States, but it will be noted that these differences and their causes are important factors in the shaping of monetary policy.

17. The *structure of the banking system* is another material factor in monetary policy. It also differs greatly in the various Member States.

In the *Federal Republic of Germany* most banks undertake all types of banking operation. In addition to sight, time and savings deposits, they can accept long-term deposits and conversely grant medium and long-term as well as short-term loans. Even the savings banks, which in the past generally confined themselves to savings and long-term credit operations, are transacting an increasing amount of short-term deposit and credit business. Although their main task is to provide finance for relatively small businesses, the largest of them, and in particular their central giro institutions, which are at the hub of their networks, take an important part in the large scale financing of industry and in underwriting syndicates. Another large category of banks includes mortgage loan institutions and building societies; these finance their long-term operations almost exclusively by bond issues and direct borrowing.

In *Luxembourg*, the banks accept sight, time and savings deposits and, conversely, grant medium and long-term as well as short-term loans. Even the Caisse d'épargne de l'Etat (State Savings Bank) which, before the last world war, used to confine itself to savings and long-term credit operations now does a considerable amount of short-term deposit and credit business.

*Dutch* commercial banks traditionally accept short-term deposits and make short-term advances. However, these banks have in recent years been attracting savings on an increasing scale, and this has led to some growth in longer term loan operations. On the other hand, the Dutch savings banks accept almost exclusively deposits on savings account, as they are obliged to do by the 1956 law on the banking system: they make chiefly medium and long-term loans. The agricultural credit co-operatives have the same powers as the commercial banks and savings banks. The major part of their deposits comes from savings; short-term lending, particularly to agriculture, is on a smaller scale than medium and long-term. A special credit establishment, the Bank voor Nederlandsche Gemeenten, makes long-term loans to local authorities.

In *Belgium* the deposit banks accept sight and time deposits as well as deposits on savings account. Although they are not forbidden to make long-term loans, these banks offer mainly short and medium-term advances, perhaps because a large part of their assets is immobilized in the form of State funds which they are obliged to hold in pursuance of the minimum reserve rules. Private savings banks can accept deposits of all kinds, but they chiefly confine themselves to savings book accounts and most of the advances they make are on a long-term basis, with short-term loans playing only a small part. But the main collector of savings in Belgium is the Caisse générale d'épargne et de retraite (General Savings and Pensions Bank). This semi-official establishment, which accepts only savings-book deposits, is the chief provider of medium and long-term loans. It invests chiefly in public funds, building loans and, to a lesser extent, in loans to industry and agriculture; it also finances exports. The

Caisse générale is also very active in the money market, particularly in day-to-day loans, taking up short-term Treasury certificates and the purchase of bank acceptances. Specialized establishments grant medium and long-term credits to industry and local authorities, finding the money chiefly by issuing their own bonds.

18. The banking systems in France and Italy are very different from those of the countries mentioned above. In both countries the law draws an almost clear distinction between short-term credit establishments and those concerned with medium and long-term credits.

In *France*, the first category includes the deposit banks (banques de dépôts), which alone hold nearly 90% of the deposits held by the banking establishments proper. The banques de dépôts may not accept deposits from the public for a term longer than two years. Since March 1957 they have also had the right to accept savings deposits under the name of "special accounts", to which strict rules apply. Their lendings and investments, and more particularly, the acquisition of participations, are subject to certain restrictions.

The banques d'affaires (investment banks) are empowered to carry out all the usual credit operations of deposit banks but are exempted from the restrictions applied to the latter in the matter of share holdings. They are authorized to accept deposits for periods or at notice of more than two years. They may also receive deposits for periods of less than two years from traders and private individuals with whom they have financial relations.

The people's banks and the agricultural credit co-operatives, which are not under the supervision of the Conseil national du crédit but conduct business in their own sectors on the same lines as the banks, also make short and medium term loans.

The distribution of long-term credit is mainly effected by a certain number of specialist establishments which attract savings. They have close financial relations with the Treasury and their activities are supervised by the State. The "long and medium-term credit banks", which come under the Conseil national du crédit, play only a limited part here.

Special mention should be made of the savings banks proper, which in France are not a part of the banking system. Under their statutes they place the funds which they collect with the "Caisse des dépôts et consignations", a public establishment which uses these funds to finance medium and long-term loans on a large scale, particularly for local authorities and for housing.

Since the thirties a distinction has been made in the *Italian* banking system between short-term and long and medium-term credit establishments. But this distinction is not very strict and there is overlapping. Within certain limits, which moreover are narrower for banks than for savings banks, these "aziende

di credito" can also carry out medium-term operations. They may accept sight, time and savings deposits without upper limit and there is a close relation between them and the special credit institutions, a part of whose capital they hold.

These special institutions (for industrial and agricultural long-term loans and the financing of public works) obtain about 60% of their resources by issuing cash certificates and placing bonds on the capital market, 25% by recourse to the banks and 15% from the Treasury. They are concerned almost entirely with long-term loans.

19. The structure of the capital market and the policy followed on that market by the responsible bodies have an important bearing on monetary policy. The key factor here is the greater or lesser volume of bank holdings of long-term securities which to some extent determines relations between the money market and the capital market and the degree in which interest rates on the capital market are dependent on the monetary policy of the Central Bank. Finally, it is important to know how much control is exercised over issues by the State.

In the *Federal Republic of Germany* the credit institutions (commercial banks and central giro institutions of the savings banks) form syndicates for the issue of bonds and shares. They have set up a committee, the "Capital Market Committee", which endeavours to regulate access to the capital market and ensure a certain consistency in the terms of issue. Representatives of the Deutsche Bundesbank may express their opinion on the situation of the capital market. From the point of view of monetary policy it is not irrelevant to observe that, in relation to the very marked increase in the volume of their operations, the banks and the savings banks hold a growing volume of transferable securities - in particular bonds issued by local authorities - and that their subscriptions have sometimes accounted for almost half the total of certain issues. The liquidity policy measures adopted by the Deutsche Bundesbank therefore generally have direct and appreciable repercussions on the capital market and consequently also influence investments financed by capital from that source.

As regards the banks the situation in the *Netherlands* is similar to that in the Federal Republic. The Dutch commercial banks can buy and sell stocks and shares without limit but their holdings in the past have generally been smaller and more stable than those of the German banks. Changes in monetary policy and the tightening of bank liquidities following the measures introduced by the Central Bank have not set off any increase in sales or purchases of stocks and shares. This is explained by the traditions of the Dutch banks. Changes in the policy of the Central Bank therefore do not have the same rapid effects on the financial market as in the Federal Republic. This is also due to the fact that, although they are authorized to use their funds to invest in real estate and grant loans on mortgage, the establishments which attract savings, including the private savings banks and the Post Office savings banks, purchase large quantities of securities on local stock exchanges. In addition the



Nederlandsche Bank has a certain influence on the volume of capital market issues and authorizes issues by foreign companies according to the capacity of the Netherlands capital market to absorb them.

In *Italy* the banks (*aziende di credito*) can buy fixed interest-bearing securities, particularly those issued or guaranteed by the State, and bonds issued by the specialized credit institutions. Their holdings are relatively large; at the end of 1960 they represented about 20% of the commercial credits of these banks. But the banks do not sell these securities on the stock exchange; they pledge them with the Central Bank when they need liquid funds.

20. In *Belgium* and *France* the deposit banks' holdings of long-term securities are negligible, either because of the regulations or because of tradition. The Belgian banks may only hold securities issued or guaranteed by the State which complete their "cover" as required by the regulations on banking ratios. However, since the introduction of a system of minimum reserves, under which, in principle, the banks have reserves only with the Central Bank, this "cover" requirement refers only to the average deposits in the period from January to October 1961. As to the French deposit banks, their holdings of securities are insignificant in relation to their other investments.

## II. THE PRINCIPAL INSTRUMENTS OF MONETARY POLICY

### CHAPTER 3

#### REFINANCING POLICY

21. Rediscount policy concerns the different forms of direct aid which under its statutes the Central Bank can grant the banks<sup>1</sup> either by purchasing from them government or private bills ("Rediscount" in the strict sense) or by granting them advances ("advances on securities"). In this wider sense of the concept of rediscount policy the expression "refinancing policy" is sometimes used.

By influencing its cost, changes in Bank rate can modify the demand for credit from the economy. But since the war particularly central banks have also made use of quantitative limitation of credits to the banks as part of their discount policy.

But whether it is exercised by manipulating interest rates or by quantitative limits discount policy differs in importance and efficacy within the Community according to the traditions of the banking systems and the practices of the respective central banks.

22. In all Common Market countries the Central Bank imposes certain conditions and certain limitations on the help it grants the banks by rediscounting bills and making advances on securities.

In this field the activity of the Central Bank is more likely to be an essential weapon in the arsenal of monetary policy in a country like France, where four-fifths of bank credit to commerce and industry takes the form of discounting of trade bills, than in the Netherlands, where the banks mainly help firms and individuals by overdraft facilities. In this respect Federal Germany, Belgium and Italy are in an intermediate position, since in these countries bank credits made available by discounting commercial bills represented, at the end of 1960, 42%, 40% and 33% respectively of all short-term credit granted to the economy by the banks.

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<sup>1</sup> In the Netherlands this aid from the Central Bank is made available through exchange brokers (wisselmakelaars).

The relative volume of bank credit granted by discounting depends to some extent on the policy followed by the Central Bank itself to encourage or restrain certain forms of credit and also on the practices of the banks, in particular their greater or lesser tendency to borrow from the Central Bank. In the Netherlands intervention by the Central Bank is considered simply as a means of helping the banks to overcome transient difficulties, and it must not have the effect of putting the banks permanently in debt to the Central Bank. In France and Belgium, on the contrary, the high volume of such indebtedness has been a regular feature of the banking system, at any rate until recent years. A large part of the assets of the Banque de France (40% at the end of 1960) consists of rediscounted bills.

The volume of the direct help of the Central Bank naturally depends on the abundance or insufficiency of the liquid funds which the banks receive from other sources, but also to some extent on the distribution of the liquid assets of the economy between the institutions managing them (banks, specialized credit institutions, Treasury). Thus in the Netherlands again the comfortable cash position of the banks generally makes it unnecessary for them to call on the Nederlandsche Bank for help in substantial amounts or for long periods, whereas in France shortage of liquidity obliged the banks in the post-war years up to 1958 to have recourse to the Banque de France almost constantly.

The importance of direct aid – rediscounting of bills and advances on securities – from the Central Bank to the banks not only differs from one country to another according to the structure of the banking system and customs in the matter of credit, but also varies according to how much use is made of other instruments of monetary policy introduced or developed since the war, such as the open-market policy and the minimum reserve policy.

23. Although in France, Belgium and Federal Germany the banks usually call upon the assistance of the Central Bank in the form of rediscounting, in the Netherlands and even more in Italy they tend to prefer advances on securities. Despite the relatively large volume of bank credit made available to the economy in Italy by discounting commercial bills, the liquidity requirements of the banks are only covered to a very secondary extent by rediscounting, if we except the refinancing of bills relating to stocks of agricultural products. The reason for which Italian banks prefer advances on securities is that this method is less costly than rediscounting, although the nominal rate has been identical for years, because the interest on discounting is paid in advance. In Federal Germany, Belgium and France advances on securities are rather the exception; moreover the rate for them is usually higher than Bank rate.

24. The degree of interdependence between Bank rate and the *lending and borrowing rates* fixed by the banks for their customers varies from one country to another. The rates charged to *borrowers*, which can influence the demand of commerce and industry for credit, are in particularly close relation to Bank rate in Federal Germany, France and Italy. In the Federal Republic and Italy the

relationship is based on an agreement between the banks which is approved by the State, and in France on decisions of the Conseil national du crédit. In the Federal Republic of Germany the rates for borrowing linked with Bank rate are maximum rates and the banks may operate below them. In France and Italy, on the contrary, it is the minimum rates which are modified and the banks may apply higher rates. The effective rates charged to borrowers do not necessarily follow the fluctuations of Bank rate, but they nevertheless tend to do so more or less closely, according to the liquidity position of the banks. In France the connection between Bank rate and the rates charged by the banks to borrowers was recently relaxed. Bank rate and the basic rate which serves as a standard for the minimum terms applicable to credit customers are only identical when the former is between  $3\frac{1}{2}$  and  $4\frac{1}{2}$ %. Variations of Bank rate below or above these limits only affect the basic rate to the extent of one half of the divergence to  $3\frac{1}{2}$ % and  $4\frac{1}{2}$ %. In Belgium and the Netherlands the banks are in the habit of following Bank rate although there is no regulation obliging them to do so. In Luxembourg they fall in line with the interest rate fixed by the Caisse d'épargne de l'Etat.

25. *The rates of interest paid on deposits* by the banks are as a general rule less directly linked to Bank rate than are the rates for advances. In Germany the Federal Office for the credit system (Bundesaufsichtsamt für das Kreditwesen), set up in January 1962, decides by agreement with the Deutsche Bundesbank whether and how far deposit rates shall follow changes in Bank rate. In France there is no direct link between the rates of the Banque de France and the rates of interest which the Conseil national du crédit fixes for sight and time deposits with banks. However, the Conseil national du crédit settles the interest rates for time deposits with banks slightly below the rates paid for government bills of comparable maturity date. Interest rates for savings bank deposits follow the same rules.

Since the beginning of 1962 in Belgium interest rates on time deposits in Belgian francs have been fixed by agreement between the Banque nationale de Belgique and the Association belge des banques in the light of the money market situation, the balance of payments and the economic trend. Previously maximum rates of interest on deposits were linked with Bank rate by an inter-bank agreement approved by the Ministry of Finance. In Italy, the maximum rates of interest on deposits are fixed by an agreement between the banks and are not tied to the official Bank rate. When the latter is changed the deposit rates are nevertheless reviewed by the Comitato interministeriale per il credito e il risparmio, and amended where necessary. In the Netherlands, on the other hand, there is no agreement between the banks and the State does not intervene in the matter of deposit rates. These are established in the light of market conditions and interest rates for time deposits generally follow the market rates for Treasury bonds.

26. The manipulation of Bank rate as an instrument of monetary policy has varied in importance in the Member States over recent years. Between the end of the war and the end of 1961 the rate was changed 24 times in the Federal

Republic of Germany, 22 in Belgium, 17 in France, 16 in the Netherlands and only 4 times in Italy.

In general, changes in Bank rate are considered as a means of influencing the demand of industry and commerce for credit; since Bank rate in varying degree affects the interest rates which the banks charge to borrowers, it largely determines the cost of money. To the extent that changes in Bank rate also affect the rates paid on bank deposits, such changes may directly or indirectly influence the trend of rates on the capital market.

However, the degree to which changes in Bank rate affect the economy depends partly on the business trend. When overall demand is very strong and firms have reason to expect this trend to continue for some considerable time, the mere raising of Bank rate may have little effect on their decisions. In such an economic situation the use of this instrument alone will not appreciably abate the demand for credit. But if there is any feeling – prompted perhaps by credit policy measures of the Central Bank – that demand will weaken, any increase in the cost of borrowing following a rise in Bank rate may seriously influence business calculations and consequently decisions. This will still be the case when on the contrary, in order to maintain a certain level of economic activity or to stimulate activity in a period of recession, Bank rate is lowered and the cost of borrowing consequently reduced. Here again any additional demand for credit seems to depend rather on the business outlook for firms – though they may still be influenced by the lower Bank rate – than on the reduction in the cost of borrowing.

Generally speaking, the Central Banks of the member countries do not consider that changes in Bank rate greatly influence the demand for credit by affecting its cost; they feel that the banks and their commercial and industrial customers interpret such changes as an indication of the general lines of monetary policy in the near future. Changes in Bank rate are significant as a pointer, and it is this aspect which influences the decisions of firms, particularly where investment and stock-building are concerned.

27. Since the return to convertibility and the extensive liberalization of international payments and capital movements, the external aspect of discount policy, which was neglected for many years, has assumed a growing importance. The central banks are now required more than in the past to conduct their monetary policy, and in particular, their policy on interest rates, with an eye to the trend in other countries. This also demands the closest possible co-ordination of economic policy in a wider sense. Conversely, as the recent trend has shown on several occasions, central banks may be faced with a dilemma: should they, or should they not, pursue for reasons of external economic policy a policy on interest rates which is not justified by the internal economic situation?

28. A change in Bank rate necessarily has a blanket effect on all sectors of the economy. For this reason some member countries apply a *selective credit*

*policy* by means of differential rates. Such a policy, however, is less prominent today than in the past: at present only the Banque nationale de Belgique and the Banque de France apply a certain differentiation in rates.

The Banque nationale de Belgique applies different rates according to the guarantees offered by the bills presented to it for discounting (acceptances, domiciliation, etc.) and according to whether the bank acceptances offered concern imports or exports. The Banque de France, which in 1947 temporarily adopted a system of differing rates for commercial and for financial paper, has since 1957 been applying a preferential rate to the discounting of bills representing export credits.

In fact, in all countries where it is followed, selective credit policy is applied less by differentiation in rates than by direct control of the distribution of credit either through directives and recommendations of the monetary authorities or by authorizations granted or rediscount assurances given by the Central Bank. Thus, in France the limitation of total medium-term credits outstanding at any time is ensured thanks to the control exercised by the monetary authorities and particularly the Banque de France at the time when bank credit is granted. The distribution of this form of credit is controlled at the source. Once approved, these credits can be refinanced automatically by the banks (having due regard to their cash ratio) at the Banque de France through specialized bodies. The Banque nationale de Belgique also influences the distribution of bank credit by certifying bank acceptances and thus automatically providing a rediscount assurance.

29. As the manipulation of Bank rate is not sufficiently effective in certain circumstances in controlling the volume of bank advances and particularly in limiting the supply of credit in periods of excess demand and abundant bank liquidity, the monetary authorities in some EEC countries have introduced *rediscount ceilings* for banks.

It is mainly in France and Federal Germany that rediscount ceilings are used as an instrument of monetary policy. In the Netherlands, where the banks are only in debt to the Central Bank in exceptional cases, and in Luxembourg, this instrument is never used. In Belgium the purpose of the rediscount quotas imposed on the banks is rather to keep a check on their management. In Italy there are no rediscount ceilings in the strict sense and when the Banca d'Italia grants "refinancing" credits to the banks it takes into consideration the exigencies of monetary policy and thus makes this help dependent on the observance of a certain ratio between advances made and deposits held by the bank.

30. In *France*, where the rules concerning rediscount of certain preferential credits (export, stocking of grain, medium-term bills) are laid down and amended by the Central Bank as part of a selective credit policy, the ceiling for the rediscounting of ordinary bills is an essential element in controlling bank liquidity. Since the war the banks have perforce become heavily indebted to the

Banque de France, so that they have almost always been very near their ceilings and have only a narrow margin for calls on the Bank. They are sometimes obliged to make use of the facility offered them of applying for permission to go above their ceilings temporarily, but in this case they must pay penal rates which are sometimes very high and which they cannot pass on to their customers. When they have excess liquidity, as during the last three years, the banks make first use of it to take up – principally for reasons of profitability – not short-term but medium-term bills. This tendency was accentuated in 1961 when a minimum liquidity ratio was imposed, coupled with a lower prescribed minimum for holdings of government paper.

In the *Federal Republic of Germany* the rediscount "quotas" are fixed for each bank as a multiple of the amount of its own funds, which implies periodical adjustments of the ceilings in step with the increase in the banks' own resources. Apart from these periodical increases, the rediscount quotas have often been amended during recent years for reasons of monetary policy. They were reduced under the restrictive credit policy of 1957 and 1959, and then raised again after March 1961 when the Bundesbank relaxed this policy. But in a general way the refinancing credits are well below the ceilings themselves. Thus the influence of this instrument of monetary policy is linked with changes in the margins not made use of, since the amount of such margins may appreciably influence the credit policy of the banks. It is particularly in conjunction with changes in minimum reserve ratios – which determine, among other things, the volume of "refinancing" by the banks – that these quotas are an effective instrument, especially when the Central Bank is applying a restrictive policy.

But, in Federal Germany as in France, the efficacy of the rediscount ceilings as a means of controlling bank liquidity depends on the banks possessing a reserve of liquidity, for instance in the form of holdings of open-market securities or foreign currencies.

31. Summing up, even in countries where the direct help of the Central Bank makes an appreciable contribution to bank liquidity, the "refinancing" policy, that is to say changes in Bank rate and rediscount ceilings, often appears somewhat ineffective unless it is supplemented by other measures directly affecting the available resources of banks.

This is evident from the monetary policy trend noted in the member countries. In Federal Germany, for instance, the system of rediscount quotas is used particularly to reinforce the control exercised over bank liquidity by the minimum reserve policy and by open-market operations of the Central Bank.

In France, the introduction of rediscount ceilings in 1948 necessitated at the same time a system of freezing that part of the assets of the banks which consisted of short-term government paper (minimum holdings of Treasury bonds), which became general in 1960 as part of the minimum reserve requirements system.

But conversely, the manipulation of discount rates and ceilings has often proved a useful adjunct to other courses of action. Thus under a policy of restricting bank liquidity a reduction of the rediscount ceilings may, as pointed out above, reinforce the effectiveness of the minimum reserve policy.



## CHAPTER 4

### OPEN-MARKET OPERATIONS

32. Generally speaking, the Central Banks of the Member States are empowered to conduct open-market operations, but their interventions on the market play a lesser role in practical monetary policy than is the case in the Anglo-Saxon countries. Since the war, however, open-market operations have tended to assume more importance among the instruments of monetary policy.

33. Up to the present, however, only the Central Banks of the Netherlands and of Federal Germany have systematically used the technique of open-market operations to act on the cash positions of the banks. In the other member countries open-market transactions or the like are effected only occasionally or on a very small scale.

In *France* the scope for the Central Bank to engage in open-market operations is limited for two reasons. First, the Bank's statutes permit such operations only with short-term bills, but in this matter the Central Banks of the other member countries abstain in practice from buying and selling long-term securities, although their statutes do not forbid this. Secondly, the open-market portfolio of the Banque de France is not large. The Bank generally confines itself to taking private bills in pawn and to purchasing Treasury bonds from the banks to help them meet temporary pressure on their cash position. As a general rule it abstains from selling bills to the banks, which are thus led to use any excess liquidity to increase their holdings of mobilizable medium-term bills – for reasons of yield – and to reduce their indebtedness to the Banque de France.

In *Italy*, there is practically no organized money market on which supply of and demand for short term funds can meet. It is therefore not possible really to speak of an open market. In recent years, however, the Treasury, wishing to attain the objects of an open market, has occasionally issued relatively long-term securities (*Buoni del Tesoro poliennali*) proceeds from which have been blocked in order to withdraw liquidity from the economy and the banks. A fund was recently established which will receive annual payments from the Treasury and will purchase government paper quoted below par with a view to providing the market with liquid resources if necessary. Finally, swap transactions, which will be discussed below, can be likened to some extent to open-market operations in their effects. These operations consist of sales of foreign currency for lire concluded by the Exchange Office with the banks. These sales of currency

by the Exchange Office, which is in close contact with the Central Bank, have had the effect of attracting bank liquidity towards foreign money markets.

In *Belgium* open-market operations are not carried out by the Central Bank itself but by a special body, the Fonds des rentes, controlled jointly by the Banque nationale de Belgique and the Treasury. Following successive new arrangements, this fund is in a position to buy and sell short and long-term securities on the money or financial markets. Fairly considerable means have been placed at its disposal and it may also have recourse up to a certain point to credit from the Central Bank and issue its own short-term certificates. Under its statutes it has fairly extensive means of influencing by its operations not only the liquidity of the banks but also that of the economy.

34. In the *Netherlands* and in the *Federal Republic of Germany*, the only two countries in which the central banks systematically carry out open-market operations in order to act on bank liquidity, the Nederlandsche Bank and the Deutsche Bundesbank have an operating fund in the shape of short and medium-term bills, which enables them to intervene on the money market, the only field in which the open-market policy is applied.

The open-market policy followed in these two countries nevertheless shows certain differences. In the Federal Republic the market on which the Central Bank carries out its open-market transactions is narrower than in the Netherlands in two respects: buying and selling of open-market securities is confined in Federal Germany to credit institutions (i.e. banks) and to a small number of public institutions; in the Netherlands, on the other hand, along with banks and exchange brokers (*wisselmakelaars*), the institutions which accept savings deposits and private businesses also figure both as buyers and sellers of open-market securities. This does not mean that all participants in the market can be contracting parties with the Nederlandsche Bank; the latter engages in open-market transactions only with the banks and the exchange brokers. On the other hand – and this is the second essential difference – the market is wider in the Netherlands, where open-market transactions also take place between the various participants. In the Federal Republic, on the contrary, such a market between the banks as chief participants in the open market has not so far developed. Transactions take place only between the banks and the Deutsche Bundesbank. In the Netherlands, therefore, conditions for the formation of a "market price" for open-market securities are rather more favourable than in the Federal Republic where this "price" is largely determined by the Central Bank which, however, may allow itself to be guided – and this happens very often – by the influence of the trend of bank liquidity.

The differences in the structure of the open market in Federal Germany and in the Netherlands give rise to other differences in the technique of open-market transactions in the two countries. For lack of a sufficiently wide market in the Federal Republic, the Deutsche Bundesbank itself fixes the rates for sale and repurchase of open-market securities. By modifying the level of these

rates, the Bundesbank encourages the banks to buy short and medium-term open-market securities (Treasury bills and bonds) or to mobilize them with it. It thus leaves the initiative to the banks while itself remaining passive. It fixes these sale and repurchase rates by maintaining, with due regard to market conditions, a certain relation between them and Bank rate. This is explained by the fact that the banks can at any time have recourse to discount credit and that most of them are almost permanently in debt to the Central Bank, even if only to be able to fulfil their minimum reserve obligations. Where there is excess liquidity the banks are thus able to choose between reducing their discount commitments and investing in open-market bills. In the contrary case the choice is between increasing their discount activities and mobilizing open-market bills. Consequently, rates for the sale of short-term open-market securities (up to 90 days) are in practice no higher than the Bundesbank discount rate. We may therefore say that the open-market policy of the Deutsche Bundesbank is an instrument both of interest rate and of liquidity policy.

In the Netherlands, on the other hand, market rates for open-market bills are more loosely related to discount rates because the Dutch banks have recourse to discounting by the Central Bank only exceptionally. The gap between the market rates for open-market bills and Bank rate is therefore generally wider than that between rates for sale and Bank rate in the German system. Whereas the Deutsche Bundesbank itself fixes the rates for sale and repurchase — with due regard to the trend of rates on the money market — the Nederlandsche Bank as a general rule only buys or sells open-market bills at the market rate and according to market requirements. To ease very short-term strains it also buys open-market securities for a short period fixed in advance under the "repurchase agreements".

As an accompaniment to the Nederlandsche Bank's open-market policy, the Netherlands Treasury, like the Italian Treasury, has on occasion withdrawn liquidity from the banks and the economy by making long-term loan issues which were hardly required by the budget situation and sterilizing the proceeds by, for instance, advance repayment of external debts.

35. If we take into consideration the total liquidity of the banking system, open-market transactions as practised in the Netherlands and the Federal Republic of Germany are of qualitative rather than quantitative significance. This is tantamount to saying that in general these transactions in no way influence the total volume of liquidity at the disposal of the banking system (cash and potential liquidity) but merely its composition. The advantage of these transactions lies chiefly in the fact that they constitute a flexible instrument convenient for balancing out temporary fluctuations in the cash position of the banking system. Except in the Netherlands and the Federal Republic, there are limitations which put a brake on the use of this instrument in the various countries. As a useful complement to the armoury of monetary policy, it would be desirable to create conditions for the commensurate development of open-market transactions as described above in the countries where they are non-existent or inadequate.

This presupposes, inter alia, the existence or the extension of a money market on which the monetary policy authorities can buy and sell open-market bills.

36. Furthermore, monetary policy could perhaps profit by making wider use of the open-market method. If non-banking circles were able to share in dealings in open-market bills — as they already do in the Netherlands, sometimes by direct transactions with the Nederlandsche Bank — open-market operations would no longer influence only the composition of bank liquidity but also its volume. To the extent that open-market bills are negotiated outside the banks with the participation of commerce and industry, the Central Bank will be able to reduce or expand the liquidity of banks whether or not they so desire, and at the same time to exert a certain influence on the composition of the liquidity of the economy. Doubtless, if it were desired to restrict or expand not only the liquidity of the economy but also bank liquidity, as would be appropriate in certain phases of the cyclical trend, this aim could only be attained by extending open-market transactions to long-term securities. It would, nevertheless, seem that close collaboration between the Treasury and the Central Bank in making systematic use of open-market operations, perhaps through special institutions, should offer possibilities for a development of the instruments of monetary policy. As we have seen, this is already practised up to a point in Belgium, where the Fonds des rentes can also buy and sell long-term securities and block the proceeds of such sales by depositing them in its account with the Central Bank, financing its purchases from the balance of this account. In the Netherlands and Italy the Treasury has on several occasions restrained the liquidity of the economy and of the banks by issuing long-term loans which were not called for by the budget situation and by freezing the proceeds of these issues.

37. By means of *forward exchange operations* with the banks the Deutsche Bundesbank in the Federal Republic of Germany and, in Italy, the Exchange Office (Ufficio italiano dei cambi, an institution closely linked with the Banca d'Italia), have exerted influences on bank liquidity comparable to those of the open market. Thanks to the progressive dismantling of exchange restrictions, the banks in Member States (except France) have enjoyed increasing opportunities for placing their liquid assets abroad. Such investments depend on the relationship between the interest rates ruling on the internal and external markets as well as on the cost of the forward covering operation. By carrying out forward covering or swap transactions with the banks, the Central Bank can to some extent affect the movement of bank liquidity to foreign countries, particularly when the comparison between interest rates on the internal market and abroad, after allowing for the cost of covering the exchange risk, offers no encouragement to invest abroad.

It is particularly the *Deutsche Bundesbank* which, since the beginning of 1959, has made systematic use of swap transactions, sometimes applying a lower discount than the market and sometimes waiving it altogether or even applying a premium. Similarly the *Italian Exchange Office* has carried out swap transactions with the Italian banks under which the latter have bought foreign

currency spot and sold it back to the Office forward in order to grant foreign currency credits to residents or non-residents or to increase their investments on money markets abroad. Although the main purpose of these swap transactions is to reduce the considerable net indebtedness of the Italian banks to foreign customers, they have nevertheless contributed to reducing the internal liquidity of the banks and transferring it abroad.

The *Nederlandsche Bank* has only once – in 1957 – carried out forward exchange operations with the banks. This was done for various reasons, in particular to avoid any contraction of the money market due to currency speculation by operators outside the banks. In recent years the interest rate policy followed by the *Nederlandsche Bank* has aimed at stimulating the investment of bank liquidity abroad and there has therefore been no reason to offer special incentives, such as swap deals, to encourage the export of money by banks.

Forward exchange operations such as are carried out by the *Deutsche Bundesbank*, and up to a point by the Italian monetary authorities, may be considered as the complement of or substitute for an internal open-market policy where the Central Banks use them to restrict or enlarge the internal liquidity of the banks without having to carry out open-market operations. This being so, such operations could be important if the strategical reserves of the Central Bank for open-market purposes proved insufficient. Forward exchange transactions also enable the Central Bank to allow money market rates to move up and down independently of rates abroad, although within very narrow limits. The interdependence of the national money markets through the medium of the international exchange market has in fact become so close now that the banks in the Member States – particularly in Federal Germany and Benelux – are no longer subject to restrictions in placing their liquid assets abroad, that it calls for co-ordination of the interest rates policies of the Central Banks.

## CHAPTER 5

### MINIMUM RESERVE POLICY

38. A further weapon has been added to the monetary policy armoury of most Member States since the war: the policy of minimum reserves. The minimum reserves system enables the monetary authorities to act directly on bank liquidity, and thus on their ability to provide credit. The policy of minimum reserves is thus a useful addition to discount and open-market policies, which tend merely to modify the composition of the aggregate liquidity of the banks.

39. Two systems of minimum reserves may be distinguished in the EEC member countries: the first, which in its pure form exists only in Federal Germany and the Netherlands, obliges the banks to keep minimum balances at the Central Bank; the second, which until recently operated in its pure form in France and Belgium, makes it incumbent on them to hold a minimum portfolio of government paper.

In Belgium since the reform early in 1962, this system has largely tended towards the traditional system of minimum reserves under which the banks must in principle keep deposits at the Central Bank. However, the monetary authorities applying the new regulations can fix the proportion of their reserves which the banks may or must hold in the form of deposits with the Fonds des rentes or of government bills of a special type deposited with the Central Bank. Under transitional arrangements the banks are further required to continue to hold the minimum portfolio of government paper laid down by the old cover ratio, but only on the basis of the average amount of their customers' deposits during a reference period, so that this minimum holding will no longer follow variations in the volume of deposits.

In France the regulations on the so-called "plancher" (minimum holdings of government paper) introduced in 1948 were supplemented in 1960 by the minimum reserve system (système du coefficient de trésorerie), under which the minimum reserves include, along with Treasury bonds, cash holdings and private bills which the banks may mobilize without reference to their discount ceiling (these are principally bills representing mobilizable medium-term credits, and bills intended for the financing of exports and grain stocks).

Italy is in an intermediate position: the banks may constitute minimum reserves with the Central Bank either on current account or in government paper.

In the Federal Republic and the Netherlands, the minimum reserves have from the beginning been a flexible instrument of monetary policy. In France, Belgium and Italy they were introduced immediately after the war because of the need to prevent the banks from liquidating their large holdings of government paper. If these had not been blocked, the Bank rate measures would have been practically without effect, because of the possible mobilization of these securities or failure to renew them on maturity.

In France and Belgium the recent reforms referred to above allow of a more flexible and efficient use of the minimum reserve ratio as an instrument of monetary policy. In Italy the present system also makes it possible, if this should be necessary, to handle this instrument of monetary policy in a flexible way. However, the monetary authorities have done so only recently (January 1962). Until then they had found other methods sufficiently effective.

40. As a general rule the *minimum reserve obligations* of the banks are calculated on the basis of specific commitments. In the Netherlands it has been possible for some time now to oblige the banks also to hold additional minimum reserves, the amount of which is calculated in relation to the trend of their advances. In some member countries the different classes of commitments are not subject to the minimum reserve obligation in the same way: the obligation, moreover, differs in scope from country to country.

All credit establishments in the *Federal Republic of Germany* are subject to the minimum reserve obligation with few exceptions, on the basis of the sight, time and savings deposits of inland customers other than banks and also of loans taken up on the internal market, for periods up to four years, from sources other than banks. The arrangements for reserves also apply to commitments of the same nature towards non-residents, including foreign banks. But for some time now the banks have been authorized, when calculating their minimum reserve obligations on liabilities to non-residents, to deduct from these liabilities the amount of their balances with foreign banks and their investments on money markets abroad.

In the *Netherlands*, where the regulations on minimum reserves are based on a gentlemen's agreement between the Central Bank and the most important credit institutions, the minimum reserve obligation applies to 39 credit institutions adhering to this agreement (including the two central agricultural credit funds) and the postal cheque service. The liabilities subject to the reserve obligation are in the main sight and time deposits in guilders of the non-banking sector (including non-residents), of banks which are not parties to the agreement with the *Nederlandsche Bank*, and finally of the foreign banks. Savings deposits are thus not taken into account in calculating minimum reserves.

In *France* the minimum reserve regulations (*réglementation du coefficient de trésorerie*) apply only to deposit banks, people's banks and agricultural credit co-operatives. For these establishments all deposits received from the

public are subject to the regulation, whether they are sight or time deposits, cash certificates ("bons de caisse") or special accounts.

In *Italy* the minimum reserve obligation applies to all credit institutions with the exception, however, of a few specialized credit institutions. All sight, time and savings deposits from the non-banking sector are subject to these arrangements.

In *Belgium* the banking ratio system applies only to the banks, i.e. to institutions accepting deposits for not more than two years. In the new minimum reserve regulations effective from 1962, the following types of bank liabilities are made subject to the holding of reserves, as under the former system of cover ratio :

- a) sight deposits and deposits for a fixed period not exceeding one month ;
- b) deposits for fixed periods of from one month to two years ;
- c) deposit book accounts.

41. Until 1961 the *minimum reserve ratios* had long remained unchanged in Belgium and Italy, although legally they could have been altered. In *Italy* the ratio of about 25 %, applied without distinction to sight, time and savings deposits, had remained in force since 1947 ; it was altered for the first time, to 22.5 %, at the end of January 1962.

In *Belgium* the banking cover ratio was also set at the same level for sight and time deposits, but at different levels for the various kinds of banks (50 to 65 %). After the reform, the transitional arrangements provide that the minimum portfolio of government paper should be calculated, at the same rates, on the average amount of deposits between January and October 1961. According to the new regulations the monetary authorities can fix the minimum reserve ratio (coefficient de réserve monétaire) and vary it from nil to 20 % for sight and one-month deposits and from nil to 7 % for one-month to two-year deposits. These rates cannot be increased by more than three points within any period of 30 days without the approval of the Ministers of Finance and of Economic Affairs.

In *France*, where the minimum holding of government paper had only been altered once since 1948, greater flexibility was introduced at the end of 1960 under the minimum reserve system (système du coefficient de trésorerie). The establishment of this system in fact enabled the Minister of Finance to reduce within a few months the required proportion of government paper in the minimum reserves from 25 % to 20 %, and later to 15 %, without producing an increase of bank liquidity. This may itself be expanded or contracted by the Banque de France which can alter the minimum reserve ratio within the limits fixed by the Conseil national du crédit (the ceiling is at present 35 %).



In the *Netherlands*, where the ratio of minimum reserves is also applied indiscriminately to all liabilities in respect of which reserves are required, the maximum ratio is 15%; the *Nederlandsche Bank* has undertaken, however, in an agreement with the banks that it will not exceed 10% except under certain conditions and after previous consultation with them.

In the *Federal Republic of Germany*, on the other hand, the minimum reserve ratio varies according to the kind of liability. The law governing the *Deutsche Bundesbank* sets a maximum ratio of 30% for sight liabilities, 20% for time deposits and 10% for savings deposits. By means of the flexible provisions of this law the *Deutsche Bundesbank* has also prescribed different ratios depending on the size of the credit institution, on whether it is in a centre where the *Bundesbank* has an office, and finally on the origin of the deposits (resident or non-resident); it has, moreover, occasionally required in respect of new deposits for the account of non-residents a higher ratio than that set for other liabilities.

42. While in Germany and in the Netherlands minimum reserves are unproductive (deposits at the Central Bank bear no interest), in France and Belgium the banks do receive interest on their blocked papers. In Italy, minimum reserves consisting of deposits with the Central Bank earn for the banks a rate of interest almost equal to that of Treasury bills which they can likewise deposit with the *Banca d'Italia* as part of their minimum reserves.

43. In Germany and in the Netherlands, the amount of the minimum reserves required of the banks is based on a monthly average. This enables them to make use of their reserves in the intervening period to meet temporary needs for cash, provided they restore the average by adding to their reserves on other days of the month. But if they do not reach the prescribed monthly average, in Germany, although not in the Netherlands, the banks have to pay interest on the deficiency at a penal rate of three points above that for advances on security. The French, Italian and Belgian banks, on the other hand, have to comply with their obligations from day to day.

44. To make the system of minimum reserves an effective instrument of monetary policy, it must be possible to adjust the minimum ratio whenever the cyclical trend and the bank liquidity situation call for such a step.

In Germany and the Netherlands the minimum reserve ratio has been changed over twenty times since it was introduced. Minimum reserves have not been used in such a flexible way in the other member countries, but since the French monetary authorities adopted the minimum reserve system (*système du coefficient de trésorerie*) at the end of 1960 they have had a more flexible instrument, which they have already used to adjust, within the overall reserves, the respective percentages of the different assets accepted as reserves and to raise the ratio in February 1962 from 30 to 32%. The recent reform in Belgium also enables the ratio of minimum reserves to be varied. Finally, by changing for the first time

in January 1962 the reserve ratio which had been in force since 1947, the Italian monetary authorities have shown that they also intend to make use of this instrument of monetary policy. But the system of minimum reserves has more or less a blanket effect upon all credit institutions, irrespective of their liquidity position or business policy. That is why the Nederlandsche Bank, which since 1954 has often altered the reserve ratio, has only done so on each occasion by a few points and, if in an upward direction, generally by not more than one point. In Germany the Central Bank has varied the reserve ratio much more widely but on a differential basis according to certain criteria, as we have seen above.

45. On account of its *overall effects*, *minimum reserves* are generally used as an instrument of policy in *Federal Germany* and the *Netherlands* at times when it seems indispensable to exert an influence on persistent trends in bank liquidity. The Central Banks iron out temporary fluctuations in bank liquidity by appropriate open-market transactions and by rediscount credit or making advances against security.

In *the German system*, in which, owing to the use of rediscount credit, the banks are generally in debt to the Deutsche Bundesbank, adjustments to the minimum reserve ratio are usually reflected in a rise or fall of this indebtedness. Thus, in the same way as the rediscount ceilings, which can also be adjusted for reasons of credit policy, the minimum reserves constitute, in Federal Germany, a particularly effective method of controlling the extent to which the banks may draw upon the Central Bank. The banks can also of course use their other liquid assets, such as open-market papers or investments on foreign money markets, to meet their minimum reserve commitments. Considerable use was made of this facility in Germany during the period of credit restraint in 1959 and 1960, when refinancing was contracted by a reduction in rediscount quotas. Later on, however, the Bundesbank exerted an influence in the other direction on the banks' investments in foreign money markets by allowing the banks to deduct them from their liabilities to non-residents when calculating the amount of their minimum reserve obligation. In that way it encouraged the export of bank funds which was at that time desirable.

The *Netherlands policy* with regard to minimum reserves is more limited in its objects. In adjusting the reserve ratio the Nederlandsche Bank is guided to some extent by the rise or fall in the gold and foreign exchange reserves and the banks are made to contribute in this way to the financing of the gold and foreign exchange reserves. Thus hitherto, if there was a loss of foreign currency, the Nederlandsche Bank lowered the minimum reserve ratio, although in such circumstances it would have been quite normal to reduce the banks' lending potential by raising the ratio. However, the position of the Netherlands is different because, as it is economically so heavily dependent on other countries, foreign exchange surpluses or deficits can have a more marked effect and exert a stronger influence on the liquidity of the money market. Consequently there are times when it may seem desirable to palliate the tightening of liquidity

caused by large withdrawals of foreign currency by lowering the minimum reserve ratio, particularly when these withdrawals of foreign currency are the result, not of an excessive expansion of bank advances, but of the conversion of customers' deposits into foreign currencies.

In addition to the existing regulations governing compulsory reserves, which date from 1954, the Nederlandsche Bank concluded in May 1960 (see section 40 above) with the credit institutions which are parties to the original agreement a new "gentlemen's agreement" on minimum reserves in order to prevent an excessive expansion of bank advances. Under this agreement the Central Bank can require certain credit institutions to make additional deposits with it if their short-term advances to the private sector should go above a pre-determined ceiling. This agreement was first put into operation in June 1961. For the year 1961 the permissible increase in short-term advances was fixed at 15% for the whole of the banking system; this ceiling, which was not exceeded during the year, was fixed after taking account of the volume of short-term bank advances considered necessary to finance increased production in 1961.

46. *The efficacy of a minimum reserve system depends upon the nature of the assets which make up the reserves* — compulsory deposits with the Central Bank or minimum portfolios of securities.

The system of minimum reserves composed of balances deposited with the Central Bank is obviously the one which, by ensuring that the banks' liquid holdings are blocked, is the more reliable instrument of credit policy. The results obtained by the system of minimum portfolios of securities are more open to question.

Compulsory reserves in the form of public securities may, however, in certain circumstances exert an influence similar to that of the traditional reserves on the liquidity and therefore the lending potential of the banks. Actually the freezing of these securities, immediately after the war, in Italy, France and Belgium helped to restrict the banks' scope for credit creation at a time when they might have been tempted to liquidate the large holdings of government paper which they had amassed during the preceding years. The essence of the "coefficient" system in Belgium or the "plancher" in France is that each bank can only use part of the liquid assets arising from new deposits to make advances to the economy. It has the same effect on the banks as if each of them had to devote the same proportion of its resources to increasing its balances at the Central Bank.

But the effect that compulsory reserves of public securities may have on the liquidity of the banking system as a whole is less certain. Inasmuch as the Treasury freezes the resources which flow in through this system of compulsory reserves, either by using them to reduce its indebtedness to the Central Bank or by converting them to meet commitments in foreign currency, it absorbs bank liquidity in the same way as the conventional system of reserves.

That was, for instance, the case in France over the last three years. On the other hand when the Treasury's position is difficult, for instance as a result of a growing budget deficit, the system of a minimum portfolio of Treasury paper works out in practice as follows: the Treasury, which usually regards this form of minimum reserve as a good opportunity for financing budget deficits, withdraws liquidity from the banks, which finds its way back to them when the Treasury makes the corresponding payments. But as this in any case has the effect of transferring liquidity from the public sector to the banks, the problem is largely one of choosing between the various ways of financing Treasury expenditure — borrowing from the banks, from the public, or from the Central Bank.

In short, the system based on a minimum portfolio of public securities does not seem to have as certain an effect on the volume of credit as that of the conventional reserves. Moreover, the requirement of a portfolio of public securities proportionate to bank deposits appears to be a less flexible instrument of credit control than the mechanism of compulsory balances at the Central Bank. It gives rise to the question whether the reserve ratio should always be adjusted solely according to the exigencies of credit policy; in such a system considerations of credit control cut across those of Government financial policy, if only because a change in the reserve ratio has direct repercussions, which may be very pronounced if the adjustment is considerable, on the Treasury's situation.

47. The Member States which used the *system of minimum portfolios of government paper* ("plancher" in France and banking ratio in Belgium) have recently made changes as noted above, with the result that they will be able to make a more flexible use of this instrument according to the exigencies of monetary policy.

In *France* the system of minimum reserve ratios introduced in 1960 has incorporated the old system of the "planchers" and should give the monetary authorities more freedom of action. The banks can now keep part of their minimum reserves in securities other than Treasury bills, in particular, bills representing medium-term advances. The easing of the Treasury's situation enabled the "plancher" of Treasury bills, originally fixed at 25%, to be reduced to 15% (in March 1962) within the reserve ratio (fixed at 30% from 31 January 1961 and raised to 32% from 28 February 1962, with a maximum of 35%). But this reduction forced the banks themselves to hold a certain amount of medium-term bills instead of negotiating them through the Banque de France. Thus the French monetary authorities now have at their disposal a means of influencing the amount of these bills.

In *Belgium*, the reform of the "cover ratio" system in 1957 loosened the hitherto close connection with the financing of budget deficits. Since then the banks have been allowed to complete their cover with certificates of the Fonds des rentes (Government Stock Equalization Account) instead of Treasury bills; the Fonds des rentes can now make better use of the proceeds of the sale of its certificates for purposes of liquidity policy. The introduction in 1962 of a variable minimum reserve system gives the Belgian monetary authorities a means of acting directly on bank liquidity.

### III. THE FINANCING OF THE PUBLIC SECTOR AND ITS INFLUENCE ON THE LIQUIDITY OF THE ECONOMY AND OF THE BANKS

48. Since the last war, the transactions of the public authorities, especially the central government, have been of the highest importance in controlling bank liquidity and that of the economy as a whole. Consequently, the ties between the financial policy of the State and the monetary policy of the Central Bank, has steadily become closer, thus calling for more intimate co-operation between the authorities and the Central Bank. To appraise the efficacy of the instruments of monetary policy used by the Central Banks, it is obviously essential to consider the *financial policy of governments*.

49. To do this, we must first examine the way in which the *State handles its cash holdings*, since the effect on bank liquidity can vary considerably according to the Treasury's methods, i.e. whether it keeps all its balances at the Central Bank or deposits some of them with the ordinary banks.

In all the countries of the Community there is some degree of concentration of public funds, or at least government funds, at the Central Bank. In *Federal Germany*, for example, the Federal and Länder Governments are obliged to keep their cash holdings at the Deutsche Bundesbank, which, within the framework of its liquidity policy, can nevertheless allow the authorities to keep deposits at the banks. In practice, however, it has proved extremely difficult to use this power of the Central Bank as a flexible instrument of monetary policy, although the Bundesbank has occasionally authorized large deposits in the banks. The influence that can be exerted on bank liquidity by the accumulation of Treasury reserves at the Central Bank was strikingly shown in Federal Germany during the years 1955 and 1956, when substantial budget surpluses (the "Juliusturm") were frozen at the Central Bank.

In *France*, the concentration of public funds is almost complete since all local authorities and public or semi-public bodies are obliged to deposit their balances with the Treasury, which can give them advances or loans. In this way the Treasury acts as a bank for the public sector. Further, it also acts as a deposit bank by collecting deposits from the public through the post office ("Comptes chèques postaux") and its own receiving offices ("Fonds particuliers"). The Treasury deposits all its liquid funds with the Central Bank.

50. *The financing of public expenditure* exerts an influence on the liquidity of the banks and of the economy which varies according to the extent of *the authorities' indebtedness to the Central Bank*, to the banks, or to the public through the issue of short or long-term paper.

All the Member States have precise regulations governing *advances by the Central Bank to the public authorities*, but they vary considerably in scope from country to country.

Except in Italy and in the Netherlands, the total amount of the Central Bank's advances to the State is subject to a fixed ceiling. In Federal Germany the limit is DM 3 000 million for the Federal Government and DM 850 million for the special funds, and an amount equal to a fixed number of DM per inhabitant in the case of the Länder Governments (at present about DM 1 000 million). The Banque nationale de Belgique may only make advances up to Bfrs. 10 000 million to the Belgian State, and Bfrs. 333 million to the State of Luxembourg. In France, the Central Bank's advances to the State are kept by law to a ceiling at present fixed at NF 4 800 million.

In Italy, the Central Bank's advances are limited to 15% of current budgetary expenditure. In the Netherlands the interest-free advances of the Nederlandsche Bank to the Treasury are subject to a limit fixed at fl. 150 million, but the Central Bank is free to make other advances to the Treasury.

In Germany, the extent to which the authorities may borrow from the Central Bank is fixed by the law governing the Deutsche Bundesbank; an alteration in the ceiling would therefore require an amendment to the law. The ceiling for the Banque de France is fixed by agreements made between the Governor of the bank and the Minister of Finance and ratified by Parliament. In Belgium the ceiling is also fixed by agreement between the Governor of the Banque nationale de Belgique and the Minister of Finance on the proposal of the Bank's Conseil de régence, but it requires only the approval of the Council of Ministers. In Italy the ceiling is fixed simply by decree.

51. In all the Member States, the *Treasury also turns to the banks for advances* to meet its needs, especially by placing with them short or medium-term government paper, and occasionally long-term securities.

As already pointed out in discussing the policy of minimum reserves, in some of the Member States the Treasury's needs are, or at least were, to some extent met automatically. The requirement that the banks should hold government paper representing a certain percentage of customers' deposits, in accordance with the system of banking ratio or the "plancher", automatically channelled part of their liquid assets to the Treasury. This method of financing government expenditure through the banks existed in Belgium and in France since the early post-war years; it has recently been brought to an end in Belgium and modified in France by reductions in the proportion of Treasury bills in the "planchers".

In Italy the Treasury is also free to place government paper with the banks in accordance with the system of minimum reserves: it is, however, left to the banks themselves to decide whether they will meet their minimum reserve obligations by holding balances or by depositing Treasury bills with the Central Bank.

In the other member countries, the Treasury or other authorities offer the banks short and medium-term securities in which to invest their liquid assets, either directly, as in the Netherlands, through their own agents in the money market, or indirectly through the Central Bank as is the case in Germany. These securities can often be rediscounted at the Central Bank or can be used as collateral for advances. In general they may therefore be considered a fairly liquid form of investment and can be put to some use for purposes of open-market policy.

52. In the Netherlands, France, Italy and Luxembourg, the Treasury also offers commercial concerns and non-banking institutions short and medium-term securities for the investment of their liquid assets and savings, although to a considerably lesser extent than before the war. In the Netherlands the interest on these securities is closely dependent on the state of the money market; in France and Italy, on the other hand, the rates of interest on tap issues of Treasury paper are comparatively stable.

In France Treasury bills are an investment much sought after by the private sector and are therefore a permanent and substantial means of covering the Treasury's needs. Although they are short-term paper and their rate of interest is only changed at rare intervals, the extent of this indebtedness actually remains stable. Experience has shown that even in times of crisis the amount of Treasury bills in the hands of the public does not show any marked decline. The Treasury nevertheless endeavoured to prolong the average term of this debt by issuing for the first time in June 1961 three to five-year bills.

In Italy, however, it seems that investment in Treasury bills bearing a comparatively stable rate of interest has in the past shown fairly substantial fluctuations. Further, the comparatively large volume of current sales of these bills has enabled the Treasury to reduce considerably its indebtedness to the Banca d'Italia thanks to the continuously increasing liquidity of the economy and of the banks due to the expansion of foreign trade.

Purchases of Treasury bills by the public do not of themselves reduce liquidity in the non-banking sector; on the other hand, when they are taken up by commercial concerns and private individuals they do decrease bank liquidity in so far as the Treasury, as in Italy and for some years now in France, freezes the money invested. In some Member States the Treasury has also floated long-term loans with a view to reducing bank liquidity. That was done on a considerable scale in Italy in 1959 when the Treasury issued bonds with maturities of seven to nine years for the specific purpose of absorbing liquidity

due to surpluses of foreign currency. In the Netherlands also the Treasury took similar steps by floating long-term loans, although the budgetary situation did not call for such action. It is also in that country more than in the others that regular use has been made of funding issues to consolidate liquid investments of the banks (for instance, through the gentlemen's agreement on compulsory reserves) and of the non-banking sector.





**Part two**

**THE INSTRUMENTS OF MONETARY POLICY  
IN THE FEDERAL REPUBLIC OF GERMANY**



## CONTENTS

Introductory remarks	57
<i>The liquidity of the economy as a whole – The liquidity of the banking system</i>	
Chapter 1: Refinancing policy	65
<i>Discount policy – Rediscount quotas</i>	
Chapter 2: Minimum reserve policy	70
<i>The legal basis of the present minimum reserve regulation – Credit institutions subject to minimum reserve regulation – Computation of minimum reserves – Differentiation in minimum reserve ratios – Interest – Penal rates – Efficacy of minimum reserve policy</i>	
Chapter 3: Open-market policy and regulation of the money market	79
<i>Legal basis – Other money-market business – Quality, term and buying and selling rates of money-market paper – The "Market" for money-market securities – The efficacy of open-market policy – The prime acceptance market</i>	
Chapter 4: The Bundesbank's operations on the foreign exchange market	92
Chapter 5: Cash management and borrowing of public authorities and their effects on liquidity	97
Chapter 6: Other ways in which the Bundesbank may influence bank liquidity	100

## TABLES

1 – Note and coin circulation and bank deposits	59
2 – Trends in the money supply	60
3 – Trends of bank liquidity	63
4 – Interest rates of the Deutsche Bundesbank – Rates for discounts and advances of the Deutsche Bundesbank and special rate of interest charged for failure to meet the minimum reserve requirement	66
5 – Reserve ratios and reserve classes	73
6 – Circulation of Treasury bills, non-interest-bearing Treasury bonds and other money-market paper	81
7 – Rates of the Deutsche Bundesbank – Applying to sales of money-market paper in the open market	84
8 – Short-term assets and liabilities of the banks in relation to foreign countries	93
9 – Present guiding ratios in regard to credits (End 1961)	101

## DIAGRAMS

1 – Bank liquidity	64
2 – Interest rates	87
3 – Data on open-market policy	89
4 – Interest-rate differential towards foreign countries, and money and capital flows	95

## INTRODUCTORY REMARKS

1. The ultimate aim of all Central Bank policy is to influence the demand for money. Apart, however, from certain open-market operations and direct discount transactions with business concerns or private persons, the Central Bank cannot as a rule exert any direct influence on the demand for money or on the volume of money – at any rate not under the German Central Bank system. Its influence is rather in most cases an indirect one; it must either attempt to influence the liquidity of the banking system, and thereby the volume of credit granted by the commercial banks, or – by changing the Bank rate and related interest rates – it must bring its influence to bear on the banks' demand for refinancing and the demand of the business community for credit, and also on the formation of monetary capital within the banks.

2. The policy of a Central Bank turns largely on the question of liquidity. In dealing with monetary policy, a distinction must be made between two forms of "liquidity". There is on the one hand the "*liquidity of the economy*", that is to say, the total volume of money in circulation in the economy, however that may be defined in detail; on the other hand, we may speak of the "*liquidity of the banking system*", that is to say, the amount of Central Bank money at the disposal of the banking system as a whole, together with such liquid reserves as are at any time convertible into Central Bank money. When reference is made to the "liquidity policy" of the Central Bank in the strict sense of the term, what is understood in the Federal Republic is always the *influencing of the liquidity of the banks* by appropriate measures.

### *a) The liquidity of the economy as a whole ("money")*

3. The expression "liquidity of the economy" is very little used in the Federal Republic. The concept generally used is "volume of money" (Geldvolumen) or sometimes "supply of money" (Geldversorgung); these terms may be used in a narrow or a wider sense.

The "volume of money" in the narrower sense is made up of:

- i) the note and coin circulation (excluding cash balances held by credit institutions);
- ii) sight deposits of home non-bank customers, including sight deposits of public authorities with banks other than the Central Bank.

The definition in its wider application also includes :

- iii) sight deposits of public authorities at the Deutsche Bundesbank ;
- iv) and, possibly, also time deposits of home customers for a fixed period or at notice of less than six months (or even longer periods – depending on the point of view adopted).

4. As there is no clear definition of the concept " volume of money " which is applicable for all purposes, this expression is not employed in the Deutsche Bundesbank statistics; the relevant table in the monthly report of the Bundesbank, which is reproduced on page 59 as Table 1, is simply headed " note and coin circulation and bank deposits ", leaving it to the reader to select for himself from the very detailed subdivisions whatever items he requires to make up his figure. Where the expression " volume of money " or " supply of money " is used in the text of the Bundesbank's monthly report, it is as a rule accompanied by explanatory notes.

The table includes all the factors comprised in the term " primary liquidity " as commonly used in the Netherlands, and also time deposits and savings deposits, which form a part of the bank balances comprised in the term " secondary liquidity ". On the other hand it does not include non-bank customers' holdings of short-term Government paper (Treasury bills, Treasury bonds, tax certificates etc), which are regarded in the Netherlands as also forming a part of " secondary liquidity " – and hence of " total liquidity ". In the Federal Republic such holdings do not play such an important part (see para.42), because hitherto it was only occasionally that any substantial amount of Treasury bills was held outside the banking system (and then only by certain public authorities).

5. The most important *sources of money supply* available to the economy are the external payments surpluses and the net amount of credit granted by the banking system as a whole ; that is to say, the credit granted to inland customers other than banks, after deducting the amount of monetary capital formed at the same time at the credit institutions (increase in savings and time deposits, proceeds from sale of bank bonds, long-term borrowing and loans from non-banks and additions to banks' own capital and reserves) (see Table 2, page 60).

In many instances, when changes in the volume of money in Germany are being studied, it is better not to include the sight deposits of public authorities at the Bundesbank in ascertaining the volume of money ; this is especially the case for certain periods in the past when sight deposits of public authorities at the Bundesbank were subject to special influences. If this narrower definition of the volume of money is employed, any changes in the sight deposits of public authorities at the Bundesbank have to be taken into account as an additional factor in determining variations in the volume of money as so defined. (Any increase in these accounts arising out of cash transactions in the home market reduces, other things being equal, the " active volume of money " ; any reduction increases it).





Table 2

**TRENDS IN THE MONEY SUPPLY**  
Increase (+) or Decrease (-)

(in million DM)

	1957	1958	1959	1960	1961
Bank credits to non-banks in Germany	+ 9 983	+ 12 542	+ 18 096	+ 17 307	+ 23 966
Formation of monetary capital at credit institutions from domestic sources <sup>1</sup>	+ 13 557	+ 11 598	+ 15 187	+ 16 170	+ 18 457
I. Surplus of credit-granting within Germany (+) or of formation of money capital from domestic sources (-)	- 3 574	+ 944	+ 2 909	+ 1 137	+ 5 509
II. Changes in Central Bank balances of German public authorities (increase -)	+ 2 606	+ 671	+ 2 686	- 2 304	- 1 293
III. Changes due to other domestic causes	- 180	- 1 062	- 649	- 1 694	+ 2 836
IV. Total from domestic sources (I+II+III)	- 1 148	+ 553	+ 4 946	- 2 861	+ 7 052
V. Changes in net claims on foreign countries (Bundesbank and other banks)	+ 5 066	+ 4 218	- 261	+ 6 269	+ 427
VI. Changes in money supply (note and coin circulation and sight deposits of domestic non-banks but excluding Central Bank balances of German public authorities)	+ 3 918	+ 4 771	+ 4 658	+ 3 408	+ 7 479
<i>For information:</i> Time deposits of domestic customers for fixed period or as notice of less than 6 months <sup>2</sup>	+ 1 605	- 481	+ 129	+ 246	+ 326

<sup>1</sup> Includes all time deposits by domestic customers.<sup>2</sup> Included in the line "Formation of monetary capital" above; these short-term deposits are sometimes treated as a part of the volume of money.

*b) The liquidity of the banking system*

6. The concept of the "liquidity of the banking system" in the narrower sense comprises the total amount of Central Bank money (bank notes and balances at the Central Bank) held in the banking system. When the term is used in its wider sense, it also includes other bank assets which can be used to increase the supply of Central Bank money. Such assets include trade bills eligible for discounting at the Central Bank, foreign exchange, short or medium-term securities issued by the Government or other public authorities and also, in certain circumstances, other securities. The justification for taking such assets into account in considering the liquidity position is that the Central Bank itself is ready – and, indeed, in some cases obliged – to take them over and, in exchange, to make Central Bank money available. It is therefore appropriate to speak of "potential liquidity" or "easily-mobilized liquidity reserves" and to describe the amount of Central Bank money actually held by the banks as "actual" or "cash liquidity".

7. The "cash liquidity" of the banks is very closely linked with their obligation to keep certain minimum reserves at the Bundesbank, as under the German system there are no surplus reserves worth mentioning (see para.32, below); on the other hand these minimum reserve balances act at the same time as "working balances" for payments purposes (see para.22). The "potential" liquidity or the real liquidity reserves of the banks consist mainly of:

- a) domestic open-market paper (including all short-term securities issued by public authorities);
- b) balances at foreign banks and funds employed in foreign money markets;
- c) commercial bills eligible for discounting at the Central Bank, but only up to the limit of the individual rediscount quotas of the commercial banks.

8. The definitions used here relate to the banking system as a whole. On the other hand, in dealing with the liquidity of individual banks or of sectors of the banking system, we may also include such assets as a single institution (though not the banking system as a whole) can use to increase its liquidity. These include credit balances with other credit institutions, securities which are saleable in the capital market, bills not eligible for discount at the Central Bank provided that they can be placed with other credit institutions etc. However important these liquid assets may be for individual banks or single groups of banks, when we are considering the liquidity policy of the Central Bank they are of no great significance. From the standpoint of liquidity policy they are a means of evening out liquidity between individual sectors of a banking system, although they have no effect on the liquidity of the banking system as a whole.

9. The cash liquidity of the banking system is a resultant of the credit and debit transactions of the Central Bank and the trend of the note and coin

circulation outside the banks. It is determined mainly by the following factors :

- i) net foreign currency transactions of the banks with the Bundesbank;
- ii) net transactions of the Bundesbank with the public sector;
- iii) changes in the note and coin circulation (and also " other factors ").

Under the German system the amount of the net transactions of the Bundesbank with the economy outside the banks and public authorities is of only very small importance compared with the foregoing factors (see paras.42 and 61 below).

The weight of the main factors for the years 1957 to 1960 is shown in Table 3 on page 63 and in the diagram 1 on page 64.

10. *Credit policy* affects liquidity of the banks by :

- a) changes in the minimum reserve obligation ;
- b) open-market operations (changes in the terms of sale and purchase of open-market paper); including certain transactions for the regulation of the money market and supplemented by forward dealings in foreign exchange ;
- c) influence on the holdings of public balances, in particular their allocation between the Central Bank and the commercial banks, and also influence on the manner of financing cash deficits of public authorities ;
- d) conditions for access to rediscount credit at the Central Bank (qualitative requirements with regard to rediscountable paper, quantitative limitations by way of rediscount quotas).

Changes in the bank rate have an indirect effect on bank liquidity, since they make access to rediscount credit more difficult or easier as the case may be. Furthermore, under the German banking system, this is the only way in which the demand of industry and commerce for advances from domestic banks can be directly influenced.

Table 3

## TRENDS OF BANK LIQUIDITY

(calculated on the basis of the average of the four weekly bank return dates  
in the last month of each financial year)

(in million DM)

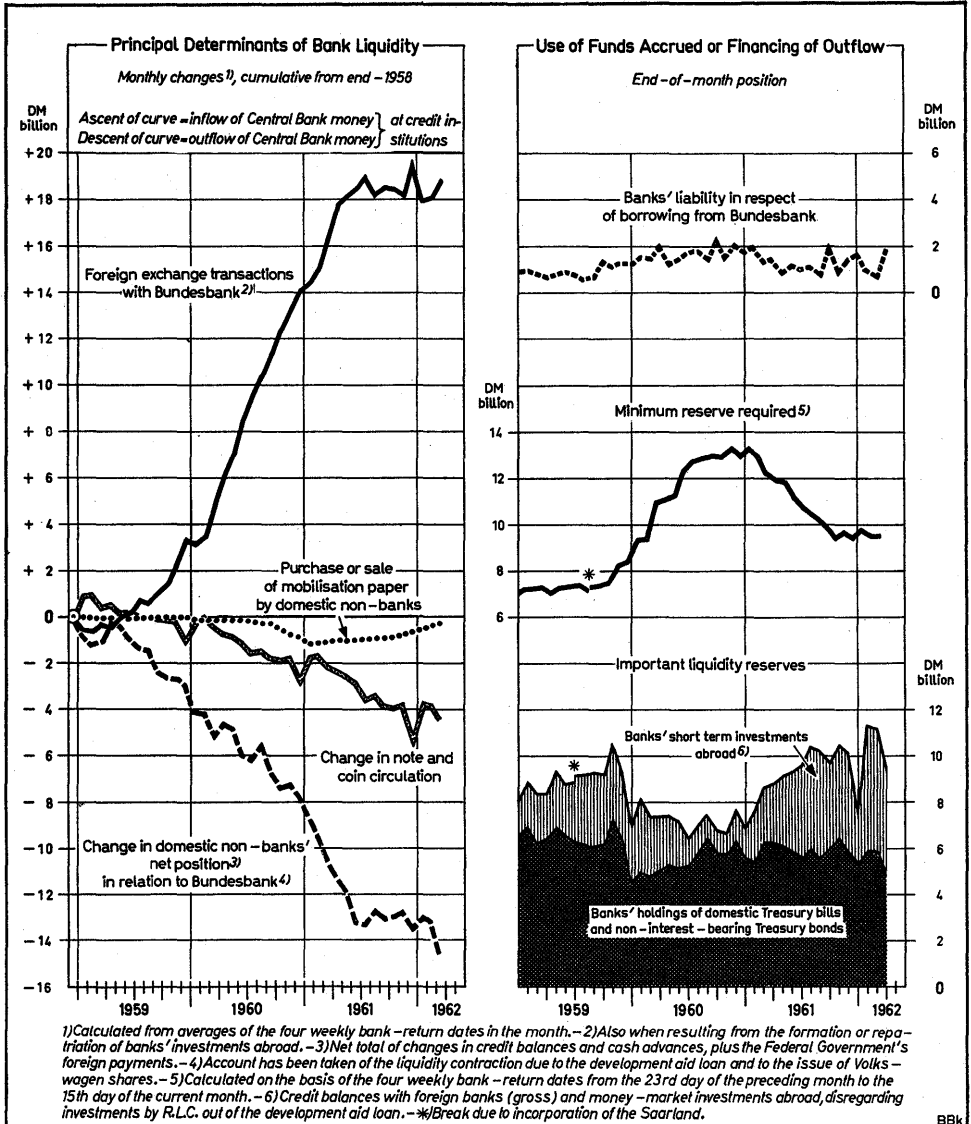
	1957	1958	1959	1960	1961
I. Changes in bank liquidity (increase +) owing to:					
1. Change in note and coin circulation	- 1531	- 1482	- 937	- 1684	- 2524
2. Domestic cash transactions of public authorities	- 232	- 2139	- 3185	- 5550	- 6748
3. Foreign currency transactions of the Bundesbank <sup>1</sup>	+ 8062	+ 5503	+ 3388	+ 10748	+ 5575
4. Other factors	- 307	+ 481	+ 348	+ 1025	+ 1286
Net effect on bank liquidity of factors 1 - 4	+ 5992	+ 2363	- 386	+ 4539	- 2411
II. Changes in balances of credit institutions at the Bundesbank (increase -) <sup>2</sup> (for comparison: change in monthly minimum reserve requirements)	- 1694 (- 1757)	- 927 (- 964)	- 1344 (- 1089)	- 4001 (- 4364)	+ 2936 (+ 3361)
III. 1. Repayment (+) or availment (-) of refinancing credits from the Bundesbank	+ 1179	+ 627	- 293	- 797	+ 480
2. Acquisition (+) or disposal (-) of home money market paper <sup>3</sup>	+ 3119	+ 809	- 1437	+ 1335	+ 45
IV. (For information) Changes in amount of short-term claims of banks other than the Bundesbank on foreign debtors <sup>4</sup>	+ 396	+ 265	+ 1503	- 1228	+ 1463

<sup>1</sup> So far as these affect bank liquidity.<sup>2</sup> Represents for the most part the changes in minimum reserve requirements. Divergencies are explained by the fact that in this table changes in credit balances are shown on the basis of an average of the dates of the Bank's four weekly returns, whereas the minimum reserve requirement needs to be satisfied only on the basis of the average of the daily balances for the month; furthermore occasionally surplus reserves appear for purely technical reasons.<sup>3</sup> As part of the Bundesbank's open-market policy.<sup>4</sup> Credit balances and money market funds employed abroad. *Unlike the other items, this item is arrived at on the basis of end-of-year figures.*

Source: Monthly Reports of the Deutsche Bundesbank.

# Diagram 1

## BANK LIQUIDITY



## CHAPTER 1

### REFINANCING POLICY

#### *a) Discount Policy*

11. According to sec. 15 of the Bundesbank Act, dated 26 July 1957, the Bank is authorized, "in order to influence the amount of money in circulation and the volume of credit granted", to fix "such rates of interest and discount as are appropriate to the business undertaken". Thus the Bundesbank can in principle apply different rates of discount for various classes of business, but so far it has made no use of this power (cf. Table 4, page 66). Sec. 19 gives the Deutsche Bundesbank the right to buy and sell at its fixed discount rate bills dated up to three months, including Treasury bills issued by the Federal Government, the Länder and the Federal Government's Special Funds (Federal Railways, Federal Postal Administration, Equalization of Burdens Fund, E.R.P. Special Fund), providing that these satisfy the conditions prescribed in the Act.

Further, under sec. 19, the Bundesbank can grant interest-bearing loans against the pledge of securities with various terms (bills, non-interest-bearing Treasury bonds, debentures listed by the Deutsche Bundesbank as eligible for this purpose), so-called "Lombard credit", granted for not more than three months and limited to a certain percentage of the face value of the securities pledged, the percentage varying according to the class of security offered. In these transactions the Bundesbank applies the so-called "Lombard rate" of interest, normally 1% above Bank rate. In principle the Bundesbank grants Lombard credit only when it is required as a stop-gap to meet liquidity difficulties, and when it has no objection to the purposes for which the advance is to be applied.

12. The Bundesbank discount rate is also normally applied in advances to public authorities up to the statutory ceiling (see chapter 5).

13. The Bundesbank discount rate is also of importance in connection with the interest rates which banks charge to their customers. In accordance with the so-called "Sollzinsabkommen" (agreement on interest rates charged to borrowers) – which is still being applied even since the new Law on the Credit System came into force on 1 January 1962 – the interest rates which the banks are allowed to charge their customers on bill credits and overdrafts are to be no higher than a specified amount above the Bank's discount rate or Lombard rate, as the case may be. Any change in Bank rate therefore automatically leads to a corresponding alteration in the maximum rates for the above-mentioned credits.

**Table 4**  
**INTEREST RATES OF THE DEUTSCHE BUNDESBANK<sup>1</sup>**  
**Rates for Discounts and Advances,**  
**and Special Rate of Interest charged for failure to meet the Minimum Reserve Requirement**

Applicable from:	Discount rate <sup>2</sup>	Rate for advances on securities	Special rate of interest charged to credit institutions for failure to meet minimum reserve requirement
	% p. a.	% p. a.	% p.a. over advance rate
1948 July 1	5	6	1
December 1			3
1949 May 27	4½	5½	
July 14	4	5	
1950 October 27	6 <sup>3/4</sup>	7	
November 1			1
1951 January 1			3
1952 May 29	5 <sup>5</sup>	6	
August 21	4½	5½	
1953 January 8	4	5	
June 11	3½	4½	
1954 May 20	3	4	
1955 August 4	3½	4½	
1956 March 8	4½	5½	
May 19	5½ <sup>6</sup>	6½	
September 6	5	6	
1957 January 11	4½	5½	
September 19	4	5	
1958 January 17	3½	4½	
June 27	3	4	
1959 January 10	2¾	3¾	
September 4	3	4	
October 23	4	5	
1960 June 3	5	6	
November 11	4	5	
1961 January 20	3½	4½	
May 5	3	4	

<sup>1</sup> Until 31 July 1957 rates of Bank deutscher Länder and of Land Central Banks.

<sup>2</sup> This is also the rate for cash advances to public authorities and to the Reconstruction Loan Corporation; cf. footnotes <sup>4</sup> and <sup>5</sup>. The discount rate for bills expressed in foreign currency was uniformly fixed at 3%, for the time being, by a decision adopted by the Board of Directors of the Bank deutscher Länder on 3 Aug. 1948. By decision of 9/10 November 1949 the Board of Directors authorised the Board of Managers to fix varying rates for bills in this class, in accordance with the discount rates of the foreign Central Banks concerned. The same applied to bills in DM which had been accepted abroad (Decision of 22/23 March 1950), and also to export drafts (Decision of 15/16 November 1950 and 23/24 May 1951); see also footnote <sup>6</sup>.

<sup>3</sup> Promissory notes arising under the export promotion scheme of the Reconstruction Loan Corporation were discounted at the preferential rate of 4% even after the raising of the discount rate on 27 October 1950 (Decision of 29/30 November 1950). This privilege in regard to the interest rate was cancelled by decision of 7/8 November 1951; and it could then be claimed only for promissory notes arising from credits which were granted or promised not later than 7 November 1951.

<sup>4</sup> Under a decision taken by the Board of Directors of the Bank deutscher Länder on 20 December 1950 the interest rate for cash advances to the Reconstruction Loan Corporation was fixed, with effect from 27 October 1950, at 4% in the case of lendings to agriculture, maritime shipping and housebuilding, and at 5½% in the case of lendings serving other purposes.

<sup>5</sup> From 29 May 1952 there was in effect only the special arrangement mentioned under <sup>4</sup> for lendings to be used for financing agriculture, maritime shipping and housebuilding, to which lendings until their redemption the rate of 4% applied.

<sup>6</sup> From 19 May 1956 onwards also discount rate for foreign bills, foreign cheques, foreigners' DM acceptances, and export drafts.

In practice, however, the rates charged by banks are often lower than these official maximum rates.

Deposit interest rates are also related to Bank rate, though less directly. Up to the date when the new Law on the Credit System came into force, on each occasion when Bank rate was changed the Central Credit Committee, on which all groups of banks are represented, submitted recommendations to the Special Committee for Bank Supervision of the German Länder as to whether, and if so to what extent, deposit interest rates should follow the changes in Bank rate. The Bank Supervision Authorities then decided, with the concurrence of the competent Federal Ministries and the Bundesbank, what changes should be made in deposit interest rates. Since the new Law on the Credit System has come into force, the Federal Supervisory Office for the Credit System has been granted powers by the Federal Economics Ministry to fix banking conditions by statutory decree. In this connection the Federal Supervisory Office can act only by agreement with the Bundesbank. Deposit interest rates – like rates of interest charged to borrowers – are only maxima; the banks can apply lower rates if they wish.

14. It is not altogether easy to form an opinion as to the efficacy of the Federal Republic's Bank rate policy. In contrast with the Bundesbank's instruments of liquidity policy (especially its minimum reserve and open-market policies), changes in Bank rate have only an indirect influence on banking liquidity, depending on how far the banks are prepared to borrow from the Central Bank. On the other hand Bank rate policy is the only means by which the Bundesbank can influence the demand for credit of bank customers – and hence of the economy in general – by means of changes in the general level of interest. A change in deposit interest rates, which is often connected with a change in Bank rate, may also have direct repercussions on interest rates in the stock market, because of the competition between securities and savings or time deposits as alternative forms of investment. Finally a change in Bank rate – in the Federal Republic as elsewhere – is taken as a pointer to the general credit policy of the Central Bank and thus also influences the policy of the banks and of business in general.

With the removal of restrictions on international payments and the resulting interdependence of the world's financial centres, changes in Bank rates (with concomitant changes in internal interest levels) have assumed special importance in relation to the international flow of short-term capital. Because of this, a Government's freedom to manoeuvre and its means of exerting an influence by its Bank rate policy may, in certain circumstances, be considerably restricted, as experience in the Federal Republic since 1960 has clearly shown.

If the Central Bank wishes a change in Bank rate to have more than the effect of a "pointer", it will take further steps to render a change in interest rates effective on the market by acting on bank liquidity. There is also another way in which interest rate policy and liquidity policy interact, for changes in



Bank rate are often made to increase the efficacy of liquidity policy measures ; by relaxing or tightening the pressure of these two forces, as the situation demands, it can be made easier or more difficult for the banks to obtain refinance at the Central Bank.

*b) Rediscount quotas*

15. A change in the Bank rate is, however, not the only way in which the Bundesbank can exert an influence on the banks recourse to refinancing. It can also restrict or extend this by laying down conditions for the discounting of bills or by varying rediscount quotas.

The Statute of the Bundesbank does no more than lay down minimum requirements for rediscountable bills (bills with three backers known to be solvent and maturing in not more than three months); but the Bundesbank in the ordinary course of business can say which bills it will discount. It has frequently refused to discount bills relating to certain classes of business, for example hire purchase transactions, interim finance for building projects and bank acceptances except when intended only to provide short-term finance for particular transactions.

The effect to the Bundesbank's refusal to rediscount bills relating to certain classes of business is of course felt mainly by the ultimate borrower because if the banks have no assurance of rediscount at the Bundesbank they are inclined to reject business of this sort. From the standpoint of credit policy, the refusal to discount certain classes of bills is generally of only minor importance ; in most cases the banks have other bills at their disposal which they can, if necessary, present at the Bundesbank for rediscounting.

16. More important from the liquidity policy aspect is that, in addition to the qualitative test which the Bundesbank applies to bills presented by the banks, the total volume of rediscount credit at the disposal of each bank is limited by so-called "rediscount quotas". All bills which are rediscounted at the Bundesbank are reckoned against this quota ; exceptions are made in respect of prime acceptances with a remaining period of up to 45 days and also for bills to finance medium and long-term export business drawn within the limits of a rediscount quota granted by the Bundesbank to the Export Credit Company ("B - Ceiling").

The level of the rediscount quota depends mainly (though the rule is not very strictly interpreted) on the committed funds of the credit institution (being its capital, including disclosed reserves and global value adjustments) and the coefficient applicable at the time ; the coefficient may however vary for different groups of banks. The credit institutions are not officially informed about these quotas but they can ascertain them on enquiry.

17. In past years the quotas have several times been reduced. On 1 May 1957, they were reduced by 15%. Then a deduction was made from the reduced quota in respect of credits taken up abroad, except in cases where they were used as direct finance for import business or to finance a merchanting transaction. Further reductions in rediscount quotas have been made since the autumn of 1959 in connection with the credit restraint policy. These reductions are needed from time to time, because the banks' own capital and reserves are increasing; if the coefficient for computing the rediscount quota remained unchanged, the financing limit would steadily increase in proportion. On 1 October 1959, therefore, when the basis of computation was being reviewed, the quotas were reduced in the aggregate by some 19%. With a further revision of quotas which became effective from 1 March 1960, there was a further aggregate reduction of at least DM 2 000 million. The smaller credit institutions received preferential treatment in that the percentage reduction made in the first DM 5 million of each individual bank's quota was 10% only, the remainder being cut by 30%. Since, at the same time as these rediscount quotas were reduced, the minimum reserve requirements were increased, and the banks, in order to satisfy these requirements, were compelled to present bills for discounting on a larger scale than hitherto, the combined effect was an appreciable contraction in the liquidity of the credit institutions. With effect from 1 July 1960, yet another reduction was made; this time the cut was increased to 15% on the first DM 5 million and to 40% on the remainder. In connection with a relaxation of credit restriction, these reductions in quotas, which had been made during 1959 and 1960, were partly withdrawn with effect from 1 March 1961 and entirely reversed from 1 November 1961.

## CHAPTER 2

### MINIMUM RESERVE POLICY

18. Compulsory minimum reserves were first introduced in Germany in 1948, when the Bank Deutscher Länder was founded. It is true that the 1934 Act on the Credit System contained a general provision to the effect that the banks should keep balances at the Central Bank sufficient to cover a certain percentage (not specified) of their customers' deposits, but the purpose of this provision was to ensure the liquidity of customers' deposits rather than to further any particular credit policy; moreover it was never implemented.

#### *a) The legal basis of the present minimum reserve regulation*

19. When the former Act on the Bank Deutscher Länder was superseded by the Deutsche Bundesbank Act of 26 July 1957, the minimum reserve provisions of the 1948 Act were adopted in a modified form. Sec. 16 (1) of the Deutsche Bundesbank Act provides:

"In order to regulate the volume of money in circulation and of credit granted, the Deutsche Bundesbank may require that credit institutions shall maintain with it balances on current account (minimum reserve) representing a fixed percentage of their liabilities in respect of sight deposits, time deposits and savings deposits and also short and medium-term borrowings with the exception of liabilities to other credit institutions which are subject to minimum reserve regulations. The percentage rates fixed by the Bank shall not exceed 30% for sight deposits, 20% for time deposits and 10% for savings deposits. Subject to these limits, the Bank may vary the percentage rates according to general considerations, fix differential ratios for certain categories of institutions and exclude certain commitments from the basis of calculation "

On 16 April 1959 the Bundesbank issued an instruction on the operation of sec. 16 of the Bundesbank Act. Bulletins are published by the Bundesbank notifying credit institutions of the minimum reserve ratios.

#### *b) Credit institutions subject to minimum reserve regulations*

20. With few exceptions, all credit institutions in the Federal Republic are subject to the minimum reserve regulations. This is because almost all German

credit institutions accept sight, time or savings deposits to which the minimum reserve obligation applies. The institutions concerned are as follows:

Commercial banks:

- Large banks,
- State and regional banks,
- Private bankers,
- Specialized banks (mainly banks affiliated to large enterprises or serving the needs of particular trades or industries);

Central giro institutions,

Savings banks,

Central institutions of industrial and agricultural credit co-operatives,

Industrial and agricultural credit co-operatives,

Private mortgage banks,

Shipping mortgage banks,

Public mortgage banks

Credit institutions with special functions (e.g. Kreditanstalt für Wiederaufbau - Reconstruction Loan Corporation)

Hire purchase finance houses

Postal cheque and Postal Savings Bank Offices

In the Bundesbank instruction, the institutions which are not liable to minimum reserve regulations are expressly specified, they are:

House-building undertakings in the public interest which are not primarily concerned with banking or savings bank business,

Pawnbroking businesses,

Building societies (Bausparkassen),

Investment companies,

Kassenvereine (institutions for clearing transactions in securities),

Credit institutions in liquidation.

### *c) Computation of minimum reserves*

21. The basis of computation for the balances which have to be maintained at the Bundesbank (minimum reserve requirement) is the total of the so-called "liabilities subject to the reserve regulations", that is, all liabilities to:

Non-banks,

Credit institutions which are not subject to minimum reserve regulations,

Foreign banks,

in respect of deposits and borrowed money; in the latter case, when the money is borrowed for a fixed period or at notice of less than four years.

The following liabilities are excluded: those to the Bundesbank in respect of money earmarked for some specific purpose and certain deposits referred to in the Deutsche Bundesbank instruction on minimum reserves.

Among the liabilities which are subject to the reserve requirements, a distinction is made between :

Sight liabilities (with a term or period of notice of up to 30 days),

Time liabilities (for a fixed period or at notice of one month or more) and savings deposits.

In determining the minimum reserve requirement (Mindestreserve-Soll), the average amount of the liabilities subject to the regulation over a period of a month is ascertained. The banks have the alternative of computing this average either on the basis of the figures at the end of each day, including non-working days, from the 16th of the previous month to the 15th of the current month, or on the position at the 23rd and last day of the previous month and the 7th and 15th of the current month.

The actual reserve (Ist-Reserve) is arrived at by calculating the simple monthly average of the daily balances held at the Bundesbank.

22. This manner of calculation allows the banks considerable elasticity in the management of their minimum reserve holdings. As the minimum reserve requirement only needs to be satisfied on the basis of a monthly average, they can use their minimum reserves for the purpose of making payments and, if necessary, can draw on them freely so long as the reserves are correspondingly increased on other days of the calculation period. Because of the latitude permitted under this arrangement, the banks need not maintain at the Central Bank any other special balances for the purpose of making current payments. The minimum reserves have thus also something of the character of "working balances", although up to now the banks have never had to employ them to their full extent in this way. Consequently so-called surplus reserves – that is to say balances held at the Bundesbank in excess of minimum reserve requirements – are as a rule very small. They are in some cases due to unavoidable errors in forecasting, and they generally amount to no more than 1% to 2% of the minimum reserve requirement.

#### *d) Differentiation in minimum reserve ratios*

23. From the time of their introduction on 1 July 1948 to the end of December 1961, the minimum reserve ratios of the Deutsche Bundesbank have been changed 29 times. Table 5 on page 73 shows these changes and also gives the present reserve ratios.

The table also shows that there has been a very wide differentiation between the various minimum reserve ratios. Sec. 16 (1) of the Bundesbank Act, which has already been referred to, gives the Bundesbank the right to differentiate within the maximum limits laid down, according to particular categories of institution.

Table 5

## RESERVE RATIOS AND RESERVE CLASSES

a) Reserve Ratios<sup>1</sup>

(per cent of reserve-carrying liabilities)

Applicable from reserve month:	Sight liabilities												Time liabilities						Savings deposits		Reserve ratios for addition to liabilities		
	Bank places						Non-bank places																
	Reserve class												Reserve class						Bank places	Non- bank places	Sight liabili- ties	Time liabili- ties	Savings deposits
	1	2	3	4	5	6	1	2	3	4	5	6	1	2	3	4	5	6					
Reserve-carrying Liabilities to Residents																							
all such liabilities																							
1948 July				10								10								5			
December				15								10								5			
1949 June				12								9								5			
September				10								8								4			
1950 October				15								12								4			
1952 May	15	14	13	12	11	10	12	11	10	9	8	8	8	7.50	7	6.50	6	5.50		4			
September	12	12	11	11	10	9	10	10	9	9	8	8	7	7	6	6	5	5		4			
1953 February	11	11	10	10	9	9	9	9	8	8	8	8	7	7	6	6	5	5		4	no special ratios		
1955 September	12	12	11	11	10	10	10	10	9	9	9	9	8	8	7	7	6	6		5			
1957 May	13	13	12	12	11	11	11	11	10	10	9	9	9	9	8	8	7	7		6			
1959 August	13	12	11	10	—	—	10	9	8	7	—	—	9	8	7	6	—	—	6	5			
November	14.30	13.20	12.10	11	—	—	11	9.90	8.80	7.70	—	—	9.90	8.80	7.70	6.60	—	—	6.60	5.50			
1960 January	15.60	14.40	13.20	12	—	—	12	10.80	9.60	8.40	—	—	10.80	9.60	8.40	7.20	—	—	7.20	6			
March	18.20	16.80	15.40	14	—	—	14	12.60	11.20	9.80	—	—	12.60	11.20	9.80	8.40	—	—	8.40	7			
June	20.15	18.60	17.05	15.50	—	—	15.50	13.95	12.40	10.85	—	—	13.95	12.40	10.85	9.30	—	—	9	7.50			
such liabilities up to the average level of the months March to May 1960																							
July	20.15	18.60	17.05	15.50	—	—	15.50	13.95	12.40	10.85	—	—	13.95	12.40	10.85	9.30	—	—	9	7.50	30   20   10		
all such liabilities																							
December	20.15	18.60	17.05	15.50	—	—	15.50	13.95	12.40	10.85	—	—	13.95	12.40	10.85	9.30	—	—	9	7.50			
1961 February	19.50	18	16.50	15	—	—	15	13.50	12	10.50	—	—	13.50	12	10.50	9	—	—	8.70	7.25			
March	18.20	16.80	15.40	14	—	—	14	12.60	11.20	9.80	—	—	12.60	11.20	9.80	8.40	—	—	8.10	6.75			
April	17.55	16.20	14.85	13.50	—	—	13.50	12.15	10.80	9.45	—	—	12.15	10.80	9.45	8.10	—	—	7.80	6.50			
June	16.25	15	13.75	12.50	—	—	12.50	11.25	10	8.75	—	—	11.25	10	8.75	7.50	—	—	7.20	6	no special ratios		
July	15.60	14.40	13.20	12	—	—	12	10.80	9.60	8.40	—	—	10.80	9.60	8.40	7.20	—	—	6.90	5.75			
August	14.95	13.80	12.65	11.50	—	—	11.50	10.35	9.20	8.05	—	—	10.35	9.20	8.05	6.90	—	—	6.60	5.50			
September	14.30	13.20	12.10	11	—	—	11	9.90	8.80	7.70	—	—	9.90	8.80	7.70	6.60	—	—	6.30	5.25			
October	13.65	12.60	11.55	10.50	—	—	10.50	9.45	8.40	7.35	—	—	9.45	8.40	7.35	6.30	—	—	6	5			
December	13	12	11	10	—	—	10	9	8	7	—	—	9	8	7	6	—	—	6	5			

<sup>1</sup> Prior to May 1954, partly different regulations applied to the Berlin credit institutions. The Saarland credit institutions have been subject to the minimum reserve requirement since August 1959.

Table 5 (continued)

Applicable from reserve month:	Sight liabilities												Time liabilities						Saving deposits		Reserve ratios for addition to liabilities		
	Bank places						Non-bank places																
	Reserve class												Reserve class						Bank places	Non- bank places	Sight liabili- ties	Time liabili- ties	Savings deposits
	1	2	3	4	5	6	1	2	3	4	5	6	1	2	3	4	5	6					
<b>Reserve-carrying Liabilities to Non-residents</b>																							
all such liabilities (Until April 1957 ratios were the same as for liabilities to residents)																							
1957 May	20	20	20	20	20	20	20	20	20	20	20	20	20	10	10	10	10	10	10	10			
September	30	30	30	30	30	30	30	30	30	30	30	30	30	20	20	20	20	20	20	20	10		
1959 April	13	13	12	12	11	11	11	11	10	10	9	9	9	9	8	8	7	7	7	6			
August	13	12	11	10	—	—	10	9	8	7	—	—	9	8	7	6	—	—	6	5		no special ratios	
November	14.30	13.20	12.10	11	—	—	11	9.90	8.80	7.70	—	—	9.90	8.80	7.70	6.60	—	—	6.60	5.50			
such liabilities up to the level as of 30 November 1959																							
1960 January	15.60	14.40	13.20	12	—	—	12	10.80	9.60	8.40	—	—	10.80	9.60	8.40	7.20	—	—	7.20	6	30	20	10
March	18.20	16.80	15.40	14	—	—	14	12.60	11.20	9.80	—	—	12.60	11.20	9.80	8.40	—	—	8.40	7	30	20	10
June	20.15	18.60	17.05	15.50	—	—	15.50	13.95	12.40	10.85	—	—	13.95	12.40	10.85	9.30	—	—	9	7.50	30	20	10
all such liabilities																							
1961 May	30	30	30	30	—	—	30	30	30	30	—	—	20	20	20	20	—	—	10	10			no special ratios

<sup>1</sup> From July 1960 onwards these ratios apply also to the addition, as compared with the level on 31 May 1960, to credits availed of by customers with third parties abroad. Up to the level as at 31 May 1960 these liabilities remain exempt from the reserve requirement.

b) Reserve Classes<sup>2</sup>

From May 1952 to July 1959		From August 1959 onwards	
Reserve class	Credit institutions with reserve-carrying liabilities (not including savings deposits)	Reserve class	Credit institutions with reserve-carrying liabilities (including savings deposits)
1	of DM 100 million and over	1	of DM 300 million and over
2	of DM 50 to under 100 million	2	of DM 30 to under 300 million
3	of DM 10 to under 50 million	3	of DM 3 to under 30 million
4	of DM 5 to under 10 million	4	under DM 3 million
5	of DM 1 to under 5 million		
6	under DM 1 million		

<sup>2</sup> The reserve class into which any credit institution is to be placed is determined by the amount of its reserve-carrying liabilities in the preceding month.

24. Sometimes the ratios for sight liabilities and savings deposits are differentiated according to "Bundesbank centres" (Bankplätze) and "others" (Banknebenplätze). A Bundesbank centre for the purposes of the minimum reserve regulations is a place in which the Deutsche Bundesbank has a branch establishment. Where there is no such branch, the reserve ratios for sight liabilities and savings deposits are lower than those for banks in Bundesbank centres. The reason for this is that in places where there is no Bundesbank branch the banks are in any case obliged to keep more till money, in particular for their savings account business, since a considerable proportion of the savings deposits can be withdrawn without notice.

25. In determining the minimum reserve ratios applicable to sight and time deposit liabilities, the credit institutions are divided into various classes, according to the amount of their liabilities liable to the reserve regulations (including savings deposits). The differentiation between centres with a Bundesbank branch and those without on the one hand, and according to reserve classes on the other, favours the smaller institutions.

26. In the course of the tightening of credit restrictions in which the Bundesbank was engaged at that time, with effect from July 1960 a special minimum reserve was introduced in respect of the *increase* in domestic liabilities subject to the minimum reserve regulations. The basis of computation for the increase in liabilities was the average amount of these, as arrived at for the purpose of ascertaining the amount of the reserve requirement on the relevant bank return dates in the months of March to May 1960. The increase since this reference period was made subject to the maximum ratio permitted by law. With effect from December 1960, this regulation was withdrawn; since that date, all domestic liabilities are subject to the same ratio.

27. Finally, for the period from May 1957 to April 1959, liabilities of banks towards non-residents were for the first time subject to higher minimum reserve ratios than were applicable to liabilities towards residents; the object of this differentiation was to stem the flow of foreign money into German banks. From January 1960 onwards, the maximum ratios were imposed on the *increase* since 30 November 1959 in liabilities towards non-residents subject to minimum reserve regulations whereas up to the amount of the liabilities that already existed before 30 November 1959 the rating ratios for non-resident deposits continued to apply. From May 1961 to the end of January 1962, in order to put an even more effective brake on the influx of foreign funds, the maximum ratios were applied to *all* liabilities towards non-residents subject to the minimum reserve regulations with the exception of customers' drawings on credits opened at foreign institutions as at the end of May 1960. Since 1 May 1961, in computing the minimum reserve the amount of balances (whether sight or time deposits) and money market funds held abroad on the selected day is allowed as deduction from liabilities towards non-residents; this offers an inducement for the export of capital.



*e) Interest*

28. It is not the practice of the Bundesbank to pay interest on minimum reserve balances. This entails a considerable loss of earning power for the credit institutions concerned; and the burden is particularly heavy if minimum reserve ratios are substantially increased for general reasons of credit policy. Minimum reserve policy is therefore not merely a factor of purely quantitative significance for the liquidity of the banking system; it also has its repercussions on interest rates. When minimum reserve percentages are increased, the banks' profitability is affected and they feel obliged to increase their charges to borrowers. It is true that under the "Sollzinsabkommen" (see page 65) interest charged to borrowers is linked with Bank rate; but this agreement only lays down maximum interest rates, and in individual cases the rates charged may be – and often are – below the maximum. An increase in the minimum reserve ratio therefore gives rise to a tendency to withdraw special concessions for borrowers – which, in times of restrictive credit policy, is a desirable end.

*f) Penal rates*

29. If the balance held by any bank at the Bundesbank falls short of the amount required under the minimum reserve regulations, interest is charged on the amount of the deficiency at a penal rate of 3% above the Bundesbank advance rate at the time. As a rule, this means a charge of 4% above Bank rate (see Table 4, page 66).

*g) Efficacy of minimum reserve policy*

30. As an instrument of policy minimum reserve regulations are used by the Bundesbank principally when some persistent trend in banking liquidity calls for a corrective, or when it is desired to influence banking liquidity in a certain way as a matter of long-term policy. The Bundesbank generally deals with short-term fluctuations in banking liquidity by money market operations, as a part of its open-market policy. The difference in the extent to which these two methods have been applied is shown by the fact that since 1948, as mentioned earlier, there have been 29 changes in minimum reserve ratios (on a few occasions changes were made on grounds other than those of credit policy), whereas the Bundesbank's selling rates for open market paper were changed 26 times in the three years 1958 to 1960 alone, during which period there were 7 changes in the Bank rate and 6 changes in minimum reserve ratios on grounds of credit policy. The restraint displayed in using the minimum reserve ratio is explained by the fact that, in spite of all differentiation, it is still a somewhat rough and ready method; it has a blanket effect on the various institutions, even though their liquidity position and their business policies may be different.

31. With the steep increase, almost continuous since 1948, in liabilities subject to minimum reserve regulations, the volume of bank liquidity immobilized would have been substantial even if the ratio had remained unchanged. The real importance of the minimum reserve weapon, however, lies in the possibility of varying the percentages from time to time. At the end of December 1961 the total liabilities subject to minimum reserve regulations amounted to nearly DM 112 000 million, so that an average increase of only 1% in the minimum reserve ratio means a reduction in liquidity of some DM 1 000 million. The ratios in force at that time meant that the liquid funds of the banks kept at the Central Bank amounted to about DM 9 000 million.

32. In assessing the qualitative effects of minimum reserve policy, in the first place it must be borne in mind that, by reason of its structure, the German banking system is more dependent on refinancing at the Central Bank than are banks in Anglo-Saxon countries. Even when in past years liquidity increased to an extraordinary degree, the banks as a whole continued to have recourse to the Central Bank. It is true that on several occasions the amount of their recourse fell to a very low level and that large sections of the banking system were for a time no longer dependent on the Bundesbank for refinance. Whether this development in past years may be taken as indicating a structural change in this respect, it is still too early to say. In the past, however, this structural feature of the German banking system – to the maintenance of which, it may be remarked in passing, minimum reserve obligations have made a substantial contribution – has been of very special importance for the efficacy of minimum reserve policy. Any increase of funds accruing to the banks, which they do not require to meet their minimum reserve obligations, is used mainly by them to reduce their refinancing liabilities at the Bundesbank. Even when there has been a great expansion in liquidity, this has never led to the formation of so-called surplus reserves to any significant amount. Neither was this the case when the indebtedness of the banks to the Bundesbank reached a very low level, because they always had opportunities of investing any liquid funds in home or foreign money market paper.

33. In general the banks can meet an increase in minimum reserve obligations only by converting their "potential" liquidity (in the form of rediscountable trade bills, money market paper and foreign exchange) into balances at the Central Bank, where they are immobilized. On the other hand, when minimum reserve ratios are reduced, certain balances are set free and the banks reconvert them into potential liquidity. In either case the liquidity of the banking system as a whole is affected. Whether the banks acquire the additional Central Bank balances by drawing on their foreign money market investments, by realizing home money market paper or by presenting bills at the Central Bank for discounting, will depend on circumstances (e.g. relative rates of interest). The important point is that the financing of increased minimum reserves lays a burden on the liquidity reserves (potential liquidity) of the banks, with the result that they are obliged to exercise greater restraint in granting credit.

34. The efficacy of the minimum reserve system in the Federal Republic is enhanced by the fact that the banks' scope for resort to the Bundesbank is limited by the so-called rediscount quotas. In conjunction with the minimum reserve policy, the importance of these quotas lies in the fact that they set a limit to the banks' recourse to Central Bank funds, even where they still have bills in their portfolios (or could obtain these in the ordinary course of their credit business) which would satisfy the Bundesbank requirements as to quality.

### CHAPTER 3

#### OPEN-MARKET POLICY AND REGULATION OF THE MONEY MARKET

35. The Deutsche Bundesbank carries out open-market operations in short and medium-term paper in order to influence the money market. The Bundesbank Act indeed also permits of open-market business in long-term securities, so that operations on the market in fixed-interest securities would be possible; up to the present, however, the Bundesbank – which incidentally does not hold any appreciable amount of long-term interchangeable securities of this sort – has not engaged in business of this type.

##### *a) Legal basis*

36. The legal basis for the Bundesbank's open-market business is sec. 21 of the Deutsche Bundesbank Act of 1957. According to this section, the Deutsche Bundesbank "in order to regulate the money market, may buy and sell at market prices in the open market":

- a) Bills which satisfy the requirements laid down in sec. 19 of the Act (dis-countable bills);
- b) Treasury bills and Treasury bonds issued by the Federal Government, one of its Special Funds or a Land;
- c) Debt certificates and Debt Register claims issued by the Federal Government, one of its Special Funds or a Land;
- d) Other bonds officially quoted on the Stock Exchange.

According to the wording of the Act, open-market business is only intended "to regulate the money market" but not to regulate or support the capital market – though that of course seldom remains unaffected by money market policy.

37. In the early years of its existence the Bundesbank's predecessor, the Bank Deutscher Länder, was able to engage in open-market operations only to a very limited extent. In fact, it had at its disposal hardly any paper which would have been suitable for such business. It is true that the Bank Deutscher Länder

and the Land Central Banks (which, until the Bundesbank was founded in 1957, together constituted the Central Bank System) had some DM 8 000 million worth of claims on public authorities. These claims, however, which had arisen in the course of the currency reform in the shape of balance sheet adjustments in the accounts of the Bank Deutscher Länder and the Land Central Banks, bear interest only at 3% ; moreover they may only be sold at their nominal value, so that in practice they are not marketable. As bank liquidity increased, it became more and more necessary to absorb the surplus liquidity, and the Bank Deutscher Länder agreed with the Federal Government that a part of these "Equalization Claims" should be converted into negotiable money market securities (Treasury bills and non-interest-bearing Treasury bonds). This arrangement was at a later date embodied in sec. 42 of the Bundesbank Act and the Bundesbank now has an operating fund of some DM 8 000 million worth of so-called "mobilization paper".

The Bundesbank is under an obligation to the Federal Government to meet all liabilities arising out of the mobilization paper which has been issued. The Federal Government, however, still pays only 3% interest to the Deutsche Bundesbank in respect of the Equalization Claims which have been converted into mobilization paper. If the Bundesbank sells mobilization paper at a yield in excess of this figure, it has to find the difference in interest out of its other earnings.

*b) Other money-market business*

38. In addition to the money-market paper originating from the agreed conversion of Equalization Claims (mobilization paper), the Bundesbank also arranges for the placing of Treasury bills and non-interest-bearing Treasury bonds issued by the Federal Government, the Länder and certain of the Federal Government's Special Funds (see Table 6, page 81). As a general rule the sale of this money-market paper does not draw off liquidity, because the issuers normally spend the proceeds of the sale, so that the money finds its way back to the banks, though sometimes after a certain lapse of time. The Bundesbank also regulates the market in the so-called Storage Agency Bills; these are issued by the Import and Storage Agencies within the ceiling of the credits granted to them by the banking syndicate, and up to a limit agreed with the Bundesbank, in the form of Government-guaranteed promissory notes, for the purpose of financing stocks of certain basic foodstuffs (cereals, fats, meat, etc.). The Bundesbank takes up these bills as they are offered on the market, on conditions appropriate to the state of the market at the time, and disposes of them again when a demand arises. The way in which this form of money market regulation operates differs somewhat from open-market operations proper; more especially, the object is not the same.

Table 6

**CIRCULATION OF TREASURY BILLS, NON-INTEREST-BEARING TREASURY BONDS AND OTHER MONEY-MARKET PAPER <sup>1</sup>**  
in millions of DM

Position at end of month	Federal Government				Länder				Federal Railways				Federal Postal Administration	Total	among which : money-market paper (col.14 less 4 less 12)
	Total	Treasury bills	Treasury bonds		Total	Treasury bills	Treasury bonds	Tax credit certificates <sup>3</sup>	Total	Treasury bills	Treasury bonds		Treasury bonds		
			Money-market paper	Ear-marked paper <sup>2</sup>							Money-market paper	Ear-marked paper <sup>4</sup>			
5	6	7	8	9	10	11	12	13	14	15					
1950	498.7	498.7	—	—	313.0	260.2	2.8	50.0	718.6	571.5	127.6	19.5	—	1 530.3	1 510.8
1951	1 306.0	608.2	697.8	—	346.3	137.8	44.9	163.6	846.0	642.1	149.2 <sup>5</sup>	54.7	—	2 498.3	2 443.6
1952	861.6	110.6	751.0	—	330.7	66.3	102.4	162.0	1 128.8	528.3	549.1 <sup>5</sup>	51.4	150.0	2 471.1	2 419.7
1953	753.6	78.7	529.9	145.0	300.2	24.3	128.3	147.6	1 159.6	519.6	553.2 <sup>5</sup>	86.8	295.9	2 509.2	2 277.4
1954	607.0	65.0	400.0	142.0	299.5	16.8	89.2	193.5	1 071.2	551.8	394.7	124.7	381.1	2 358.8	2 092.1
1955	138.0	—	—	138.0	321.2	30.6	149.5	141.1	824.2	472.1	216.5	135.6	405.3	1 688.7	1 415.1
1956	94.0	—	—	94.0	547.7	—	409.7	138.0	718.0	432.9	102.1	183.0	500.0	1 859.7	1 582.7
1957	—	—	—	—	897.8	—	661.3	236.5	1 111.6	320.8	538.9	251.9	439.8	2 449.2	2 197.3
1958	—	—	—	—	545.6	—	311.1	234.5	1 371.0	398.6	590.0	382.4	300.0	2 216.6	1 834.2
1959	295.8	65.2	230.6	—	419.7	—	163.7	256.0	1 171.1	296.8	445.0	429.3	269.9	2 156.5	1 727.2
1960	880.8	—	880.8	—	269.7	—	105.5	164.2	1 085.9	199.4	445.0	441.5	192.2	2 428.6	1 987.1
1961	407.6	—	407.6	—	133.6	—	33.7	99.9	1 293.1	182.4	590.0	520.7	264.3	2 098.6	1 577.9
1960 March	778.2	22.1	756.1	—	419.9	—	158.2	261.7	1 090.4	180.9	475.0	434.5	266.0	2 554.5	2 120.0
June	834.8	20.0	814.8	—	337.3	—	122.9	214.4	1 259.9	285.0	530.0	444.9	220.3	2 652.3	2 207.4
September	820.3	—	820.3	—	298.0	—	116.1	181.9	1 034.0	98.8	480.4	454.8	275.6	2 427.9	1 973.1
December	880.8	—	880.8	—	269.7	—	105.5	164.2	1 085.9	199.4	445.0	441.5	192.2	2 428.6	1 987.1
1961 March	740.9	—	740.9	—	265.8	—	105.2	160.6	955.6	133.9	411.9	409.8	150.4	2 112.7	1 702.9
June	683.7	—	683.7	—	230.1	—	75.2	154.9	985.4	204.6	355.9	424.9	195.7	2 094.9	1 670.0
September	513.7	—	513.7	—	156.7	—	46.7	110.0	1 130.9	100.0	583.4	447.5	300.4	2 101.7	1 654.2
December	407.6	—	407.6	—	133.6	—	33.7	99.9	1 293.1	182.4	590.0	520.7	264.3	2 098.6	1 577.9

<sup>1</sup> Except money-market paper deriving from the conversion of equalization claims, and except Storage Agency bills.

<sup>2</sup> Issued for the purpose of a special financial adjustment between Federal Government and Länder.

<sup>3</sup> Land of Bavaria: moreover, up to 31 March 1955, also Berlin debt certificates.

<sup>4</sup> To provide security for investment credits.

<sup>5</sup> Including non-interest-bearing Treasury bonds special series "S" (resulting from the temporary conversion of bonds).

Source: Monthly Reports of the Deutsche Bundesbank.

With regard to the purchase and sale of so-called prime acceptances by the Bundesbank, see sec. 50 et seq.

*c) Quality, term and buying and selling rates of money-market paper*

39. The reason why money-market paper – apart from those securities with a relatively short remaining life – is suitable as a form of investment for the banks' liquid funds is that it can, if required, be returned to the Central Bank and in this way exchanged for Central Bank money. Treasury bills and non-interest-bearing Treasury bonds can also be discounted at the Bundesbank at its own currently fixed to repurchase price. In the case of Treasury bills there is a formal promise to discount. There is no such promise attached to non-interest-bearing Treasury bonds, but the Bundesbank has always taken up such bonds when offered, at its currently fixed price.

40. Mobilization paper takes the form of 2- and 3-month Treasury bills and also non-interest-bearing Treasury bonds with 6, 12, 18 or 24 months to run. The Bundesbank is however not always prepared to sell paper with the currency period desired by the banks. In a period of rapidly rising liquidity and falling interest rates, as for example in 1958, there is a pressing demand from the banks for paper with a longer currency and correspondingly higher rate of interest. As on that occasion the Bundesbank had no desire to withdraw too much liquidity, from the middle of 1958 until the beginning of 1959 it entirely discontinued the sale of non-interest-bearing Treasury bonds, so that the only recourse left to the banks was to invest in Treasury bills, which carried a lower rate of interest and, moreover, a rate which was constantly falling. From the beginning of 1959 the Bundesbank only gradually resumed the sale of the longer-term Treasury bonds. Conversely, in April 1960, that is to say in a period of restraint the Bundesbank sold no Treasury bills from its mobilization portfolio but only Treasury bonds bearing a higher rate of interest; it hoped in this way to exert a somewhat stronger restraining influence on bank liquidity. In February 1961, in accordance with a policy of lower interest rates pursued for balance-of-payment reasons, the Bundesbank began selling only short-term paper, that is Treasury bills and non-interest-bearing Treasury bonds with a currency of not more than a year, and the sale of higher interest-bearing paper with a currency of more than a year was discontinued.

41. In practice, the open-market policy works through the actions of the Bundesbank in *varying* its selling and repurchase rates for different forms of money-market paper according to the current trend of the money market and in accordance with the intentions of its liquidity policy. These changes in the selling and repurchase rates of money-market securities are the real hub of the Bundesbank's open-market policy. Changes in selling rates are publicly announced in the following form:

Example : Press announcement of the Deutsche Bundesbank dated 3 January 1962

With effect from 4 January 1962 the selling rates for the money-market securities listed below are reduced as follows :

	Since 20 October 1961 %	From 4 January 1962 %
<i>1. Federal Government and Federal Railways Treasury bills</i>		
with a currency of 60 - 90 days	2	1 7/8
with a currency of 30 - 59 days	1 7/8	1 3/4
<i>2. Non-interest-bearing Treasury bonds issued by the Federal Government, the Federal Railways and the Federal Postal Administration</i>		
with a currency of ½ year	2 3/8	2 1/4
with a currency of 1 year	2 1/2	2 3/8
<i>3. Storage Agency Bills</i>		
with a currency of 60 - 90 days	2 1/8	2
with a currency of 30 - 59 days	2	1 7/8

The selling rates for Treasury bonds with a currency of 1½ to 2 years remain unchanged (2 5/8% and 2 3/4% respectively)

The rates at which money-market securities are repurchased before maturity are not published. They are fixed at a certain margin above the published selling rates. These margins may vary according to the state of the money market, the way in which the Bundesbank wishes to influence the market and the type of security concerned ; yet these margins between selling and repurchase rates in practice often remain unchanged for fairly long periods so that the rate at which the Bundesbank will repurchase varies in accordance with its selling prices - though on a higher level. Table 7 on page 84 traces the changes in selling rates for the various classes of money-market securities since the beginning of 1958.

*d) The "Market" for money-market securities*

42. It is a special feature of open-market operations in the Federal Republic that dealings in money-market securities take place only between the Bundesbank



Table 7

**RATES OF THE DEUTSCHE BUNDESBANK**  
**Applying to Sales of Money-Market Paper in the Open Market**

(% per annum)

Applicable from:	Treasury Bills of Federal Government and Federal Railways running for		Non-interest-bearing Treasury Bonds of Federal Government, Federal Railways and Federal Postal Administration running for				Storage Agency Bills running for	
	30 to 59 days	60 to 90 days	6 months	12 months	18 months	24 months	30 to 59 days	60 to 90 days
	<b>1958</b>							
January 2	3 3/8	3 1/2	3 3/4	4	4 1/4	4 1/2	3 1/2	3 5/8
January 6	3 1/4	3 3/8	3 5/8	3 7/8	4 1/8	4 3/8	3 3/8	3 1/2
January 17	3 1/8	3 1/4	3 1/2	3 3/4	4 1/8	4 3/8	3 1/4	3 3/8
April 15	3 1/8	3 1/4	3 1/2	3 5/8	3 7/8	4 1/8	3 1/4	3 3/8
May 30	3 1/8	3 1/4	3 1/2	3 5/8	3 3/4	4	3 1/4	3 3/8
June 27	2 5/8	2 3/4	3	3 1/8	3 1/4	3 1/2	2 3/4	2 7/8
July 11	2 1/2	2 5/8	2 7/8	3	3 1/8	3 3/8	2 5/8	2 3/4
August 11	2 3/8	2 1/2	2 3/4	3	3 1/8	3 3/8	2 1/2	2 5/8
October 28	2 1/4	2 3/8	2 5/8	2 7/8	3	3 1/4	2 3/8	2 1/2
<b>1959</b>								
January 10	2 1/8	2 1/4	2 1/2	2 5/8	2 7/8	3 1/8	2 1/4	2 3/8
April 9	2	2 1/8	2 3/8	2 1/2	2 3/4	3	2 1/8	2 1/4
April 15	1 7/8	2	2 1/4	2 3/8	2 5/8	2 7/8	2	2 1/8
September 4	2 3/8	2 1/2	2 3/4	3	3 1/4	3 1/2	2 1/2	2 5/8
September 23	2 1/2	2 5/8	2 7/8	3	3 1/4	3 1/2	2 5/8	2 3/4
September 30	2 5/8	2 3/4	3	3 1/8	3 3/8	3 5/8	2 3/4	2 7/8
October 16	2 1/2	2 5/8	2 7/8	3 1/8	3 3/8	3 5/8	2 5/8	2 3/4
October 23	3 1/2	3 5/8	3 7/8	4 1/8	4 1/4	4 1/2	3 5/8	3 3/4
October 28	3 1/2	3 5/8	3 7/8	4 1/8	4 1/4	4 3/8	3 5/8	3 3/4
December 21	3 5/8	3 3/4	4	4 1/4	4 3/8	4 1/2	3 3/4	3 7/8
<b>1960</b>								
February 29	3 3/4	3 7/8	4 1/8	4 3/8	4 1/2	4 5/8	3 7/8	4
March 3	3 7/8	4	4 1/4	4 1/2	4 5/8	4 3/4	4	4 1/8
June 3	4 3/4	4 7/8	5 1/8	5 1/4	5 3/8	5 1/2	4 7/8	5
November 2	4 5/8	4 3/4	5	5 1/8	5 1/4	5 3/8	4 3/4	4 7/8
November 3	4 3/8	4 1/2	4 3/4	4 7/8	5	5 1/8	4 1/2	4 5/8
November 11	3 7/8	4	4 1/4	4 3/8	4 1/2	4 5/8	4	4 1/8
December 20	3 5/8	3 3/4	4	4 1/8	4 1/4	4 3/8	3 3/4	3 7/8
<b>1961</b>								
January 20	3 1/8	3 1/4	3 1/2	3 5/8	3 3/4	3 7/8	3 1/4	3 3/8
February 9	3	3 1/8	3 3/8	3 1/2	3 5/8	3 3/4	3 1/8	3 1/4
February 14	2 7/8	3	3 1/4	3 3/8	3 1/2	3 5/8	3	3 1/8
March 3	2 3/4	2 7/8	3 1/8	3 1/4	3 3/8	3 1/2	2 7/8	3
March 8	2 5/8	2 3/4	3	3 1/8	3 1/4	3 3/8	2 3/4	2 7/8
March 17	2 1/2	2 5/8	2 7/8	3	3 1/8	3 1/4	2 5/8	2 3/4
March 23	2 3/8	2 1/2	2 3/4	2 7/8	3	3 1/8	2 1/2	2 5/8
April 26	2 1/4	2 3/8	2 5/8	2 3/4	2 7/8	3	2 3/8	2 1/2
May 5	2 1/8	2 1/4	2 1/2	2 5/8	2 3/4	2 7/8	2 1/4	2 3/8
October 4	2	2 1/8	2 3/8	2 1/2	2 5/8	2 3/4	2 1/8	2 1/4
October 20	1 7/8	2	2 3/8	2 1/2	2 5/8	2 3/4	2	2 1/8

on the one hand and credit institutions and certain public authorities (e.g. Federal Postal Administration, Social Insurance Institutions) on the other. It is in practice impossible for business undertakings or private individuals to acquire Treasury bills, Treasury bonds or other money-market securities at the selling prices fixed by the Bundesbank. The Bundesbank sells them only to the above-mentioned groups, while the banks can sell them to non-bank customers only within the limits laid down in the "Habenzinsabkommen" (Agreement on deposit interest rates); moreover the banks have very little interest in business of this sort because it would lead to withdrawals from deposits. The agreement referred to lays down that Treasury bills, non-interest-bearing Treasury bonds and other specified securities must not be sold to non-bank customers when within less than 30 days of maturity. Although the agreement in principle permits the sale of paper with more than 30 days to run, it stipulates that the current rates of the discount market or money market must be scaled down, which makes it hardly worth while for non-bank customers to invest in this form of security. The placing of mobilization paper outside the banks in the hands of the public authorities referred to is normally not of much importance from the standpoint of open-market policy. It is true that it immobilizes certain non-bank funds, which would otherwise pass to certain banks and increase their liquidity, but its effect on the banking system is not so extensive as that which open-market operations would have if large sections of the public or business undertakings were to participate.

43. In contrast to New York or London, there is no market for money-market paper on which business can be done between the credit institutions (and any other interested parties) at discount rates varying according to supply and demand. Money market paper provides the credit institutions and the public authorities with an outlet for investment of their liquid funds. Apart from cases where they are held to maturity, these securities can always be converted into Central Bank money by selling them back to the Bundesbank at the current repurchase rate.

*e) The efficacy of open-market policy*

44. The fact that the private non-bank sector is in practice entirely excluded from participation in money-market transactions and that there is no real market for open-market paper outside the Central Bank has an important bearing on the character and efficacy of open-market policy as carried out in Germany. In certain other countries, in which there is a real market for open-market securities, both short and long-term, and in which the business community participates as well as the banks, the Central Bank, by intervening on this market, can arbitrarily reduce or increase the liquidity of the banks. In the Federal Republic, on the other hand, all that happens is that the Central Bank makes known the terms on which it is prepared to do open-market business with the banks. To a large extent, the Central Bank – except where it discontinues the sale of certain types of security for the reasons mentioned above – leaves the initiative

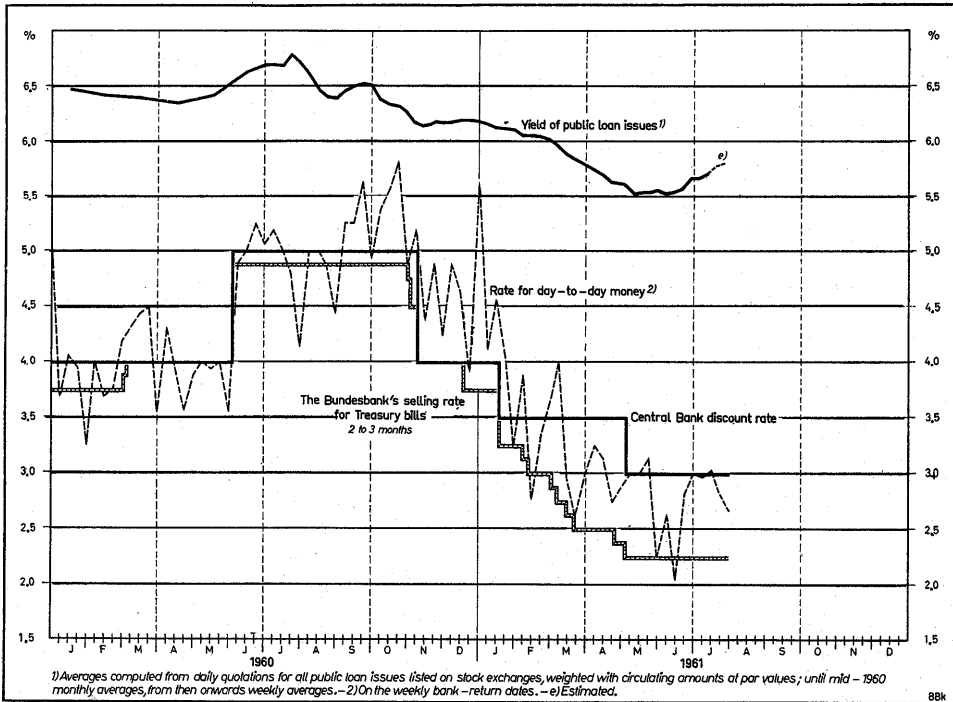
for sales or purchases of open-market securities to the market, that is, to the banks. The banks' decisions as to how far they will buy from the Central Bank or sell back to it on its own terms, are governed by their own liquidity position and the opportunities for alternative investment of their funds (investment on foreign money markets, repayment of rediscount credits to the Central Bank, etc.). Of course the Bundesbank exerts an appreciable influence on the volume of operations through the level of, and changes in, the rates at which it sells and repurchases money-market paper. If the banks react in a way which, in the opinion of the Bundesbank, is incompatible with the line of liquidity policy which it is following, it alters its selling and repurchase rates accordingly.

45. Thus the German system of open-market operations is just as much an instrument of interest policy as of liquidity policy; indeed it must sometimes be regarded as being concerned more with interest rates than with liquidity. Just as Bank rate influences (or, at any rate, is intended to influence) the extent to which the banks acquire Central Bank money by rediscounting trade bills or transfer funds back to the Central Bank — in which case the initiative lies with the banks — so the changes in the Bundesbank's selling and repurchase rates are factors which determine to what extent the banks buy money-market securities from the Central Bank or return them to it. Yet on the other hand there are in the German system considerable differences between discount and open-market policies; by reason of their influence on the debtor and creditor interest rates applied by the credit institutions, changes in Bank rate have a much more far-reaching influence on the interest rate structure as a whole than changes in the Central Bank's dealing rates for open-market securities; this latter instrument is admittedly employed much more frequently and, in particular, as it is more flexible, it can quickly be adapted to market fluctuations even in the short term (see Diagram 2 on page 87). Furthermore the banks' powers of obtaining liquid funds by discounting bills at the Central Bank, involve quite different institutional arrangements from those required for obtaining funds by returning money-market securities to the Bundesbank.

46. On the other hand it must not be overlooked that the sale of "medium-term" Treasury bonds in particular (that is, those with a currency of 1 to 2 years) does represent a corresponding immobilization of liquid funds of the purchasing banks — and one which could not have been achieved merely by means of Bank rate policy. Experience shows that this longer-term money-market securities are seldom discounted a considerable time before maturity, in many cases, to do this would mean a loss of earnings for the banks concerned.

47. In contrast to other countries, in which money-market rates deviate quite substantially from Bank rate, under the German system this has seldom been the case for a long period, at least so far as the open-market for Treasury bills is concerned. It is true that in times of extreme liquidity the rate for Treasury bills may fall considerably below Bank rate (see Diagram 2); yet in this case the banks will prefer to apply their available funds to reducing as far as possible their indebtedness to the Central Bank, because this carries a higher rate

Diagram 2  
INTEREST RATES



1) Averages computed from daily quotations for all public loan issues (listed on stock exchanges, weighted with circulating amounts of par values; until mid-1960 monthly averages, from then onwards weekly averages. - 2) On the weekly bank - return dates. - e) Estimated.

BBk

Source : Monthly Report July 1961 of the Deutsche Bundesbank.

of interest. For various reasons such a loss of rediscounting business may be unwelcome to the Bundesbank, so that the question may then arise whether it should deal with the situation by a downward adjustment of Bank rate or arrange that the rate for Treasury bills does not fall too much below Bank rate. On the other hand, the Treasury bill rate will not remain above Bank rate for long without causing a tendency for the banks to procure Central Bank money on a larger scale by discounting bills, and using the proceeds for direct or indirect investment in higher-yielding money-market securities. The close connection between Bank rate policy and the fixing of open-market dealing rates is also shown by the fact that, when there are changes in Bank rate, normally there are corresponding adjustments to open-market rates, and these create that state of liquidity on the money market which is necessary before the new Bank rate can become fully effective. Occasionally these alterations in open-market rates precede a change in Bank rate; sometimes they are made at the same time.

48. The relationship between Bank rate and open-market discount rates for short-term money-market investments thus determines to a great extent how far the banks procure Central Bank money by rediscounting trade bills or on the

money market (by inter-bank loans) or by the return of money-market paper to the Central Bank. The Bundesbank's selling and buying prices are also normally the most important standard of comparison, by reference to which the banks decide whether to employ their available funds in domestic or foreign money-market investments. Of course, in making such a comparison of the yields obtainable at home and abroad, the cost of the forward exchange cover has also to be taken into account (see on this point chapter 3). It may, however, be affirmed though with reservations that the decision whether an inflow of liquidity is used for investment in the home money market, for investment abroad or for reducing indebtedness to the Central Bank, depends on the relationship existing at the particular time between the Central Bank's open-market dealing rates, foreign open-market rates (including the cost of covering the exchange risk) and Bank rate.

49. In conclusion we may mention the orders of magnitude within which the Bundesbank's open-market operations (exclusively transactions in mobilization paper) have fluctuated during various periods in recent years (see Diagram 3 on page 89).

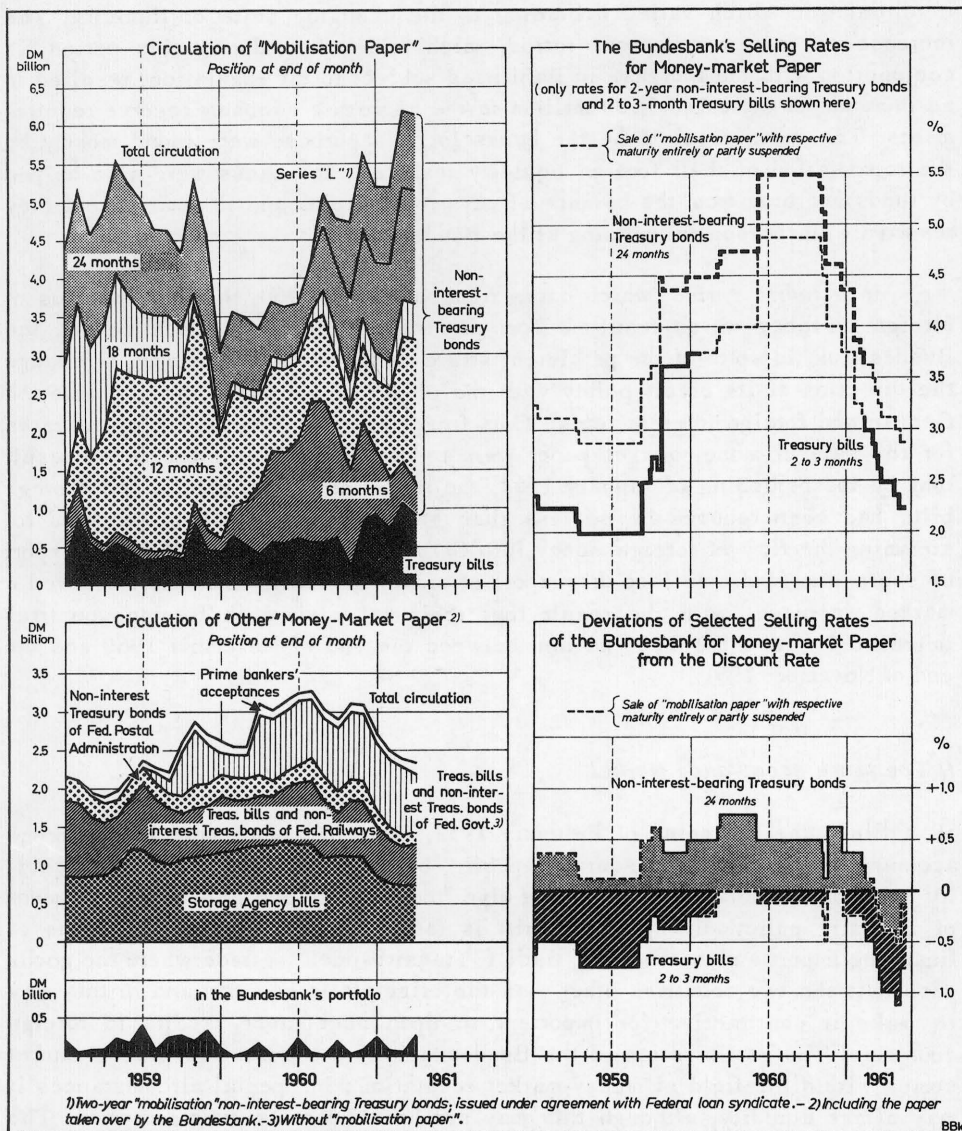
In the *first period* of open-market operations, lasting from 1956 to 1958, in which the liquidity of the credit institutions showed a marked expansion as a result of the inflow of foreign exchange, the banks employed their surplus funds partly to reduce their indebtedness to the Bundesbank and partly to buy open-market paper from the Bundesbank. Because of this, the circulation of mobilization paper rose from some DM 1 400 million at the end of 1956 to DM 4 200 million at the end of 1957, until in August 1958 it reached a peak of nearly DM 7 200 million. This increase took place, despite the fact that as early as 1957, and even more in 1958, the selling rates for open-market paper were continually reduced, until in August 1958 the rate for 3-month Treasury bills had fallen as low as 2½%.

The *second period* in the development of the money market extends from the middle of 1958 to the autumn of 1959. During this period the inflow of liquid funds at the banks was no longer so marked and the banks' holdings of mobilization paper, after various fluctuations, fell to a lower level. As, under the pressure of the funds which had already reached the banks (supported by reductions in Bank rate and open-market rates) short-term interest rates continued to fall on the market up to the spring of 1959, the result was that there was a marked difference between interest rates in the Federal Republic and those abroad (particularly in New York), so that in the first nine months of 1959 the banks were able to improve their net short-term position abroad to the extent of some DM 2 000 million. The banks obtained part of the Central Bank money required for this purpose by reducing their holdings of Bundesbank mobilization paper.

The *third period* in the development of the money market commenced with the change-over to a policy of credit restraint in September 1959 and lasted until

Diagram 3

DATA ON OPEN-MARKET POLICY



November 1960. The Bundesbank's open-market rates were raised from their lowest point in the summer of 1959 (when the rate for sales of 3-month Treasury bills was down to 2%) in about the same proportion as Bank rate, that is, by  $2\frac{5}{8}\%$  to  $2\frac{7}{8}\%$  (according to their currency period); from June to November 1960 the rate for sales of 3-month Treasury bills was  $4\frac{7}{8}\%$ . During this period there were very great fluctuations in the volume of mobilization paper in circulation which varied according to the changing state of liquidity. The increases in minimum reserve ratios which took effect during this period, in conjunction with the increase in liabilities subject to the regulation, resulted in an increase of some DM 5 500 million in the aggregate minimum reserve requirements. The funds required by the banks for this purpose were found mostly by the repatriation of their foreign liquidity reserves; the banks were also helped by funds accruing from the balance-of-payments surplus and to some extent they resorted to increased refinancing at the Bundesbank.

In a *fourth period*, which dates from November 1960, the large surplus of foreign currency which resulted from the inflow of foreign funds caused the Bundesbank, in spite of the persistent strain on the internal economy, to change the direction of its credit policy with the object of narrowing the gap between German and foreign interest rates. Thus from November 1960 onwards, the rates for the sale of money-market paper were reduced step by step with the result that by the beginning of January 1962, the rates for Treasury bills and storage bills had been reduced by no less than 3%. The way was thus prepared for stemming the flow of foreign money into Germany and for a revival of the export of short-term funds. In fact the export of money by banks once more showed a marked increase, with the result that their net claims on foreign countries improved by some DM 3 600 million between the end of November 1960 and the end of November 1961.

*f) The prime acceptance market*

50) Since the beginning of February 1959, there has once more been a prime acceptance market in the Federal Republic, but from the point of view of liquidity policy it has not been of any great significance. It is not a special instrument of liquidity policy; its principal aim is rather to provide a cheap means of financing import and merchanting trade ("Transithandel" – trade where the goods pass between two countries other than the originator's country) and in this way to make it unattractive for importers to open acceptance credits in foreign countries. The participation of the Bundesbank in the prime acceptance market comes within the field of money-market regulation; in special circumstances it may affect liquidity, although this may not have been its main intention. The legal basis for the participation of the Bundesbank in operations on the prime acceptance market is sec. 21 of the Bundesbank Act (to which reference has been made in paragraph 36) which deals with open-market transactions. Under this section, bills which meet the requirements of discount business can also be used for open-market operations.

51. The prime acceptance market, which was revived in 1959 with the help of the Bundesbank, is on a more restricted scale than in pre-war days, because the only bank acceptances which can be negotiated are those employed in the financing of import and merchanting trade. It is indeed only for this type of bill that the Bundesbank has promised to give its assistance, in pursuance of its liquidity policy. The credit institutions whose acceptances qualify as prime acceptances are selected according to certain objective criteria. Certain maximum limits are fixed for the amount of discountable prime acceptances which a credit institution may hold at any given time. The Privatdiskont A.G., which was founded in Frankfurt in 1959, acts both as broker in dealing in prime acceptances on the stock exchange and also buys and sells them itself; further, it is the only liaison office between the market and the Bundesbank. The latter, for its part, buys prime acceptances only directly from the Privatdiskont A.G. and not from the credit institutions which participate in such business; the same applies to sales.

52. In order to give prime acceptances the status of first-class investments, it was necessary for the Bundesbank to declare its readiness to buy them in case the Privatdiskont A.G. should at any time not be able to place all its holdings on the market or to take them over itself by employing day-to-day money or its own funds. The buying, selling and middle prices for prime acceptances, which are quoted each day on the stock exchange for "longs" (60-90 days) and "shorts" (30-59 days), are fixed by the Privatdiskont A.G. by agreement with the Deutsche Bundesbank.

53. Since it was formed in the spring of 1959, the prime acceptance market has not assumed any great importance. The circulation of prime acceptances has so far not risen to more than DM 200 million. By comparison with the cost of foreign credits to finance foreign trade transactions, the cost of prime acceptances is still relatively high because, although the rate of discount in their case is sometimes below Bank rate, the banks' commission on acceptances and stamp duty (at the appreciable figure of 0.6%) have to be added.



## CHAPTER 4

### THE BUNDESBANK'S OPERATIONS ON THE FOREIGN EXCHANGE MARKET

54. Since the beginning of 1959 the Bundesbank has regularly dealt in the forward exchange market, by concluding with German banks forward covering operations or U.S. dollar "swaps" (i.e. selling dollars spot and at the same time buying them back forward) for up to 3 months, and in some cases even 6 months. In this class of business the Bundesbank either waives completely its right to charge any forward discount or covers the exchange risk on terms which are more favourable than market rates. Occasionally, it has even allowed the banks a forward rate at a premium over the spot rate. In this way, by making use of the difference between home and foreign interest rates, the banks are encouraged to transfer funds abroad – indeed in many cases it is only because of this Bundesbank support that they are able to export funds at all. This arrangement will only hold good to the extent that, and so long as, the Central Bank considers it expedient as a matter of policy. At the same time – at any rate, so long as the forward deals are done at little or no cost – this tends to bring home money-market rates more nearly into line with those for comparable forms of investment abroad, in particular with those in New York.

55. When the Bundesbank began this class of business in January 1959, it stated that its intention in intervening in the forward foreign exchange market was only to get the banks off to a good start in building up a sizeable holding of short-term foreign investments and that it reserved the right in due course to discontinue the provision of exchange rate cover or to bring its charges nearer to those of the market. At the end of 1958, that is before the Bundesbank commenced its forward exchange operations, the net external position of the German banks was unfavourable to the extent of DM 1600 million; that is, their short-term obligations to foreign countries were greater by this amount than their short-term claims and money-market investments abroad (see Table 8, page 93). Since in the first half of 1959 money-market rates in Frankfurt were well below those in New York and, it was possible thanks to the Bundesbank's swap transactions, to exploit this interest rate differential more than in the past, the German banks increased their holdings of short-term foreign investments so greatly that in April 1959 their net short-term position abroad was balanced and shortly afterwards showed a surplus. Indeed, by the spring of 1959 it had become apparent that the result of the Bundesbank's action in covering the exchange risk free of charge was that the higher interest rates obtainable abroad strongly attracted the liquid funds of the German banks. As this threatened to conflict

Table 8

SHORT-TERM ASSETS AND LIABILITIES OF THE BANKS<sup>1</sup> IN RELATION TO FOREIGN COUNTRIES<sup>2 3</sup>

in millions of DM

Position at end of year or month	Net assets or liabilities	Assets						Liabilities					
		Total	Balances at foreign banks and money-market paper				Short-term credits	Total	Non-residents' deposits, by depositor groups				Short-term credits
			Total	Deposits payable on demand	Time deposits	Money-market paper			Total	Foreign banks	Non-banks		
Enterprises and individuals	Public authorities												
1955	- 1 397	524	320	312	7	1	204	1 921	1 473	730	622	121	448
1956	- 2 309	715	379	362	13	4	336	3 024	2 114	1 197	733	184	910
1957	- 2 285	1 320	775	307	20	448	545	3 605	2 650	1 580	914	156	955
1958	- 1 551	1 919	1 040	431	128	481	879	3 470	2 893	1 625	1 075	193	577
1959	- 272	3 471	2 543	754	543	1 246	928	3 743	3 410	1 784	1 095	216	333
1960	- 2 526	2 368	1 315	526	410	379	1 053	4 849	3 641	1 679	1 348	308	1 253
1961	- 2 262	3 926	2 778	651	906	1 221	1 148	6 188	3 985	1 903	1 419	311	2 203
1959 March	+ 197	2 758	2 022	486	916	620	736	2 955	2 499	1 175	867	231	456
June	+ 145	3 356	2 651	542	1 219	890	705	3 211	2 893	1 474	953	229	318
September	+ 762	3 977	3 108	680	1 478	950	869	3 215	2 931	1 407	955	264	284
December	- 272	3 471	2 543	754	543	1 246	928	3 743	3 410	1 784	1 095	216	333
1960 March	- 392	3 457	2 383	746	813	824	1 074	3 849	3 380	1 741	1 085	231	469
June	- 2 002	2 279	1 192	590	260	342	1 087	4 281	3 479	1 767	1 063	346	802
September	- 2 317	2 085	1 014	489	211	314	1 071	4 402	3 324	1 626	1 152	285	1 078
December	- 2 526	2 368	1 315	526	410	379	1 053	4 894	3 641	1 697	1 348	308	1 253
1961 January	- 857	3 872	2 743	652	956	1 135	1 129	4 729	3 234	1 440	1 216	323	1 495
February <sup>2</sup>	- 141	4 317	3 106	724	1 150	1 232	1 211	4 458	3 149	1 402	1 166	333	1 309
March <sup>2</sup>	- 628	4 431	3 166	574	1 493	1 099	1 265	5 059	3 501	1 716	1 197	327	1 558
April	- 389	4 996	3 774	560	2 096	1 118	1 222	5 385	3 644	1 773	1 250	350	1 741
May	- 36	5 516	4 320	608	2 448	1 264	1 196	5 552	3 660	1 835	1 262	317	1 892
June	- 22	5 982	4 785	625	3 077	1 083	1 197	6 004	3 836	1 884	1 372	322	2 168
July	+ 387	6 587	5 296	611	3 612	1 073	1 291	6 200	3 872	1 983	1 282	317	2 328
August	+ 989	6 863	5 493	707	3 496	1 290	1 370	5 874	3 574	1 723	1 238	295	2 300
September	- 73	5 760	4 489	637	2 597	1 255	1 271	5 833	3 497	1 600	1 214	351	2 336
October	+ 343	5 893	4 674	619	2 827	1 228	1 219	5 550	3 466	1 619	1 230	304	2 084
November	+ 443	6 111	4 786	708	2 824	1 254	1 325	5 668	3 491	1 643	1 249	293	2 177
December	- 2 262	3 926	2 778	651	906	1 221	1 148	6 188	3 985	1 903	1 419	311	2 203

<sup>1</sup> Other than Bundesbank.<sup>2</sup> Figures for the period following the economic incorporation of the Saarland (6 July 1959) include the assets and liabilities of the Saarland banks in relation to foreign countries.<sup>3</sup> Assets and liabilities in foreign currency are valued at the parity rate prevailing at the end of the period indicated.

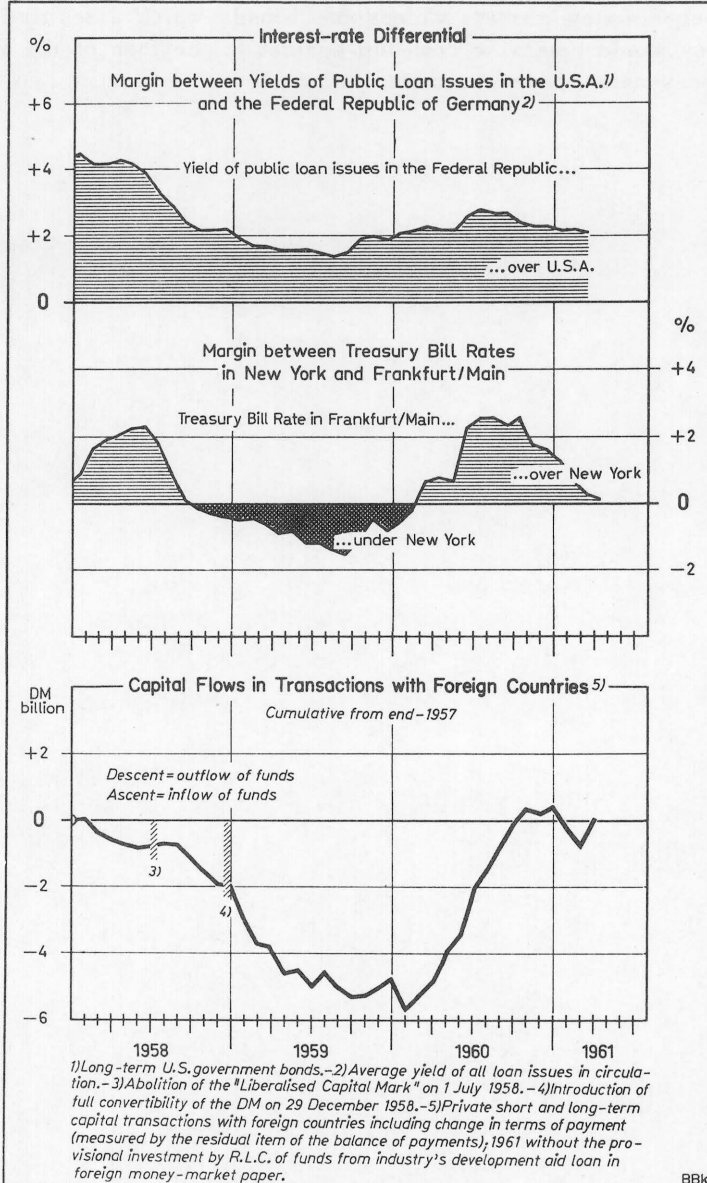
Source: Monthly Reports of the Deutsche Bundesbank.

with the Bundesbank's policy at that time, the swap rate was raised step by step until it amounted to 7/8% in July 1959 and thus reached the market rate. Shortly after this, by the end of October 1959, the Bundesbank withdrew entirely from participation in forward foreign exchange transactions. Notwithstanding this, the volume of short-term money-market investment abroad continued to expand during this period, with certain fluctuations, because the difference in interest rates – especially in comparison with the United States and Canadian markets – was still very marked (see Diagram 4, page 95). In explanation of its more cautious policy, the Bundesbank pointed out that, whatever justification there had been for maintaining its old swap rate unaltered, there was even less reason now because the liquidity of the credit institutions was under a relatively heavy strain and, if the Bank continued to encourage the export of money by maintaining low swap rates, this would probably lead to a further drain on the banks' other liquid funds, in particular on their holdings in domestic money-market paper "unless home discount rates were gradually adjusted to the level of foreign rates". When in September and October 1959 there was a change-round in German credit policy, there was no longer any reason to counteract the pull of foreign interest rates on the liquid funds of the banks; the Bundesbank therefore once more began to intervene in the forward exchange market and, after a short transition period, it once more provided facilities for U.S. dollar swaps without charging for covering the exchange risk. So long as the comparable money market rates in New York (and in other financial centres in which short-term investments could be made via the dollar) were higher than in the Federal Republic, there was still an inducement to export money or to hold on to existing investments in the foreign money market. The short-term claims and money-market investments of the banks at the end of January 1960 reached a peak of DM 4 200 million. The fall in New York rates and the restrictive liquidity policy in the Federal Republic then caused the German banks to repatriate on a fairly large scale such foreign balances and investments as were not directly required for business purposes. At the end of October 1960, the corresponding figure for claims on foreign countries amounted to no more than DM 2 000 million. The policy of relaxation which the Bundesbank had followed since the autumn of 1960 made it possible for money once more to be exported on a large scale; an additional factor which stimulated such exports was that banks were temporarily allowed to conclude U.S. dollar swaps at premiums of up to 1½% per annum above the spot rate. Moreover, from May 1961, as mentioned in paragraph 27, the banks were allowed to deduct the amount of their short-term foreign investments from the amount of liabilities subject to the minimum reserve regulations, and this gave a special stimulus to the export of money. Later in 1961, short-term interest rates in Germany approximated so closely to those abroad that the Bundesbank could begin to sell U.S. dollars to the credit institutions either at par or even at steadily widening discounts.

56. The Bundesbank's experience with swap transactions shows that it can in many ways use this instrument to supplement its internal open-market policy, it forms, as it were, a means of "fine adjustment". The assumption by the Central Bank of the cost of providing forward cover has meant that movements

Diagram 4

INTEREST-RATE DIFFERENTIAL TOWARDS  
FOREIGN COUNTRIES, AND MONEY AND CAPITAL FLOWS



Source: Annual Report 1960 of the Deutsche Bundesbank.

in foreign money rates (in relation to movements in corresponding home rates) have a direct effect on home liquidity; conversely, this effect on the domestic money market is greatly attenuated if the cost of the forward covering operations forms an obstacle to the flow of home funds to foreign countries — and if large amounts are involved these costs go up steeply. The Bundesbank's swap transactions also supplement its open-market policy to the extent that greater investment in foreign money markets widens the bounds which a restrictive open-market policy would otherwise come up against in the form of the volume of domestic money-market paper available.

## CHAPTER 5

### CASH MANAGEMENT AND BORROWING OF PUBLIC AUTHORITIES AND THEIR EFFECTS ON LIQUIDITY

57. The deposits of public authorities with banks and the Central Bank are in general very large. The most important public authorities must keep their accounts - with certain exceptions which will be referred to later - at the Deutsche Bundesbank. This obligation is the counterpart to the facility which they enjoy under the Bundesbank Act for obtaining cash credits from the Bundesbank up to certain statutory limits. Cash surpluses or deficits of public authorities, so far as they lead to increases or decreases in the balance kept at the Central Bank or to credits being taken up there, have a direct effect on the liquidity of the banking system. The great influence exerted by the accumulation of cash reserves by the Federal Government in the years 1953 to 1956 (known as the "Juliumsturm") on the liquidity of the German banking system is a matter of common knowledge. It had the effect of reducing bank liquidity, which was useful from the standpoint of the policy being followed at that time; it was indeed expressly welcomed by the Central Bank as a support of its liquidity policy. The Federal Government's cash surpluses were, however, not the result of a financial policy pursued primarily on grounds of liquidity; they arose rather from the accidental circumstance of the time-lag which occurred in the expenditure of the occupation (later NATO) authorities, and later on of the German Defence Ministry. Bank liquidity may however be strongly influenced, not only by the specific level of cash surpluses or deficits of the various public budgets, but also by the distribution of public cash reserves between the Central Bank and the outside banks, as well as by the way in which any deficits in public budgets are covered.

58. As regards the distribution of public deposits between the Bundesbank and the banks, sec. 17 of the Bundesbank Act (which is headed "Deposit Policy") gives the Bundesbank certain means of exerting an influence. This section reads:

"The Federal Government, the Special Equalization Fund, the E.R.P. Special Fund and the Länder shall deposit their liquid funds, even when cash balances are earmarked under the Budget for some special purpose, at the Bundesbank on current account. Funds shall not be deposited or invested elsewhere without the consent of the Bundesbank; in this connection, the Deutsche Bundesbank must take into account the interest of the Länder in maintaining their State and Land banks".

59. It is significant that this section appears in the part of the Act which deals with the powers of the Bundesbank in matters of monetary policy. In principle, the Bundesbank's attitude to any application for exceptions to this rule should be governed only by considerations of monetary and credit policy. Still, there is one important qualification; the Bundesbank must "take into account the interest of the Länder in maintaining their State and Land banks". This point is met by an arrangement under which, on the application of the Länder, quotas are fixed for the funds which the Länder may keep at specified institutions. Under this arrangement, in a number of Länder considerable balances have accumulated in recent years and the fact that any funds in excess of the quota figure must in any case be deposited with the Central Bank partially offsets any tendency for the liquidity of the banking system to be increased. Decisions on applications by either of the Special Funds mentioned in the section for permission to deposit funds elsewhere than at the Central Bank are made, as far as possible in the light of the liquidity position at the time. Considered as a whole, however, it will be seen that the authority in respect of monetary matters which is granted by sec. 17, is not necessarily capable of being developed into a real, flexible and convenient instrument of liquidity policy, in such a way that the cash balances of public authorities can be transferred to and from between the Central Bank and the outside banks according to the requirements of credit policy.

60. Of course, any grant or refusal of *cash advances* from the Bundesbank to *public authorities* to cover their cash deficits are of particular importance to liquidity policy, because any such advances granted by the Central Bank must directly increase the liquidity of the banking system. Sec. 20 of the Bundesbank Act gives the Bundesbank authority to grant to the Federal Government, the Länder and specified public Special Funds "short-term credits in the form of current account advances or advances in the form of Treasury bills" up to certain limits which are laid down in the Act. In the case of the Federal Government, the ceiling is DM 3 000 million; to this figure must be added special credits granted for the fulfilment of the Federal Government's obligations as a member of the International Monetary Fund and other international financial organizations. The ceilings for the Länder and the Special Funds are considerably lower; details may be found in the Act. From the standpoint of liquidity policy, two considerations are important:

a) The establishment of a ceiling does not, itself, mean that the administrations concerned have a claim to Central Bank credit up to this figure; there is no "automatic" right to borrow. The statutory ceiling represents rather the utmost limit to which the Bundesbank may go at its discretion in granting credit. It may, for reasons of monetary policy, decline to go as far as that limit. Furthermore, the ceiling may only be used for "cash advances", that is, advances for meeting temporary difficulties, but not for covering permanent budget deficits. In each specific case, therefore, agreement must be reached between the Bundesbank and the public authorities concerned as to the interpretation of this provision.

b) Resort to borrowing up to this ceiling does not necessarily lead to creation of Central Bank money. The credit ceiling can indeed be drawn upon in the form of cash or Treasury bills advances; so far as the Treasury bills are accompanied by a Bundesbank promise to rediscount them, the volume of these in circulation in the market is, under sec. 20 of the Bundesbank Act, to be regarded as utilization of the credit ceiling at the Bundesbank; this applies in principle to all Treasury bills of the Federal Government. In this way the Central Bank is able to a large extent to cover the public authorities' need for short-term credit, within the limits of the ceiling, through the money market, by seeing to the placing of the bills on the market. It should be noted that the non-interest-bearing Treasury bonds (6 to 24 months) which are issued by the Federal Government and other public authorities to cover their financial requirements are not reckoned against the credit ceiling, because the Central Bank gives no firm promise to discount them (see Chapter 3, sec. 39).



## CHAPTER 6

### OTHER WAYS IN WHICH THE BUNDESBANK MAY INFLUENCE BANK LIQUIDITY

61. Direct grants of credit by the Bundesbank to business firms (other than banks), as was customary with the former Reichsbank, are not provided for in the Deutsche Bundesbank Act. Consequently it is not possible in this way to bring any influence to bear on the liquidity of the banking system.

62. Although the so-called Directive III cannot be regarded as an instrument of liquidity policy, it can yet be looked upon as a means for the maintenance of a certain structure of liquidity at the banks. In 1951 the Bank Deutscher Länder drew up "credit directives" as a part of the conditions of business which the banks have to satisfy if they wish to have access to refinancing credit at the Central Bank. These credit directives regulate :

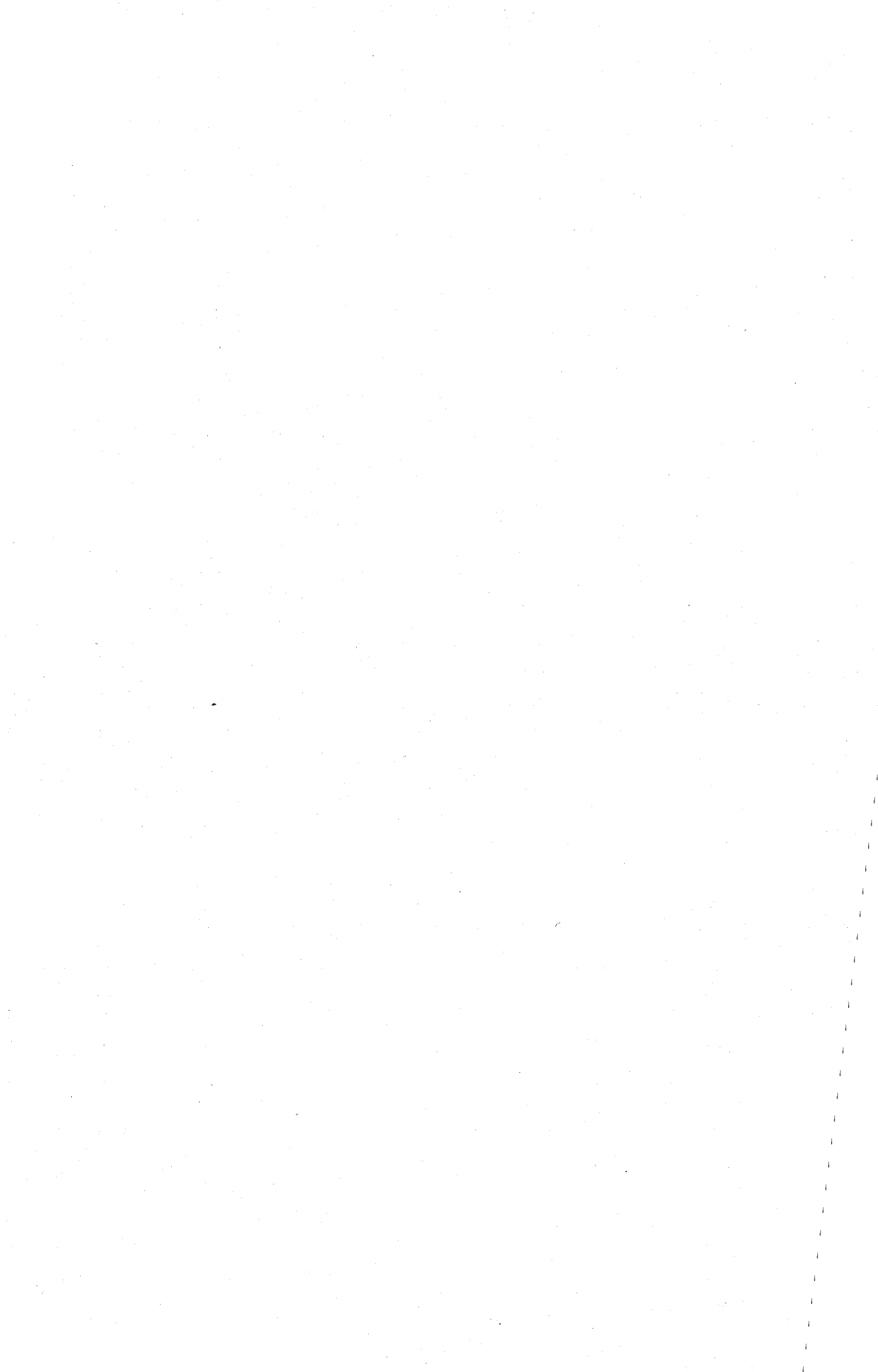
- a) the ratio of short and medium-term credits to liable funds ;
- b) the ratio of customers' borrowing to liable funds and deposits ;
- c) liquidity ;
- d) the ratio of acceptance credits to liable funds.

Table 9 on page 101 shows the current credit ratios.

63. The system of credit ratios was also incorporated in the new Act on the Credit System which entered into force 1 January 1962. This law contains general provisions dealing with banks' own capital (sec. 10) and with guarantees of adequate liquidity (sec. 11), the implementation of which lies with the Federal Supervisory Office for Credit system, by agreement with the Bundesbank and after consultation with the leading associations of the credit institutes.

**Table 9**  
**PRESENT GUIDING RATIOS IN REGARD TO CREDITS**  
(End 1961)

Guiding Ratio	Commercial Banks <sup>1)</sup>	Savings Banks	Industrial Credit Cooperatives	Agricultural Credit Cooperatives	Central Giro Institutions	Central Institutions of Industrial Credit Cooperatives	Central Institutions of Agricultural Credit Cooperatives
I	The total of the short-term and medium-term lendings to business and private customers shall not exceed 18 times the liable funds of the commercial bank. <sup>2)</sup>	The total of the short-term lendings to business and private customers shall not exceed 15 times the liable funds of the savings bank.	The total of the short-term lendings to business and private customers shall not exceed 15 times the liable funds of the industrial credit cooperative (plus the addition to these which is permitted by law).	The total of the short-term lendings shall not exceed 15 times the liable funds of the agricultural credit cooperative (plus the addition to these which is permitted by law).	The total of the short-term lendings to business and private customers shall not exceed 15 times the liable funds of the central giro institution.	The total of the short-term lendings to business and private customers shall not exceed 5 times the liable funds of the central institution of industrial credit cooperatives.	The total of the short-term lendings shall not exceed 20 times the liable funds of the central institution of agricultural credit cooperatives.
II	The debtors shall not exceed 60 per cent of the liable funds and deposits. <sup>2)</sup>	The total of the debtors plus the bills drawn on debtors shall not exceed 60 per cent of the liable funds and deposits, the savings deposits being taken at the rate of only 50 per cent.	The total of the debtors plus the bills drawn on debtors shall not exceed 70 per cent of the liable funds (plus the addition to these which is permitted by law) and of the deposits.	The total of the debtors plus the bills drawn on debtors shall not exceed 70 per cent of the liable funds (plus the addition to these which is permitted by law) and of the deposits.	The total of the debtors plus the bills drawn on debtors shall not exceed 70 per cent of the liable funds and deposits, the savings deposits being taken at the rate of only 50 per cent.	The total of the debtors plus the bills drawn on debtors shall not exceed 80 per cent of the liable funds and deposits.	No Guiding Ratio established.
III	The liquid resources shall not be less than 20 per cent of the borrowed funds.	The liquid resources shall not be less than 15 per cent of the borrowed funds, the savings deposits being taken at the rate of only 50 per cent.	The liquid resources shall not be less than 15 per cent of the borrowed funds, the savings deposits being taken at the rate of only 50 per cent.	The liquid resources shall not be less than 15 per cent of the borrowed funds, the savings deposits being taken at the rate of only 50 per cent.	The liquid resources shall not be less than 20 per cent of the borrowed funds, the savings deposits being taken at the rate of only 50 per cent.	The liquid resources shall not be less than 20 per cent of the borrowed funds, the savings deposits being taken at the rate of only 50 per cent.	No Guiding Ratio established.
IVa	The total of acceptance credits and bills drawn on debtors shall not exceed three times the liable funds.						
IVb	The acceptance credits and bills drawn on debtors, included in such credits and bills, and not serving directly to finance exports, imports or crops, shall not exceed the liable funds.						
<p><sup>1)</sup> Big banks with branch networks, state, regional and local banks, and private bankers. — <sup>2)</sup> If the position of a commercial bank in regard to Guiding Ratio I is substantially better than the standard laid down, then the Deutsche Bundesbank may take this into account in the application of Guiding Ratio II (decision of 20/21 June 1951).</p> <p><b>Remarks</b></p> <p>Any credit which a credit institution has granted to expelled persons is in principle left out of account in determining whether, and if so, to what extent, the credits granted by the institution are in accordance with the Guiding Ratios, provided that the Lastenausgleichsbank (Bank für Vertriebene und Geschädigte) — (Equalisation of Burdens Bank) — has guaranteed the credit and has placed the funds at the disposal of the credit institution. This applies also to that part of the credit on which the credit institution itself carries the commitment (decision of 11/12 April 1951).</p> <p><b>Definitions</b></p> <p><b>Liable funds:</b> These are the liable capital and reserves ("Eigenkapital") within the meaning of Article 11 paragraphs 2 and 3 of the Banking Law (Kreditwesengesetz), plus the global adjustment of values permitted under the tax laws.</p> <p><b>Debtors:</b> Credits in current account, and acceptance credits.</p> <p><b>Liquid resources:</b> Cash holdings, balances at Deutsche Bundesbank, postal cheque account balances, cheques and bills, Treasury bills and non-interest-bearing Treasury bonds of the Federal Government and the Länder, certain foreign Treasury bills and non-interest-bearing foreign Treasury bonds.</p> <p><b>Borrowed funds:</b> Deposits, monies and loans taken, own acceptances and promissory notes in circulation.</p> <p>The definitions of the Guiding Ratios conform closely with those which are in current use in the banking statistics. There are full explanations indicating which items in the form for the statistical return must be used in the calculation for the purpose of each of the Ratios.</p>							



**Part three**

**THE INSTRUMENTS OF MONETARY POLICY  
IN FRANCE**



## CONTENTS

Introductory remarks	107
Chapter 1: Structure of the banking system <i>Institutions accepting deposits of a monetary nature – Institutions accepting savings ("ressources d'épargne") – Machinery for medium-term advances</i>	108
Chapter 2: The concept of liquidity <i>The liquidity of the economy – Bank liquidity</i>	113
Chapter 3: Discount policy <i>Bank rate policy – Rediscount "ceilings"</i>	118
Chapter 4: Open-market operations <i>Legal and technical bases – The effectiveness of open-market operations</i>	123
Chapter 5: Direct action to influence bank lendings and investments: "Floors" for Treasury bills, and the special system of minimum reserves	126
Chapter 6: Direct control of bank lending to the economy	129
Chapter 7: Relations between the Treasury and the banking system <i>The various functions of the Treasury – Treasury liquidity – Interest rate policy with respect to short-term debt</i>	133

## ANNEXES

I – Balance-sheet of the Banque de France : constituent items	140
II – Development of money-market liquidity from 1956 to 1960	141

## TABLES

1 – Supply of money and near-money, and contra-items	144
2 – Liquid and short-term savings	145
3 – Short-term credit and mobilizable medium-term credit – classified by types of credit institutions	146
4 – Short-term credit and mobilizable medium-term credit – breakdown according to the nature of resources	147
5 – Short-term credit and mobilizable medium-term credit – breakdown according to financing and form of credit	148
6 – Possible recourse to the Banque de France	150
7 – Trends in Banque de France and money-market interest-rates	151

## DIAGRAM

Principal factors in the money market	152
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## INTRODUCTORY REMARKS

1. The concept of credit policy is more familiar in France than is that of monetary policy. In this study, monetary policy will be considered from the point of view of the way in which the monetary authorities manipulate the armoury of instruments available to them to control the volume and the use made, by the public and by the banks, of means of payment and liquid savings. In this sense, monetary policy will be examined from the point of view of action to influence liquidity.

It would be well, however, to outline the salient features of the French banking system before going into the question of what is to be understood by "liquidity" in France. Two introductory sections will facilitate analysis of the means of action available to the monetary authorities to influence the economy and the banks.



## CHAPTER 1

### STRUCTURE OF THE BANKING SYSTEM

2. A study of the instruments of liquidity policy in France can only be useful if it is clearly understood that the organization of this country's banking system differs from that of other countries in at least two ways :

a) by the distinction which obtains between institutions which accept deposits of a monetary nature and those which collect savings (paras. 3 to 12);

b) by the special role played by the Treasury (paras. 13 to 17).

3. Traditionally the role of the French banks is to supply short-term credit. Only exceptionally have they tried to attract savings, preferring to leave this to the institutions set up for this purpose by the State.

The tendency for French finance or banking institutions so to specialize stems mainly from historical factors. It was officially recognized in legislation passed in 1941 and again in 1945.

4. To facilitate the study of monetary policy, banking establishments can be divided into two main categories: those which work with funds of a monetary nature and those that deal with savings. A place apart must, however, be kept for institutions specializing in medium-term credit, because of the particular machinery used in this form of financing.

#### *a) Institutions accepting deposits of a monetary nature*

5. This first category includes ordinary banks and a few official institutions set up for the express purpose of supplying credit to certain sectors. Both accept deposits from their customers and use them mainly for granting short and medium-term credit to the economy.

Among the ordinary banks the *deposit banks* proper are predominant. A deposit bank cannot accept deposits for a term of more than two years, nor may it hold more than 10% of the capital of concerns other than banks or financial establishments.

The "Banques d'affaires" are entitled to carry out all the credit operations effected by the deposit banks; but they can accept deposits of a term less

than two years only if the depositors are either traders or private persons with whom they have financial relations.

Lastly, certain *semi-official institutions* are authorized, like the banks, to accept deposits from the public and to make short-term advances, but only in a given sector of the economy: credit for small and medium-sized firms ("Banques populaires"), credit for farmers ("Caisses de crédit agricole").

The ordinary banks come under the authority of the Conseil national du crédit (National Credit Council) and the supervision of the Commission de contrôle des banques (Banking Control Commission), but the semi-official institutions are subject to the direct supervision of the public authorities. Like the banks engaging in general activities, they are, however, subject to the influence the Banque de France exerts over all institutions making use of its facilities.

The greater part of short-term lending is provided by the banks proper. At the end of 1960, the total for short-term advances was NF 46920 million, including NF 37420 million for registered banks, NF 4160 million for the "Caisses de crédit agricole" and NF 2050 million for the "Banques populaires".

*b) Institutions accepting savings ("ressources d'épargne")*

6. This group includes, first of all, the "Banques d'affaires" — for that part of their business financed from their own funds or from deposits of a term of not less than two years — and the "Banques de crédit à long et moyen terme", which may not accept deposits for terms of less than two years and which make advances for a similar minimum period. The share these institutions have in banking business as a whole is, however, very small.

7. But the distribution of long-term credit is largely in the hands of a certain number of specialized institutions, which collect savings and maintain close financial relations with the Treasury; their activities are under Government control.

These institutions use their own funds, but more particularly savings deposits and the proceeds of their issues on the capital market, for the purpose of making long-term advances to industry and to private persons for purposes of industrial equipment ("Crédit national"), commercial equipment ("Caisses de crédit mutuel" and "Caisses de crédit coopératif"), agricultural equipment ("Caisses de crédit agricole"), or for housing ("Crédit foncier").

Among them, the "Caisse des dépôts et consignations" occupies a particularly important position because of the size of the capital resources it accumulates: it uses the funds deposited with it mainly by the savings banks to make direct loans to local authorities and certain public undertakings for the benefit of various sectors of business activity, among which housing is of special importance.

The total direct loans granted by the specialized institutions (from resources other than public funds) to industry and commerce stood at NF 13 750 million on 31 December 1960, and was distributed among the various institutions as follows (in NF '000 million):

Caisse des dépôts	5.94
Crédit national	1.90
Caisse nationale de crédit agricole	3.72
Crédit foncier	2.02
Other institutions	<u>0.17</u>
Total	13.75

c) *Machinery for medium-term advances*

8. Based as it is on the traditional distinction between the short and the long term, the French banking system was ill-suited to the distribution of medium-term credit, which raises special financing problems. For this reason the development of this form of credit in the last twenty years has required co-operation between the two categories of establishments discussed above.

9. Broadly speaking, medium-term advances, intended for the financing of equipment and external trade, are supplied by establishments of the first category, i.e. banks in the widest sense (ordinary banks, "banques populaires", "caisses de crédit agricole"), in the form of 90-day bills renewable up to a maximum of five years.

10. The specialized institutions classified above in the second category have two ways of participating in the financing of medium-term lending.

Some grant only a supplementary guarantee for these loans. For example, the "Caisse nationale des marchés de l'Etat" is empowered under certain conditions to give its "aval" (supplementary endorsement) to bills drawn to finance capital development expenditure in private and nationalized industry, and the "Banque française pour le commerce extérieur" gives its "aval" to medium-term loans intended to mobilize export claims.

11. The other specialized institutions participate in the provision of medium-term credit not only by authorizing the granting of advances by the banks, but also by *mobilizing* bills representing medium-term loans by discounting them for the establishments from which they originated: this is the case with the "Crédit national" (industrial equipment), the "Caisse nationale de crédit agricole" (rural and farming equipment), and the "Crédit foncier" (housing).

The financing of housing has certain special features when it takes the form of "special building loans" granted under the Act of 21 July 1950. The

loans are granted by the "Sous-comptoir des entrepreneurs", the corresponding bills are discounted at the "Crédit foncier de France", and these advances are themselves mobilizable with the "Caisse des dépôts", which also takes part in the refinancing of certain equipment loans.

12. The institutions which re-discount bills representing medium-term loans may in their turn mobilize them without limit at the Banque de France. As the banks and the specialized institutions have made great use of their scope for mobilizing medium-term bills, the discount portfolio for these bills had until recently grown steadily in the balance-sheet of the Banque de France, in pace with the issue of new bills.

In the last three years, however, the portfolio of the Banque de France has thinned out because of the limitation on the total of certain medium-term advances (building, equipment for nationalized undertakings), and also because the banks and the specialized institutions – notably the Caisse des dépôts – were able to accommodate a greater volume of medium-term bills from their own resources :

Mobilizable medium-term loans, financed by:	at 31 . 12 . 1958	at 31 . 12 . 1959	at 31 . 12 . 1960
a) the banks	0.83	4.15	2.80
b) specialized institutions <sup>1</sup>	2.33	3.23	4.51
c) the Banque de France	<u>15.03</u>	<u>11.46</u>	<u>12.85</u>
Total (in NF '000 million)	18.19	18.84	20.16

<sup>1</sup> Caisse des Dépôts et Consignations, Caisse de consolidation et de mobilisation des crédits à moyen terme, Crédit National, Caisse Nationale de Crédit Agricole, Crédit Foncier de France et Sous-comptoir des entrepreneurs, finance institutions.

From 1958 to 1960, the Banque de France's share in the financing of medium-term lending fell from 82% to 63%.

13. The *Treasury* itself exerts a direct influence on the banking system in the wide sense of the term. Its activity is not unlike that of an ordinary bank, since it accepts sight deposits from, and makes loans to, private persons and industry.

14. The Treasury collects deposits from the public through the post offices ("Comptes chèques postaux") and over the counters of its own agencies ("Fonds particuliers"). The post office facilities provide the public with a far greater number of points where they can make payments than do the banks (17 000 as against 4 000), which explains why this Treasury item is assuming growing importance in the overall money supply: the proportion grew from 5.3% in 1946 to 11% in 1960. Cash deposited with the Treasury represents more than a fifth of all sight deposits.

15. The Treasury also takes part in the creation of "near-money" by tap issues of bills, designed to absorb the short-term savings of firms and private persons. They are of two types. Fixed term bills are for one year, two years, and – since June 1961 – five years, with the option of redemption at the end of the third year. Progressive interest bills are for a maximum period of three years, but are repayable on demand three months after subscription; despite the fact that these bills are therefore almost immediately convertible into cash, their total remains in practice very stable.

16. The Treasury also participates in economic activity as a short and medium-term lender to industry and to private persons.

It makes equipment loans to firms in various sectors of the economy (energy, agriculture, industry, transport, trade and tourism). These loans are distributed, under appropriations included each year in the Finance Law, to the "Fonds de développement économique et social" (FDES) either directly by the Treasury or through certain specialized credit institutions ("Crédit national", "Caisse nationale de crédit agricole", co-operative credit institutions).

It encourages housebuilding by making loans at low rates of interest to institutions concerned with low-cost housing (H.L.M.), and it takes part in the funding of special housing loans by granting advances to the "Crédit foncier".

The scale of medium and long-term Treasury lending emerges from the following table, which shows the breakdown by financing institutions of all non-mobilizable medium and long-term loans extended in Metropolitan France. It will be seen that the Treasury finances about 70% of the total:

Totals at the end of the year in NF '000 million

	1958	1959	1960
<i>1. Treasury loans</i>			
a) Loans by the FDES	13.25	15.84	18.38
b) Loans to institutions concerned with low-cost housing (H.L.M.)	7.23	9.26	11.24
c) Advances to the "Crédit Foncier" for funding of special housing loans	<u>0.68</u>	<u>2.33</u>	<u>3.63</u>
Total of Treasury loans	21.16	27.43	33.25
<i>2. Loans by the specialized institutions</i>	<u>8.03</u>	<u>10.16</u>	<u>13.75</u>
<i>Total non-mobilizable medium and long-term loans (1 + 2)</i>	29.19	37.59	47.00

## CHAPTER 2

### THE CONCEPT OF LIQUIDITY

17. The concept of liquidity can be considered from two points of view. In its broad sense it covers the notion of *liquidity of the economy* and corresponds to the volume of the money supply in its widest sense. As *bank liquidity*, however, it refers only to bank holdings of notes and coin and deposits at the Central Bank (cash liquidity), and the banks' possibility of recourse to credit from the Central Bank (potential liquidity).

#### *a) The liquidity of the economy*

18. As in other countries, the expression "liquidity of the economy" has no precise and generally accepted definition. In the narrow sense, it corresponds to what is known in French terminology as either "disponibilités monétaires" or "masse monétaire", i.e. all means of payment formed by coin, banknotes of the Banque de France and sight deposits (in all, "money supply"). To these money resources thus defined in the narrow sense ("primary liquidity") may be added time deposits at banks and easily realizable savings, i.e. the whole of what is sometimes called the "secondary liquidity" of the public.

19. Trends in the liquidity of the economy as defined above can be followed in quarterly tables published by the Conseil national du crédit. They show fluctuations in notes and coin in circulation plus sight deposits and their contra-items (see Table 1), and fluctuations in "liquid and short-term savings" (see Table 2).

It will be noted that "disponibilités monétaires" in the narrow sense includes within the item "sight deposits", not only deposits with the banks and with the Banque de France, but also those of private persons and industry with the Treasury, either deposited directly at its agencies ("fonds particuliers") or deposited in the French postal cheque system.

The total of the items in the table entitled "supply of money and near-money, contra-items" represents the "primary liquidity of the economy".<sup>1</sup> The Banque de France adds under the heading "time deposits" and "special accounts"

<sup>1</sup> It includes, however, only the bank deposits of private persons and industry, deposits with the French postal cheque service and with the agencies of the Treasury. It includes neither those of local authorities nor those of the "correspondents of the Treasury". Nor do the figures published give any breakdown as between residents and non-residents.

(comptes spéciaux) the time accounts accepted by the banks, the "bons de caisse" with a fixed date issued by the banks, and the savings accounts with deposit books, taking the view that although these are "secondary liquidity" not immediately usable, they constitute additional resources, helping to bring total liabilities into equilibrium with total assets. In addition, fairly substantial transfers may take place between demand accounts and time accounts, with the result that the fluctuations within one or other of the categories lose all significance outside the general development of bank deposits.

20. The table concerning liquid and short-term savings (Table 2) covers:

- a) Time deposits at banks, and "bons de caisse" issued by the banks, and the "comptes d'épargne" (special accounts),
- b) Treasury bills issued to the public – private persons and industry. This category must be distinguished from bills ("bons en comptes courants") issued on the money market and held mainly by the banking system,
- c) Deposits in savings banks (with no limit on withdrawals),
- d) Lastly, the proportion of the three and five-year bonds and debentures of the "Caisse nationale de crédit agricole" subscribed by the public.

21. On the basis of this information it is possible to draw up tables showing the trends of primary and secondary liquidity outside the banking system, comparable with those used by the Nederlandsche Bank, or a consolidated balance-sheet of the entire banking system of the kind published by the Bundesbank. The research department of the Ministry of Finance goes so far as to make a detailed study of the financial operations affecting each of the sectors dealt with in the national accounts. It is not possible, however, for the results to be published soon enough or often enough for them to be used in analysing current trends.

22. *The contra-items of the supply of money and near-money* comprise three elements which are headings in the table drawn up by the Conseil national du crédit. Gold and foreign exchange, claims on the Treasury, credit by the banking system to the economy.

The first heading traces the movement of the balance of those items which, in the Banque de France's return, reflect the trend in exchange reserves. It does not include the banks' foreign currency holdings and commitments, which are not evident from their balance sheets.

Claims on the Treasury are held respectively by the banking system and by private persons and industry. Those of the banking system correspond:

- a) for the Banque de France: to its loans and advances to the Government, to its holdings in the postal cheque system; to coin it has received from the State and has not yet put into circulation, to tax and duty certificates known as

"obligations cautionnées", and other Government paper (Treasury bills and, until 1955, paper concerning public expenditure which the Banque has discounted or bought "en pension" (i.e. under an agreement to resell to its former owner);

b) for the banks : to the Treasury bills subscribed or discounted by the banks.

The claims of private persons and industry on the Treasury – this time on the assets aide – are divided into three categories of assets already mentioned in the breakdown of the money supply ; credit balances of private persons and industry in the postal cheque system ; their credit balances with direct agencies of the Treasury ("Fonds particuliers des comptables"), and lastly the total of till money.

The third contra-item to the money supply corresponds to credit to the economy<sup>1</sup> from the banks and the Banque de France in the form of short-term credits and mobilizable medium-term advances. It can be broken down by categories of credit institution (Table 3), according to the financing of credits and the form they take (Table 5), and, lastly, according to the nature of the resources (Table 4).

From this last point of view, the operations of specialized institutions, which, particularly in the case of medium-term credit, work alongside the banks by appropriating for the financing of such credit part of the savings they receive, explain the discrepancy between the volume of lending to the economy as indicated in the table of contra-items and that shown in the two above-mentioned tables.

#### *b) Bank liquidity*

23. The liquidity of the banks in France consists less in practice in "liquidité de trésorerie" proper, i.e. in notes and coin, deposits with the postal cheque system or with the Banque de France, than in the possibility for recourse to credit from that bank in accordance with its rules.

In the absence of a genuine system of compulsory reserves blocked with the Central Bank, the banks tend to keep to a minimum their cash liquidity (coin, notes, balances with the post office) and their balances with the Banque de France – all unproductive – so that they only maintain in this form the "float" needed for their daily operations. For many years the "cash liquidity" of the banking system has been a bare 2.5% of the assets of banks as a whole.

24. The real bank reserves, or "potential liquidity", lie in the recourse the banks may have to the Banque de France, which assists them either (a) by

<sup>1</sup> i.e. business concerns and individuals. Except where otherwise indicated, the expression has the same definition throughout this study.



discounting or by its money-market transactions – purchasing outright or "en pension" short-term private or Government paper and long-term paper or (b) by means of 30-day advances against the deposit of Government paper (see Table 6).

The potential liquidity of the banks does not include short-term claims on foreign countries. The banks, if they are authorized intermediaries ("intermédiaires agréés"), do no more than effect the exchange transactions requested by their customers, on behalf of the Exchange Stabilization Fund. Thus they do not, strictly speaking, maintain foreign exchange portfolios. Nor are they authorized to convert into francs the currency they borrow from their own foreign correspondents.

25 The fluctuations of bank liquidity can be followed in the light of those of the money market, which is defined in France as the market for liquidity in the form of Central Bank balances. It is a market formed by holders of current accounts with the Banque de France (i.e. mainly the banks, finance institutions and the Treasury), who daily balance out their temporary cash surpluses and requirements. Private persons and businesses do not have access to this market. The equation of the supply of and demand for funds is facilitated by specialized intermediaries: brokers, who are simply the point of contact, and rediscount houses, which act as contracting parties, both for borrowers and for lenders.

The market is strongly influenced by the operations of the Banque de France, which ultimately balances the market by supplying liquidity where it is lacking or by resorbing surpluses at the end of the day.

26. The main factors in bank liquidity are those which determine the expansion or the contraction of the banks' liquid assets on the money market and the fluctuations in their scope for recourse to the Banque de France: gold and foreign exchange movements, notes in circulation, Treasury operations.

These factors, which it is possible to study in the balance-sheet of the Banque de France (see diagram in Annex), reflect the play of independent forces which directly affect the banks.

The public's needs in notes and coin and the external payments balance are the result of current economic trends and psychological factors. The monetary authorities themselves can only influence these factors in the longer term, acting by an appropriate credit policy on the business situation which determines them.

The volume of the banks' liquid deposits at the Central Bank varies according to whether their business leads them to require the Bank to supply or accept banknotes or foreign currency. The total volume of this liquidity remains unchanged and the money market tends to balance automatically, if the movements of foreign exchange and banknotes cancel each other out, for example if the balance of payments shows a surplus equal to the increase in the note circulation.

In fact, the movements of foreign currency and of notes in circulation have for long periods in the past tended to produce a chronic drain on liquidity in the French money market. An expansion in the note circulation larger than that of most other countries has often been coupled with a deficit, sometimes a heavy one, on the balance of payments. The resulting net liquidity requirements have obliged the Treasury and the banks to resort to the bank of issue, and this aid now constitutes the greater part of that bank's assets. For this reason short-lived liquidity surpluses are normally used for the partial amortization of loans previously granted by the Bank. This is why trends on the money market are reflected in the movement of bank indebtedness to the Central Bank far more than in the fluctuations in the banks' credit balances with the Central Bank, which are regularly levelled out.

Treasury operations (the Treasury does not maintain deposit accounts with the banks) constitute a third factor which affects liquidity and which is beyond the control of the banks: all transfers of funds between the banks and the Treasury are immediately reflected in their current accounts with the Central Bank. The fluctuating cash position of the Treasury has an effect of expanding or contracting bank liquidity which is additional to that of movements of foreign currency and of the note circulation, so that it becomes an important factor in the money market, outside the control of the banks and in relation with which the Central Bank must plan its interventions.

An explanation of the various phases in the development of the money market from 1956 to 1960 will be found in Annex II.

27. It was only in the post-war period that French monetary policy turned towards influencing bank liquidity, with the aim of exercising quantitative control over the distribution of credit.

The main instrument of monetary policy has continued to be Bank rate, or more precisely Bank rate policy, by which the Central Bank can either exert a general effect by varying the cost or the volume of rediscounting or can act selectively by varying the rates for different classes of credit.

Central Bank intervention in the open market is of secondary importance in policy designed to control overall bank liquidity. It is intended only to level out spasmodic fluctuations on the money market, not to bring about substantial or lasting variations in the volume of this liquidity.

Control over the volume of bank liquidity was strengthened in 1948 when minimum holdings of government paper ("planchers") were introduced at the same time as rediscount ceilings. Additional machinery was created in 1960 in the shape of a special system of minimum reserves ("coefficient de trésorerie").

Lastly, it is impossible to understand the Central Bank's influence over bank liquidity without taking account of the special part played by the Treasury in the French monetary system.

## CHAPTER 3

### DISCOUNT POLICY

28. Combining as it does opportunities for both quantitative and selective control, discount policy is still today one of the key instruments of French monetary policy. However, its use as a general instrument for influencing bank liquidity is a relatively recent innovation which has emerged with the development of post-war disinflationary policies.

The Central Bank's discount policy is bound to be of great importance in a country in which about 80% of the banks' credit to the economy takes the form of the discounting of commercial bills.

As in other Common Market countries, the Central Bank's influence on the banks with respect to rediscounting is traditionally made easier in France by the commercial banks' dependence on the Banque de France, due to the high proportion of paper money in the total money supply. Despite a long-term tendency for sight deposits to expand, banknotes in circulation still represented at the end of 1960 almost 40% of the total money supply, time deposits, "bons de caisse" and special accounts.

For this reason, when any bank expands its lending it finds itself obliged to cope with a proportionate demand for banknotes and other things being equal, this compels it to seek the aid of the Central Bank and so brings it under that Bank's control.

#### *a) Bank rate policy*

29. Manipulation of Bank rate was for a long time the only way of controlling the supply of credit in France. Because the banks in the post-war period have been almost constantly "in the Bank" – which itself holds more than a fifth of the short-term paper held by the banking system – any variation in Bank rate makes itself felt in the banks and, through them, in the cost of bank advances to the economy. This makes Bank rate an important weapon in monetary policy and explains why the authorities have altered it seventeen times since 1945.

The close connection in France between short-term rates of interest and the Central Bank's discount rate is brought out in two different ways :

30. 1. From the point of view of finance for the banks, the rediscounting of bills by the Central Bank is of essential importance for making available to them liquid funds. It thus sets a guiding rate for the money market, where liquid resources change hands. The size of the commitments of money market operations to the Central Bank explains why the rates at which transactions take place depend closely on the rates charged by the bank of issue for refinance.

At times when liquidity in the money market is plentiful, the banks have substantial margins for rediscounting and avoid borrowing on the market at a higher rate than that charged them by the Banque de France; the call money rate therefore tends to fall in line with Bank rate. When, on the other hand, a tight cash position forces the banks to exhaust their rediscount margins, the market rates rise above the official discount rate.

31. 2. With respect to the cost and volume of bank credit from the standpoint of the borrowers – individuals and business – the influence of Bank rate stems mainly from the close link between the official discount rate and the rates of interest charged by the banks. Interest rates charged to borrowers have been gradually linked with Bank rate, though it should be noted that this remark concerns minimum rates, and the actual rates are based on the bank's estimates of the risk involved in each operation. The minimum official rates, fixed by the Conseil national du crédit, comprised two parts: a basic component equal to Bank rate, and various commissions. Variations in Bank rate were thus reflected fully in the minimum rates applicable to the ordinary banks' advances.

In December 1959 the monetary authorities, in an attempt to make Bank rate more effective as a policy instrument, established a new definition of the basic rate, which then became distinct from the Central Bank's rate, where the latter was below 3.5% or above 4.5%. Whenever in future Bank rate passes beyond these limits, the basic rate used to settle minimum terms for customers will only be altered by half the difference between Bank rate and 4.5% or 3.5%, as the case may be. The result is that when money is dear and Bank rate is above 4.5%, the banks will, in principle, be encouraged to scale down their commitments to the Central Bank, and consequently the volume of their advances, more drastically than in the past, when they were able to pass on any Bank rate increases to their customers in full. Conversely, when money is cheap, the cost of bank advances will fall more slowly than the official discount rate and the banks will be encouraged to increase their aid to the economy, since re-discount operations will leave them a wider profit margin than under the previous system. These new arrangements should normally cushion the impact on industry of adjustments in Bank rate intended to influence the banks' willingness to make new advances and the scale on which they may do so.

32. By charging selective rates, discount policy can encourage certain forms of credit or certain sectors of the economy and can be linked up with the requirements of foreign trade, re-equipment and reconstruction.

For example, the Banque de France decided in 1947 to reserve ordinary discount rate for commercial bills and government paper. Other paper representing debt not connected with a commercial operation was to be discounted at a half per cent more.

In September 1948, however, the Banque de France returned to the principle of uniform rates. But there has been one exception to this principle since April 1957 and it concerns export credits : export drafts have been rediscounted since then at a stable rate below ordinary Bank rate. This special rate has remained at 3% whereas the discount rate charged on other advances has been changed several times and was 5% from the middle of 1957 to the autumn of 1958.

#### *b) Rediscount "ceilings"*

33. But Bank rate policy is designed above all to exercise quantitative control of credit by acting on bank liquidity : manipulation of Bank rate is not effective enough to curb the demand for bank credit in times of rising prices, or to restrain the supply of credit if bank liquidity is plentiful.

The regulations concerning *rediscount ceilings* brought into force in September 1948 constitute the main instrument for influencing bank liquidity in this way.

Even before this date most of the banks had been assigned a rediscount ceiling by the Banque de France. The purpose of the measure had, however, been solely that of preventing each institution considered separately from resorting to accommodation to an extent not warranted by its size or in particular by its own resources. The very large banks, which could have extensive recourse to the money market and, broadly speaking, made very little use of Central Bank rediscount facilities, were not affected by this rule.

34. From the moment that it seemed necessary to keep the rediscount portfolio of the Banque de France below a certain limit, the monetary authorities decided to fix a rediscount maximum for all institutions and to suit the aggregate of the ceilings to changes in the business trend. The ceilings were fixed for each bank by the Banque de France on the basis of its information on the requirements of each.

From 1951 to 1957, their total rose gradually from NF 1850 million to NF 6200 million. In June 1957, the Banque de France decided to lower these ceilings by 20%, in two steps of 10% each with effect from 10 July and 10 August of the same year, to offset the inflationary effects that might result from advances it was being obliged to make to the Treasury at the same time. A further reduction decided on in November brought the ceiling down to 65% of the total prior to 10 July. The Banque de France has granted since then, in 1960 and in the first quarter of 1961, a number of increases to allow for developments in

the structure of certain banks, and the rediscount ceilings now total approximately NF 6 000 million.

Originally, the ceilings imposed separately on each institution represented the maximum permitted recourse as at the end of each month. Between any two of these reference dates, the banks could therefore obtain funds above their credit ceiling which they would have to repay by the end of the month. This loophole had the effect of making end-of-month settlements increasingly difficult, and of obliging the Banque de France to increase its assistance to the money market.

Thus, from 1951, the Central Bank declined to continue supplying banks which had reached their ceiling with the additional liquid funds they needed, save by taking their bills "en pension" at rates higher than normal Bank rate. As applied to discounts granted beyond the ceilings within a margin of 10% of these ceilings or for accommodation exceeding this limit, these penalty rates are known respectively as "taux d'enfer" and "taux de super-enfer".

This innovation has the effect of imposing on banks exceeding their ceilings a penalty they have to pay without being able to pass it on automatically to their customers. By altering the rates on several occasions, the Banque de France has varied the severity of this penalty according to the situation.

35. The fixing of rediscount ceilings would have lost its point if the banks, disposing as they did at the end of the war of a large portfolio of Treasury bills, had been left free to rediscount them with the Central Bank or not to renew them on their maturity. The banks were therefore called on at the same time to retain a minimum portfolio of Treasury bills. The imposition of "floors" ("planchers") for government paper, which will be described in Chapter 5 below, is an automatic restraint on the volume of loans the banks can make to their customers.

36. The banks have nevertheless several "safety valves" which enable them to mitigate the effects of the measures mentioned above on their liquidity.

To obtain liquid funds, they can, firstly, apply to the Banque de France for discount of Treasury bills they hold exceeding the obligatory minimum, when these bills are within three months of maturity: the Bank discounts them at a fixed rate. In practice, however, their opportunities are, for two reasons, somewhat limited. In the first place the play of short-term rates has induced the banks in recent years to keep only the smallest possible volume of "free" bills above the obligatory minimum - their total holding of "free" bills was more in the nature of an irreducible "strategic reserve" (masse de manoeuvre) than a genuine liquidity reserve. In addition, the Banque de France, which since 1958 has no longer been required to discount automatically the "bankable" Treasury bills of the banks, decided on 16 December 1960 to make discounting of this paper subject to prior agreement: this discounting of Treasury bills maturing in less than three months was until then theoretically part of open market policy,

but the fact that it was automatic deprived it in reality of any effectiveness. In making it subject to prior agreement, the Banque de France has reassumed the initiative in this field and can thus influence the liquidity of the market.

But the real safety valve lies in the facilities for mobilization "hors plafond" (exempted from the ceiling) of certain paper carried by the banks.

The banks are free, first of all, to rediscount without any limitation their portfolio of export drafts of a currency of less than two years, and this also applies to their portfolio of bills guaranteed by the "Office national inter-professionnel des céréales". Bills of this second category, drawn by the storage agencies, are endorsed with an "aval" by the "Office des céréales" and presented for rediscounting to the Banque de France, either by the "Caisse nationale de crédit agricole" for bills drawn by the official co-operatives, or by the banks for bills drawn by the independent co-operatives.

In particular, the banks are free to mobilize without any limit their medium-term paper. They can do this through the "Crédit national" or the "Caisse des dépôts", since both these institutions are in their turn entitled to rediscount this paper with the Banque de France.

From the point of view of control of bank liquidity, the freedom to rediscount medium-term paper without restriction gives the banks back part of the room for manoeuvre they lost when the machinery of rediscount ceilings was instituted. In periods when their liquidity is contracting, the banks will tend to mobilize medium-term paper automatically without holding it themselves; the "safety valve" then becomes fully effective to an extent corresponding to the pace at which this kind of credit is created.

When, on the other hand, the banks' cash situation is favourable, the banks will tend to keep medium-term paper in their portfolios – its mobilization generally costs them more than does that of ordinary paper – rather than to take back this ordinary short-term paper from the Central Bank.

As will be seen below in Chapter 5, the efficacy of these safety valves was curtailed at the end of 1960 by the institution of the "coefficient de trésorerie" (a special system of minimum reserves).

## CHAPTER 4

### OPEN-MARKET OPERATIONS

37. The use of the open-market technique as a means of influencing the money market presupposes certain conditions which do not obtain in France, in contrast to certain other Community countries. The Central Bank's interventions generally have more modest objectives and play only a secondary part in the control of bank liquidity.

#### *a) Legal and technical bases*

38. Intervention by the Banque de France on the free market was permitted only relatively recently. On 17 June 1938 a Decree-Law empowered the Banque de France, "for the purpose of influencing the volume of credit and regularizing the money market", to purchase on the open market, within the limits and under the conditions fixed by the General Council of the Bank, short-dated negotiable Government securities and discountable private bills and to resell the same without endorsement.

The operations of the Central Bank on the open market cannot therefore concern long-term securities. They concern solely:

1. Treasury bills;
2. certain short-term bills (S.N.C.F. bills, bank acceptances, bills guaranteed unconditionally by the "Caisse nationale des marchés de l'Etat", and export paper backed by a bank "aval");
3. Short-term export drafts.

As the regulations forbid the deposit banks to accept from the public deposits for a term exceeding two years, the banks, following a cautious and traditional policy, do not invest in long-term securities as a counterpart to their deposits and therefore do not deal on the market in long-term paper either among themselves or with the Central Bank.

This long-standing abstention of the French banks from operations in long-term securities tends to keep the money market separate from the capital market, and limits the opportunities for adjusting the capital needs of the two categories of market: the French money and capital markets are for this reason less closely interdependent than is the case in other countries.



*b) The effectiveness of open-market operations*

39. The scope for intervention by the Banque de France on the money market in order to influence the liquidity of the banking system is not, then, very extensive.

The paper held by the Central Bank as a result of its intervention on the money market is shown in its balance-sheet under the heading "negotiable paper purchased in France". The total value of the portfolio of negotiable paper held by the Bank has for some years been within the range of NF 2 000 million to NF 3 000 million, this last figure being rarely exceeded. These relatively small figures bear witness to the secondary role played by open-market operations in France.

The limited nature of the operations is borne out in particular by the volume of the Bank's purchases of Treasury bills: in the ten years from 1948 to 1958 the volume of short-term government paper held by the Banque de France remained virtually unchanged, whilst the portfolio of these securities held by the banks increased during the same period by nearly NF 5 000 million.

Moreover, open-market operations were used in France mainly in one direction, since this was a period in which the market suffered almost constantly from a shortage of liquidity. Purchases of Treasury and other paper by the Banque de France were merely slowed down or speeded up according to the needs of the moment.

40. The purchases of the Banque de France are made either outright or "en pension". Their purpose varies according to the section of the money market – government paper (Treasury bills) or private paper – they affect.

On the Treasury bill market, the Banque de France intervenes mainly with outright purchases. It generally charges a fixed rate for discounting "bankable" Treasury bills – purchases of which ceased to be compulsory in 1958 – and the market rate when its operations concern bills with currencies exceeding three months. Its operations thus tend to facilitate the rotation of the banks' portfolios and the adjustment of maturities within these portfolios.

On the other hand, on the private bill market – which has for several years been the real call money market – the Bank's intervention solely takes the form of very short-term "pensions" (usually one day), at a fixed rate, in fact at Bank rate. The purpose of these operations is to ensure equilibrium on the very short-term money market without influencing the underlying trend. Broadly speaking, they swell very rapidly at the end of the month, only to subside just as quickly immediately afterwards.

The practice of taking private paper in pawn ("en pension") was gradually introduced from 1948 to 1951 to give more flexibility to the policy of limiting

rediscount; in October 1951, it was feared that these new opportunities might aid circumvention of the regulations in force and "limits" were fixed for each institution on dealings in private paper on the open market.

However, the Banque de France purchases outside the "limits", and on terms near to discount rate, the bank acceptances or "avals" covering export drafts, where these have a currency of less than two years. These purchases, which are made at the preferential rate of 3%, have assumed considerable importance in recent years.

The Banque de France's operations on the open market are thus essentially technical and marginal in character. Their effect is no more than that of supplementing on the money market the main operations carried out by the Central Bank to influence the volume of bank liquidity by what is the traditional channel in France, that of the rediscounting of commercial bills.

## CHAPTER 5

### DIRECT ACTION TO INFLUENCE BANK LENDINGS AND INVESTMENTS: "FLOORS" FOR TREASURY BILLS, AND THE SPECIAL SYSTEM OF MINIMUM RESERVES

41. The nature of the monetary and banking structure in France and the effectiveness of discount policy have obviated the need for a system of minimum reserves such as that in force in the United States and, of more recent date, in Federal Germany and in the Netherlands.

As organized in these countries, the machinery of minimum reserves consists in obliging the banks to make deposits with the Central Bank up to a minimum total calculated as a percentage of their current liabilities.

The need for a system of reserves in its strict form has not been felt in France because of the close dependence of the banks on the Central Bank. In addition a system of "floors" ("planchers") for government paper has been organized since 1948, which, supplemented in 1960 by the regulations introducing a special system of minimum reserves ("coefficient de trésorerie") exerts on bank liquidity an effect similar to that exerted by minimum reserves.

42. The obligation for the deposit banks to comply with a "liquidity ratio" ("coefficient de liquidité") serves requirements other than those of monetary policy. According to this rule, the deposit banks' liquid holdings – i.e. till money, balances with the Treasury, with the postal cheque system and with the Central Bank, Treasury bills, paper mobilizable at the Central Bank and negotiable securities – must represent at least 60% of the sight and short-term (up to three months) liabilities of the institution concerned. This provision was devised simply as a safety rule to ensure that depositors will be able to withdraw their money at any time. It has none the less helped the Banque de France in its control over the banks' credit policy, since the Banking Control Commission, which has the task of seeing that these decisions are complied with, allows finance bills (as opposed to commercial bills) to be included in the calculation of this ratio only if they are eligible for rediscount at the Banque de France.

43. Under the rule concerning minimum holdings of government paper established in 1948 to ensure effective working of the machinery of rediscount "ceilings", the banks are compelled to retain the portfolio of Treasury bills they held on 30 September 1948, and 20% of any increase in deposit liabilities since that date has to be invested in Treasury paper.

At that time this obligation only confirmed the actual situation, because of the large portfolio of Treasury bills held by the banking system. At the end of 1948 the "reserve" thus blocked in government paper represented in practice an average of 28% of bank deposits. Later this proportion declined a little and it was officially fixed at 25% when the methods of calculating the "floors" were revised in 1956. Thereafter, a quarter of any increase in deposits in the banks was automatically placed in Treasury bills, with allowance for a time lag while the banks adjusted their holdings.

The "floors" device in the form it was given strengthened the means of action open to the monetary authorities, whilst shielding the Treasury from any sudden unloading of the short-term public debt held by the banking system.

44. The technique of "floors" for government paper and rediscount "ceilings" seemed an adequate means of controlling the volume of credit in the ten years from 1948 to 1958, when bank liquidity was under almost continuous strain except in 1954 and 1955.

But thanks to very heavy inflows of foreign exchange following a recovery in the balance of payments, the banks accumulated heavy reserves of liquidity in medium-term bills in the course of 1959 and 1960, i.e. in bills rediscountable with the Banque de France outside the ceilings. At the beginning of 1960, the portfolios of medium-term paper held by the banks totalled about NF 4 000 million. The scale of this potential run on the Banque de France meant that the monetary authorities might not be able to defend themselves if there were to be an excessive expansion of demand for credit.

45. They therefore felt impelled to supplement the arrangements to block a proportion of bank holdings.

On 6 October 1960, the Conseil national du crédit decided to institute a special system of minimum reserves ("coefficient de trésorerie"). It was designed to oblige the banks to finance for themselves, from their own current resources, part of the advances which, under the regulations in force until then, were exempt from the system of rediscount ceilings.

Technically, the "coefficient de trésorerie" compels the banks to maintain a minimum relationship between certain components of their liquid or mobilizable assets and certain components of their sight or time liabilities.

The denominator of the coefficient comprises the same components from the liabilities side as those selected for the calculation of government paper "floors" - i.e. broadly speaking, the banks' current liabilities - whilst its numerator comprises the following components of the assets side:

a. Liquid holdings (till money, balances with the Banque de France and the postal cheque system);

b. Treasury bills (including those held under the regulations concerning "floors");

c. Paper mobilizable with the Banque de France above the "ceilings", i.e. medium-term paper, bills backed by the "aval" of the "Office des céréales", and short-term export drafts.

By making the "floors" system one of general application, this new machinery gives the monetary authorities the possibility of influencing bank liquidity without unduly straining the profit and loss accounts of the banks, since the latter continue to earn income on the asset components included in the "coefficient".

46. The Banque de France fixes the rate of the "coefficient de trésorerie" within the limits settled by the Comité des dépôts du conseil national du crédit - i.e. at present between 35% and 15%.

The "coefficient de trésorerie" was brought into force as from 21 January 1961 and was fixed at 30% by order of the Banque de France. It was raised to 32% as from 28 February 1962. As a result of a decision of the Ministry of Finance, the ratio of Treasury bills to liabilities was lowered, within the coefficient, from 25% to 20%. Easy conditions at the Treasury led to a further reduction in the rate of the "floors" for Treasury bills: it was brought down to 17 ½% on 30 June 1961 and to 15% from 31 March 1962.

The reductions in the rate of the "floors" within the "coefficient de trésorerie" has the automatic effect of blocking an equivalent additional amount of medium-term paper in the banks' holdings.

The entry into force of the "coefficient de trésorerie" did not lead to an immediate reduction in the liquidity of the banks, since the percentage had been deliberately fixed at a level which "froze" the current situation. But in the future manipulation of this rate may give the monetary authorities an effective instrument for preventing any heavy increase in bank liquidity from engendering an excessive rise in lending to the economy, just as, conversely, it might be used to avoid too steep a decline in the volume of this lending as a result of a tightening of the cash position of the banks.

## CHAPTER 6

### DIRECT CONTROL OF BANK LENDING TO THE ECONOMY

47. The direct control of lending to the economy seemed, just after the war, a natural concomitant of the policy of Government intervention in economic life. It was used first of all to keep the distribution of financial resources between the different sectors reasonably in line with the real resources available, and it was used later to facilitate the execution of the reconstruction and modernization programme undertaken under the Monnet Plan. Its importance declined gradually after 1948 as facilities for direct action to influence bank liquidity were introduced. It nevertheless still plays a decisive part in certain classes of financial operations (medium-term and hire purchase finance).

48. Such direct intervention has only been made possible thanks to the detailed information network provided for the Conseil national du crédit by the "Service central des risques". This service was set up in March 1946 and reorganized in 1948. It is managed by the Banque de France and has a twofold aim: that of giving the monetary authorities information on the distribution of credit among about a hundred branches of activity and that of advising the banks as to the total credit granted to any given firm. The banks are required to provide monthly returns detailing the credits opened in favour of these firms, and the amounts actually drawn, whenever the credits opened exceed NF 100 000 for discounts of commercial bills proper and short-term paper guaranteed by the "Caisse nationale des marchés de l'Etat", and NF 50 000 for credits of any other kind. The proportion of credit thus brought under census in comparison with all bank credit has grown from 45% in 1946 to about 85% today. The "Service central des risques" and its local offices advise the banks each month automatically of the credits opened and taken up, by category, in the name of each of the customers for whom a declaration has been made. It is forbidden to divulge any of this specific information to third parties. By the same procedure a half-yearly statistical breakdown makes it possible to evaluate certain categories of credit (indirect discounts, export credits) which are not segregated in the monthly declaration.

49. This instrument has enabled the authorities to influence directly the volume of credit in any given sector of business or commercial activity. For example, the banks have on several occasions been called on to cut their lending for the stocking of wines (1948 to 1950 and 1957 to 1958), to the leather industries (1948) or on the other hand to grant more liberal advances to the livestock industry (1949), or for exports. These measures were taken in different ways ranging from a mere recommendation to a ban on all lending.

A different and much more generalized form of intervention has been practised when banks had been asked to take into consideration, before granting advances, not only their customers' solvency but also the usefulness of the loan to the economic life of the country as a whole, and the question whether the money asked for is essential. The effect of these instructions has been strengthened by the obligation imposed on the banks to request from their customers a detailed "dossier", and to obtain prior authorization from the Central Bank for operations exceeding a certain figure.

50. By a decision of January 1947, the banks were asked to require from business concerns before any examination of an application for credit (other than in the form of guarantees, endorsement of bills of exchange, discount of government paper or commercial bills) the presentation of a "dossier" which the Banque de France may ask to see and which must include :

- a) the balance-sheets of the firm for the last three years ;
- b) a provisional up-to-date estimate of the approximate value of stocks of raw materials and finished goods, together with details of sundry debtors and of the investment portfolio ;
- c) a statement disclosing bank accomodation already obtained, and the plans for expenditure and repayment of the credit applied for, together with evidence showing that no alternative means of raising the required liquid funds, e.g. by speeding up sales, was available.

51. Since the same date, applications for credit (defined as in the preceding paragraph) which bring or are likely to bring the total credit opened by one or several banks to the same firm beyond a given figure cannot be granted without prior assent from the Banque de France. This procedure, known as "prior authorization", was originally applicable to advances of NF 300 000 and above. The limit was gradually raised. It was increased to NF 500 000 in February 1948, to NF 1 million in April 1950, to NF 5 million in October 1951, and to NF 10 million in July 1959. The Banque de France demands at the time of application all the information specified (balance-sheet, profit and loss account, turnover, etc.) and endeavours as far as possible to reserve credit facilities for firms whose activities are important to the economic life of the country. It should be mentioned that as from 1951 commercial bills are also taken into account in the prior authorization procedure.

The scope for Central Bank intervention is further strengthened by the fact that by tradition non-commercial paper is only re-discountable after prior agreement.

52. A similar procedure is applied to mobilizable medium-term loans granted for a period of from two to five years, which can be rediscounted at a specialized institution (see sec. 11) by the handing over of renewable three-month notes.

130 Provided the Central Bank authorized the issue of this paper, it can be further

rediscounted at the Banque de France, without reference to the rediscount ceilings. According to case, the intervention of the Central Bank takes three distinct forms: sometimes it is represented on the Committee which is to give a decision on loan applications presented to the rediscount institution concerned; sometimes the Central Bank fixes for the rediscount institution a general limit on the rediscounting of a given category of credits; sometimes it obtains from this institution or from the public authorities agreement to limit certain operations.

Control of the first kind is exercised over ordinary medium-term credit for the equipment of industrial and commercial concerns and for the financing of exports. The equipment of agricultural undertakings is, on the other hand, subject to a general rediscount limit of the Banque de France. Lastly, it was laid down in July 1957 that the nationalized undertakings could finance through bank credit only one-fifth of their investment programmes and, in January 1959, that they would have the option of recourse to such lending only within a limit set, approximately, by the scale of their repayments of previous loans.

As for medium-term credit to building and construction, granted in the form of special five-year loans under the Act of 21 July 1950, the Ministry of Finance and the Banque de France have taken care since 1958 to ensure that the new credit granted during the business year should be kept at a level close to that of loans reaching maturity in the same period. On maturing, these credits are funded for fifteen additional years by the "Crédit foncier", mainly with the use of public funds received from the Treasury through the "Caisse de consolidation et de mobilisation des crédits à moyen terme" and of long-term loans which the "Crédit foncier" floats on the capital market.

53. Consumer lending was brought under specific control in the relatively recent past when hire purchase sales began to assume some importance in France.

The adoption by the Conseil national du crédit of measures designed to control the development of hire purchase sales dates from 28 July 1954. The regulations in force limit the period for which loans may be granted and fix a minimum down payment. When the operation is financed by a bank or a finance house, there is another limitation: the total of credit of this kind granted is limited to a given multiple of the establishment's own capital and reserves.

The rules are relaxed or tightened according to the general business situation and to trends on the markets for the various goods sold on hire purchase. For example, the down payment has been lower since July 1950, and the maximum period of credit longer, for household appliances, and for radio and television sets than for motor cars. The fluctuations in total consumer credit figures bear witness to the effectiveness of the restrictive measures applied, in particular, in 1956 and 1957, and of the relaxation in 1958 and 1959. But the volume of hire purchase business has so far been too small in France for it to be possible



to isolate the impact of the measures applied from that of other factors influencing the general state of business.

54. Lastly, the authorities limited for a time the total volume of bank lending of all kinds – both short and medium-term – to a figure corresponding for each of the banks to the average figure for the last quarter of 1957, an additional margin of 3% being allowed for new credits for exports. These decisions were taken on 7 February 1958 and were rescinded on 5 February 1959.

## CHAPTER 7

### RELATIONS BETWEEN THE TREASURY AND THE BANKING SYSTEM

55. As has already been observed (see sec. 27) Treasury operations are one of the factors in the money market affecting the cash position of the banks. We have now to examine how the transactions of the Treasury exert an influence on bank liquidity.

#### *a) The various functions of the Treasury*

56. The Treasury holds an important place in the French monetary system. Unlike that of other countries, the French Treasury not only acts – directly through its own network of public agencies – as government cashier and cashier for a certain number of institutions and local authorities which are called " correspondants "; it also has monetary and banking functions.

The activity of the Treasury is similar to that of a bank to the extent that it takes part in several ways in the creation of money. The role of deposit bank played by the Treasury is not moreover confined to the two kinds of funds mentioned above in sec. 16 and classified in the tables of the Conseil national du crédit among the components of the money supply (accounts with the postal cheque system and " fonds particuliers " of the agencies).

The Treasury receives deposits of many kinds of resources, which vary in the extent to which they belong to the public domain. It acts as cashier not only for the Government but also for the special budgets and the local authorities, and it collects the funds of a large number of other public or semi-public " correspondants ", some of which are specialized credit institutions (" Caisse des dépôts ", " Crédit agricole ", " Crédit national " etc.), others industrial or commercial institutions (National energy undertakings, French State Railways, " Office des céréales ", " Office de l'Azote ", " Potasses d'Alsace ", etc.).

The situation of the Treasury depends, therefore, not only on the Government's strictly budgetary operations but also on a large number of operations carried out at the instance or on behalf of the Treasury's " correspondants ". Neither of these two kinds of operation affects the liquidity of the Treasury unless they involve settlements with the banking system, and these can only be carried out through the Central Bank, since the Treasury does not maintain accounts with the ordinary banks.

57. Among the "banking" functions of the Treasury, there is one which deserves separate examination, since it concerns monetary relations between the various countries of the franc area. The Treasury acts as a clearing house within this area by playing the part of a central bank for the overseas banks of issue, creating and neutralizing liquidity on the occasion of transfers between France and the rest of the franc area.

Transfers between the franc area and other monetary areas are handled by the Exchange Stabilization Fund ("Fonds de stabilisation des changes"), which is managed by the Banque de France and, since its reform in 1959, is no longer in direct contact with the Treasury. Previously a surplus or deficit in the balance of payments led, through the working of machinery for advancing francs from the Treasury to the Fund, to an outflow or inflow of cash for the Treasury. Since 1949, the francs created or withdrawn on the occasion of foreign currency movements have been supplied or received directly by the Banque de France.

For money transfers between the countries of the franc area the exchange of means of payment between France and the overseas banks of issue is carried out through the Treasury. The Treasury has committed itself to supplying the banks of issue of the overseas countries and territories of the franc area with the metropolitan francs which they need, on the condition that they place local currency at the Treasury's disposal for the transfers to overseas countries and territories. Thus, settlements between France and the rest of the franc area are not included under the same heading of the "contra-items of the money supply" as are settlements between France and foreign countries. They do not affect the "gold and foreign exchange" holding of the Banque de France, but the monetary system's claims on the Treasury<sup>1</sup>.

The machinery in operation leads to a distinction being made, from the angle of their impact on the home monetary situation, between private money transfers and public operations.

Only private transfers between France and the overseas countries of the franc area can have the effect of altering the internal money supply and the extent of the Treasury's indebtedness to the banking system. When funds belonging to individuals or firms are transferred from France overseas, they are added to the franc balances deposited with the Treasury by the appropriate overseas banks of issue and enable the Treasury to repay by the same amount advances from the Banque de France.

By contrast, when the Treasury makes payments to overseas countries, it credits the funds directly to the accounts in its own books held by the banks

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<sup>1</sup> Since 1959 the Central Banks of Tunisia and of Morocco have been "correspondants" of the Banque de France, and no longer those of the Treasury. Settlements between these two countries and the rest of the franc area therefore no longer affect the Treasury and must be treated as settlements with foreign countries.

of issue concerned, and this operation does not have the effect of altering the internal money supply or the total of its "contra-items".

In fact, the overseas countries' accounts with France have in recent years shown a relatively marked degree of equilibrium between these two categories of transfer: the net "public" transfers from France to the overseas countries of the franc area tends to offset, and even to exceed slightly, the net private and commercial settlements in the opposite direction. Thus, the balance of private transfers from overseas to France normally works in the direction of internal monetary expansion and reflects the return to France through "private" channels of capital remitted overseas through "public" channels.

It will be noticed that this machinery is not such as to yield exact statistical data. Admittedly it is possible to subtract from the monetary system's claims on the Treasury the contra-item of the variations in the money supply stemming from private transfers between the mother country and the rest of the franc area. But this process has a certain arbitrary element; apart from the fact that private transfers cannot always be easily distinguished from public operations, it is contrary to the principle of the unity of public finance.

#### *b) Treasury liquidity*

58. The Treasury's activities affect the banking system in two ways. As a bank, the Treasury has the means of stepping up or scaling down the money supply. In its capacity as an instrument for implementing the finance law and carrying out operations of the "correspondants du Trésor" and of the overseas banks of issue, it must at all times be able to make transfers from its own sector to the banking system, by maintaining at the Banque de France the balances such payments require, by recourse to the banks (including the specialized institutions) or, where necessary, by recourse to the Central Bank itself.

Of course, the distinction between these two roles, which in practice are often completely merged, must not be exaggerated. If no distinction is made, however, there is, the risk of confusing the Government budget deficit with fluctuations at the Treasury, whereas there is no absolute correlation between these two matters, both because of the expenditure the Government engages in abroad and the way in which the Treasury finances its commitments in metropolitan francs.

59. There being practically no income to offset Government budgetary outlay in the overseas countries of the franc area, this outlay is broadly speaking identical with the deficit recorded there. In 1956, of the overall budget deficit of NF 10 040 million nearly three fifths (NF 5 900 million) concerned operations overseas. In recent years the growth of the burden borne in these countries and the reduction in the overall budget deficit has had the effect of concentrating overseas the entire deficit; in 1960 the effective deficit of NF 4 150 million

comprises a surplus of NF 2 530 million for operations in France and outside the franc area and a deficit of NF 6 680 million for operations in the overseas territories.

The deficit on the budgets has therefore only a slight direct impact on the internal monetary system and Treasury liquidity. The commitments to be financed overseas are in fact covered by cash resources in local currency representing mainly the equivalent value in that currency of private funds transferred to France.

But the private transfers from overseas themselves exert an indirect influence on the French monetary system and impose a strain on liquidity in the mother country in the long run equal to or even higher than the overseas deficit. For example, in 1960, an overseas deficit of NF 6 680 million (i.e. virtually the whole of public expenditure in these countries) was recorded as against a net balance of private transfers to France of NF 7 340 million. (In 1956, the corresponding figures were NF 5 900 million and NF 5 490 million).

60. The large scale of the deficit or of the commitments stemming from overseas money transfers does not necessarily mean that the Treasury has difficulties as regards its cash position.

It is true that its power to create money is limited by the degree of confidence the currency inspires in those who use it and by the fact that the Treasury cannot itself arbitrarily increase the share of the money supply held by private persons and firms with the postal cheque system, since they are entitled to ask for their balances to be exchanged for banknotes, foreign currency (subject to the exchange regulations) or bank deposits.

But the general trend of the Treasury's account at the Banque de France depends mainly on the one hand on the timing of public receipts and expenditure, and, on the other on the aid the Treasury can obtain from the banks and the specialized institutions.

61. The Treasury must be able at any moment to carry out operations pursuant to the Finance Law or those requested by the "correspondants du Trésor" (and, in particular, by the post office acting on behalf of holders of accounts with the cheque system) or by the overseas banks of issue. Such operations raise no problems for it as long as they do not go beyond a mere book transfer between two of the three categories (a transfer between depositors in the same category is an even simpler matter). The transfers take place within the Treasury's own payments sphere and therefore affect its relations neither with the bank of issue nor with the ordinary banks.

The position is quite different if one or other of these categories of operator applies for payment in banknotes, or foreign currency or for transfer to a sight deposit at a bank. In all three cases the Treasury can only execute such orders

by debiting its account with the Banque de France. Each of them therefore leads to a fall in its balance with the bank of issue and this will affect its liquidity situation unless it can at the same time through any one of these three channels attract a corresponding volume of fresh funds in the form of deposits or subscriptions to government paper. In other words, the question whether it can close its own "circuit" or not determines whether it must resort to aid from the Banque de France.

The Treasury's means of influencing the volume of these transfers are very limited. Rates of interest on government paper are traditionally stable in France, for reasons which will be given below, and these movements can only vary with the greater or lesser liquidity of the banks and of the economy as a whole, and in particular with the impact on them of fluctuations in the balance of payments. As the situation now stands, the Treasury is very much dependent on general factors affecting the economy.

*c) Interest rate policy with respect to short-term debt*

62. The system of short-term Treasury paper issues is a reflection of the high degree of specialization and the relative segregation of short-term financing machinery in France.

Strictly speaking, there is no true money market in France, as there is in certain other countries, on which the supply of demand for short-term capital can be matched and balanced through the free play of interest rates.

— Firms and individuals obtain short-term capital directly through the banks. The terms for bank credit are in accordance with scales fixed for the whole of the banking system in relation to Bank rate (see sec. 31);

— The Treasury draws either on the liquid savings of firms and individuals by the issue of paper (bons sur formules) or on the liquidity of the banks by the assignment of bills held in the form of entry in current account (bons en comptes courants).

The issues of bills in paper form constitute, alongside deposits in savings banks and time deposits in banks, one of the three forms of investment available for the public's liquid savings. They appeal mainly to savers who are not interested in investments on the stock exchange and who are not greatly influenced by fluctuations in interest rates.

Bills held in the form of current account entries are in practice reserved for the banks, for which they represent the compulsory use of a proportion of deposits under the regulations establishing "floors". Up to the amount fixed by these "floors", the banks cannot decline to take up these bills, nor can they discuss terms.

63. The above explains why the French Treasury does not alter the volume of and the rates for its short-term issues as frequently as happens in other countries.

Were it to interrupt its issues of Treasury bills in paper form (or if it varied the terms too often) it would run the risk of impairing the smooth working of savings machinery which is particularly effective and which enjoys the confidence of the general public; the funds thus diverted from their traditional use would largely be devoted to more liquid investments (particularly in view of the limits set to savings bank deposits) or would be spent on the consumer goods market.

For bills held in the form of current account entries, an interruption of the issues would raise very quickly the problem of the bank's compliance with the rule concerning minimum holdings of government paper; experience in recent years has shown that they have bought very little in the way of bills beyond the compulsory minimum.

Moreover, the French Treasury has available, through the operation of Banque de France advances to the Government, a mechanism for the automatic adjustment of its resources and commitments. Where, for example, it finds itself with a temporary surplus of short-term resources as compared with requirements, it makes it a rule to use this surplus, as in 1959 and 1960, to repay the Central Bank's (advances and thus "neutralize" from the monetary point of view the possible consequences of an expansion of internal liquidity.

64. The fixing of the rates for Treasury bills is, in the last analysis, not so much a consequence of the Treasury's need to adapt itself to the fluctuating trends on a "market" as a response to the need to establish a satisfactory equilibrium between the yield of the various kinds of investment open to the public.

Thus the rates for bills in paper form are fixed as much in the light of the rates ruling for deposits in savings banks, time deposits in banks and compulsory holdings as by reference to Bank rate.

As for the rates on bills held in the form of current account entries, they are no doubt fairly closely linked to Bank rate, given the scale of the French banks' indebtedness to the Central Bank, but the link cannot be a hard and fast one. Admittedly the Treasury is careful not to fix the rate for bills above Bank rate, as this would offer the banks an incentive to buy bills with the aid of money borrowed from the Central Bank. On the other hand, when Bank rate is raised, the Treasury is not obliged to raise proportionately the rate on bills which the banks are compelled to purchase under the "floor" regulations. The Treasury may wish to avoid an unnecessary increase in the cost of servicing the national debt. It may also wish to make use of the disparity created between the cost of the banks' debt to the Central Bank and the yield on their compulsory  
138 holdings of bills to support a general policy of credit restraint.

65. The easing of the internal monetary situation thanks to the recovery in the balance of payments from the beginning of 1959 led the French monetary authorities to cut interest rates. The Treasury has not since then made issues on the capital market and this is part of the policy of lowering long-term interest rates.

As for investment outlets for short-term savings, interest rates were cut from 1 July 1960 on Treasury bills and as from 1 January 1961 on deposits in savings banks. In addition, the range of Treasury bills issued to the general public was supplemented in June 1961 by a new device — bills maturing in three or five years — intended to help in funding, to some extent, the floating national debt. At the same time the rates on progressive interest rate bills — repayable on demand at the request of the bearer three months after purchase — were once again lowered.

A cut in Bank rate made possible the parallel easing of bank credit terms as a whole. However, at least up to the end of 1960, there was no accompanying reduction in the rates on bills held in the form of current account entries, since these has been deliberately maintained at a relatively low level having regard to the 1957 increase in Bank rate. Subsequent cuts in 1958 and after, therefore, had the effect of bringing the situation nearer to normal. In October 1960 Bank rate and the rate for bills held as entries in current account were once again at parity. Not until then was it decided to lower slightly the rates for these bills.



ANNEX I

BALANCE-SHEET OF THE BANQUE DE FRANCE : CONSTITUENT ITEMS

1. *Notes in circulation*

2. *Gold and foreign exchange*

*Assets* : a) Gold<sup>1</sup>  
b) Advances to the Exchange Stabilization Fund  
c) Balances available on demand abroad

*Liabilities* : Credit balances  
a) of foreign central banks and international organizations  
b) of the Exchange Stabilization Fund

3. *Funds for the " Public Sector "*

*Assets* : a) Loans and advances to the State  
b) Till money  
c) Current accounts with postal cheque system  
d) Discounted tax or customs duty certificates (" obligations cautionnées ")  
e) Rediscounted medium-term " housing " paper

*Liabilities* : Current credit balances  
a) of the Treasury  
b) under economic co-operation agreements  
c) of the French finance institutions

4. *Funds for the " Banks " and other sectors*

*Assets* : a) Discounted bills (apart from " obligations cautionnées " and medium-term " housing " paper)  
b) Negotiable securities  
c) 30-day advances  
d) Advances on long-dated securities  
e) Items in course of collection

*Liabilities* : Current deposits of the French banks.

Under this fourth heading are also usually included the balance of miscellaneous assets and liabilities and current credit balances of individuals.

140 <sup>1</sup> Including, where appropriate, loans in gold to the Exchange Stabilization Fund.

## ANNEX II

### DEVELOPMENT OF MONEY-MARKET LIQUIDITY FROM 1956 TO 1960<sup>1</sup>

Two major phases are distinguishable in the history of events from 1956 to 1960, the turning point being May 1958.

1. From the beginning of 1956 to May 1958, the liquidity of the money market was subject to continuous strain under the combined effects of an increase in notes and coin in circulation and the outflow of foreign exchange. This outflow was very heavy at the beginning of the period but tended to ease off from August 1957 (20% surcharge). As for the expansion in the note circulation, this had already been damped down a little between September and October 1956, with the issue of the 1956 5% loan, and it slowed down further at the end of 1957, owing, it would seem, to rumours concerning a possible withdrawal from circulation of 10 000 franc notes. The inflow of notes at this time made conditions rather easier on the market, which was therefore able to cope with the December maturity more easily than in 1955.

This continued tightening of liquidity on the market, although it was less marked at the end of the period under review, meant that considerable assistance had to be provided by the Central Bank. However, the indebtedness of the "public sector" and that of the banks did not follow the same trend.

For the full year 1956, the indebtedness of the public sector grew much less than did that of the banks. Several factors account for this phenomenon: the reserves of liquidity accumulated by the banks (notably in medium-term bank paper) during the years in which conditions on the market had been easy – 1954 and 1955 – were heavier than those of the Treasury, which also had to cope with the amortization of the Central Bank's special advances of 1953. In addition, the July increase in the "ceilings" for bills, and the national loan of September-October caused heavy transfers of liquidity from the banks to the Treasury.

Early in 1957, since the reserves of the various operators on the market were very limited, the continuing pressure on liquidity was to call into question the "ceilings" fixed by the Banque de France on its various forms of assistance. The monetary authorities were therefore faced with a choice and the following course was adopted: agreements between the Bank and the Government in May

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<sup>1</sup> The figures used in this Annex and in the graph to which it refers are based on the *weekly* returns of the Banque de France; for this reason slight discrepancies will be found between them and those given in the tables, which are based on monthly returns.

and June, and later in November, provided for an overall increase of NF 550 000 million in the "ceiling" on advances to the Government; alongside this, the rediscount "ceilings" of the banks were, in July and August, and later in December, lowered by a total of more than NF 200 000 million.

It therefore fell to the Treasury to cover the money-market deficit in 1957. For the full year, the indebtedness of the public sector swelled by NF 566 000 million, nearly as much as the total net outflow of notes and foreign exchange (NF 585 000 million). The indebtedness of the banks, however, after reaching a peak in April 1957, fell towards the end of the year to a level near to that of 1956, since presentation of medium-term paper had offset the lowering of the "ceilings".

2. The floating of the 3½% loan in 1958 marks a shift in the trend on the money market which was to be confirmed early in 1959.

Purchases of gold by the Banque de France at the time of the loan and in subsequent months neutralized in the second half of 1958 the effects on the money market of outflows of notes, which in any case slowed down towards the end of the year as a result of the nervousness of a section of the population over the change from the old franc to the new. Overall indebtedness to the Banque de France therefore became stable.

In 1959 an exceptional inflow of foreign exchange (NF 7 600 million) coincided with the lowest annual increase in notes and coin in circulation since 1948 (NF 700 million). The money market thus received fresh liquidity totalling nearly NF 7 000 million. Although noticeably less rapid, this flow of fresh liquidity continued during the first half of 1960 (+ NF 500 million), since the inflow of foreign currency continued to exceed the outflow of notes.

The main feature of these last three half years was therefore that the money market became unusually independent of the Banque de France. Both the Treasury and the banks shared in this, though the extent to which they did so varied at different times.

Until the end of August 1959, i.e. during the period of the heaviest inflow for the money market taken as a whole, it was the cash situation of the banks which benefited most from the influx of foreign exchange. They were able to cut their recourse to the Central Bank, notably in respect of medium-term paper, by almost NF 5 000 million, or about three times more than could the public sector.

On the other hand, from September on, the tendency for the public sector to reduce its indebtedness gathered momentum and this continued until the middle of 1960 (NF 4 590 million between the end of August 1959 and the end of June 1960). At the same time, conversely, the banks were once again obliged

to put themselves in debt, which they did to an appreciable extent : NF 2 500 million between the end of August 1959 and the end of June 1960. By drawing from the money market more liquidity than the Banque de France was pumping into it through movements of notes and foreign exchange, the Treasury forced the banks "into the Bank". The maintenance of approximate balance in the execution of the budgets, and of a high rate of public subscription to Treasury bills, coupled with an increase in bills subscribed by the banks under the "floors" regulations because of the large growth of bank deposits in 1959 - all these factors combined in this period to induce the Treasury to contract bank liquidity and thus to neutralize the tendencies towards internal monetary expansion which were emerging in the French economy.

Table 1

## SUPPLY OF MONEY AND NEAR-MONEY, AND CONTRA-ITEMS

in NF '000 million

	31.12. 1956 <sup>1</sup>	31.12. 1957 <sup>1</sup>	31.12. 1958 <sup>1</sup>	31.12. 1959	31.12. 1960	31.12. 1961
<i>Supply of money and near-money</i>						
a) Notes in circulation	31.14	32.68	34.69	34.95	39.32	44.35
b) Coin in circulation	0.67	0.75	0.78	0.76	1.13	1.28
c) Sight deposits	34.04	37.94	40.26	48.21	55.34	65.16
of which : i) At the banks	(26.69)	(29.52)	(30.80)	(37.57)	(42.67)	(50.54)
ii) With the postal cheque system, the Treasury and the Banque de France	( 7.35)	( 8.42)	( 9.46)	(10.64)	(12.67)	(14.62)
Total money supply	65.85	71.37	75.73	83.92	95.79	110.79
a) Special accounts	-	0.15	0.38	0.85	1.43	2.04
b) Time deposits	2.32	3.83	4.13	5.43	7.58	9.61
Total supply of money and near-money	68.17	75.35	80.24	90.20	104.80	122.44
<i>Contra-items</i>						
a) Gold and foreign exchange (net)	3.73	-0.31	-0.07	7.16	10.48	15.29
b) Claims on the Treasury	24.14	30.13	31.10	31.31	33.33	34.61
c) Credit extended to the economy by the banks and the Banque de France	40.24	45.77	48.68	53.81	62.04	73.45
Total	68.11	75.59	79.71	92.28	105.85	123.34
Miscellaneous	+ 0.06	- 0.24	+ 0.53	- 2.08	- 1.05	- 0.90
Total of contra-items	68.17	75.35	80.24	90.20	104.80	122.44

<sup>1</sup> Including the Saar.

Table 2

## LIQUID AND SHORT-TERM SAVINGS

in NF '000 million

	31.12. 1956	31.12. 1957	31.12. 1958	31.12. 1959	31.12. 1960	31.12. 1961
Time deposits with banks, and cash certificates ("bons de caisse") <sup>1</sup>	2.32	3.83	4.13	5.43	7.58	9.61
Special accounts	—	0.15	0.38	0.85	1.43	2.04
Deposits in savings banks (including capitalized interest)	17.48	19.24	22.28	26.16	29.51	33.20
a) National Savings Bank	(7.55)	(8.23)	(9.42)	(10.91)	(12.05)	(13.29)
b) Ordinary savings banks	(9.93)	(11.01)	(12.86)	(15.22)	(17.38)	(19.78)
c) Savings - credit	—	—	—	(0.03)	(0.08)	(0.13)
Treasury bills (subscriptions less repayments)	9.87	10.97	12.16	15.85	19.41	23.30
a) Bills in paper form	(9.32)	(10.39)	(11.54)	(14.77)	(18.15)	(21.87)
b) Bills held by firms in form of current account entry	(0.55)	(0.58)	(0.62)	(1.08)	(1.26)	(1.43)
3- and 5-year certificates of the "Caisse nationale de crédit agricole" (held by the public)	0.50	0.66	0.87	1.27	1.93	2.76
<b>Total</b>	<b>30.17</b>	<b>34.85</b>	<b>39.82</b>	<b>49.56</b>	<b>59.86</b>	<b>70.91</b>

<sup>1</sup> Including the Saar for 1956, 1957 and 1958.

Table 3

**SHORT-TERM CREDIT AND MOBILIZABLE MEDIUM-TERM CREDIT**  
**Classified by types of credit institutions**  
**(totals and changes)**

in NF '000 million

	December 1960	Changes	December 1961
<b>I. Credit granted by the banks</b>			
<b>A. Overdrafts</b>	8.81	2.59	11.40
<b>B. Commercial bills</b>			
a) Short-term			
i) Held by the banks	27.36	+ 5.22	32.58
ii) Discounted by the Banque de France	7.92	+ 0.80	8.72
iii) Held by the specialized institutions	0.09	+ 0.04	0.13
<b>Total</b>	35.37	+ 6.06	41.43
b) Medium-term			
i) Held by the banks	2.80	+ 2.20	5.00
ii) With the Banque de France	6.07	- 1.36	4.71
iii) Held by the specialized institutions	0.58	- 0.15	0.43
<b>Total</b>	9.45	+ 0.69	10.14
<b>Total I</b>	53.63	+ 9.34	62.97 <sup>1</sup>
<b>II. Credit granted by the finance institutions</b>			
<b>Commercial bills</b>			
a) Short-term (finance of hire purchase business)			
i) Held by the finance institutions	0.44	+ 0.01	0.45
ii) Held by the banks	2.05	+ 0.77	2.82
iii) Discounted by the Banque de France	0.10	-	0.10
<b>Total</b>	2.59	+ 0.78	3.37
b) Medium-term			
i) Held by the finance institutions	0.06	+ 0.22	0.28
ii) Held by the specialized institutions	0.14	- 0.02	0.12
iii) Discounted by the Banque de France	0.13	- 0.11	0.02
<b>Total</b>	0.33	+ 0.09	0.42
<b>Total II</b>	2.92	+ 0.87	3.79
<b>III. Medium-term credit granted by the "Sous-Comptoir des entrepreneurs" and the "Crédit foncier de France"</b>			
i) Bills held by the specialized institutions	3.58	- 0.24	3.34
ii) Bills discounted by the Banque de France	5.71	+ 0.66	6.37
<b>Total</b>	9.29	+ 0.42	9.71
<b>IV. Medium-term credit granted by the "Caisses de crédit agricole"</b>			
i) Bills held by the "Caisses de crédit agricole"	0.15	+ 0.16	0.31
ii) Bills discounted by the Banque de France	0.94	- 0.01	0.93
<b>Total</b>	1.09	+ 0.15	1.24
<b>V. Credits granted by the Banque de France</b>			
A. Bills discounted directly for customers	0.08	+ 0.01	0.09
B. Advances against security	0.07	-	0.07
<b>Total</b>	0.15	+ 0.01	0.16
<b>Grand Total</b>	67.08	+ 10.79	77.87 <sup>1</sup>

<sup>1</sup> Excluding non-mobilizable medium-term commercial bills held by the banks (NF 650 million on 31.12.1961).

Table 4

**SHORT-TERM CREDIT AND MOBILIZABLE MEDIUM-TERM CREDIT**  
 Breakdown according to the nature of resources  
 (totals and changes)

in NF '000 million

	December 1960	Changes	December 1961
<i>Credits financed from monetary resources</i>			
A. Short-term			
i) Overdrafts (Items IA plus VB of Table 3)	8.88	+ 2.59	11.47
ii) Bills held by the banks and the Banque de France	37.51	+ 6.80	44.31
Total	46.39	+ 9.39	55.78
B. Medium-term bills held by the banks and the Banque de France			
	15.65	+ 1.38	17.03
Total (A + B)	62.04	+ 10.77	72.81 <sup>1</sup>
<i>Credits financed from savings</i>			
a) Short-term bills held by the specialized institutions and the finance institutions	0.53	+ 0.05	0.58
b) Medium-term bills held by the specialized institutions and the finance institutions	4.51	- 0.03	4.48
Total	5.04	+ 0.02	5.06
Grand Total	67.08	+ 10.79	77.87 <sup>1</sup>

<sup>1</sup> Excluding non-mobilizable medium-term commercial bills held by the banks (NF 650 million on 31.12.1961).



Table 5

**SHORT-TERM CREDIT AND MOBILIZABLE MEDIUM-TERM CREDIT**  
**Breakdown according to financing and form of credit (totals)**

in NF '000 million

	Total	financed by			
		banks	special- ized <sup>1</sup> and finance institutions	the Banque de France	the "Caisse de conso- lidation et de mo- bilisation " (5)
	(1)	(2)	(3)	(4)	(5)
<b>I. 31 December 1960</b>					
<b>1. Short-term</b>					
- Overdrafts	8.88	8.81	-	0.07	
- Bills	38.04	29.41	0.53	8.10	
<b>Total</b>	<b>46.92</b>	<b>38.22</b>	<b>0.53</b>	<b>8.17</b>	
<b>2. Medium-term</b>					
Credits granted by agree- ment with:					
- the "Crédit foncier " or the "Sous-Comptoir des entrepreneurs "					
- Loans to building:					
special loans	8.55	-	2.29	5.69	0.57
other credit	1.56	0.35	0.96	0.25	
- Equipment credit:					
private sector	0.58	0.34	0.03	0.21	
- the "Crédit national " or the "Caisse des dépôts "					
- Equipment credit	3.03	1.68	0.11	1.24	
- Export credit	1.16	0.04	-	1.12	
- the "Caisse nationale des marchés de l'Etat "					
- Equipment credit:					
private sector (Art.8)	0.70	0.23	-	0.47	
nationalized under- takings	3.49	0.16	0.25	2.93	0.15
- the "Caisse nationale de crédit agricole "					
- Credit to agriculture	1.09	-	0.15	0.94	-
<b>Total</b>	<b>20.16</b>	<b>2.80</b>	<b>3.79</b>	<b>12.85</b>	<b>0.72</b>
<b>Grand Total</b>	<b>67.08</b>	<b>41.02</b>	<b>4.32</b>	<b>21.02</b>	<b>0.72</b>
Credits borne by the banking system (2) + (4)			62.04		

Table 5 (continued)

	Total	financed by			
		banks	special- ized <sup>1</sup> and finance institutions	the Banque de France	the "Caisse de conso- lidation et de mo- bilisation" (5)
	(1)	(2)	(3)	(4)	(5)
<b>II. 31 December 1961</b>					
<b>1. Short-term</b>					
- Overdrafts	11.47	11.40	-	0.07	
- Bills	44.89	35.40	0.58	8.91	
<b>Total</b>	<b>56.36</b>	<b>46.80</b>	<b>0.58</b>	<b>8.98</b>	
<b>2. Medium-term</b>					
Credits granted by agree- ment with :					
- the "Crédit foncier" or the "Sous-Comptoir des entrepreneurs "					
- Loans to building :					
special loans	8.88	-	2.36	6.33	0.19
other credit	1.97	0.63	1.18	0.16	
- Equipment credit :					
private sector	0.72	0.62	0.07	0.03	
- the "Crédit national" or the "Caisse des dépôts "					
- Equipment credit	2.72	2.54	0.04	0.14	
- Export credit	1.59	0.09	-	1.50	
- the "Caisse nationale des marchés de l'Etat "					
- Equipment credit :					
private sector (Art.8)	0.88				
nationalized under- takings	3.51	1.12	0.17	2.94	0.16
- the "Caisse nationale de crédit agricole "					
- Credit to agriculture	1.24	-	0.31	0.93	
<b>Total</b>	<b>21.51</b>	<b>5.00</b>	<b>4.13</b>	<b>12.03</b>	<b>0.35</b>
<b>Grand Total</b>	<b>77.87<sup>2</sup></b>	<b>51.80<sup>2</sup></b>	<b>4.71</b>	<b>21.01</b>	<b>0.35</b>
Credits borne by the banking system (2) + (4).			72.81 <sup>2</sup>		

<sup>1</sup> Other than the "Caisse de consolidation et de mobilisation des crédits à moyen terme" (Fund for the consolidation and discounting of medium-term credits).

<sup>2</sup> Excluding non-mobilizable medium-term commercial bills held by the banks (NF 650 million on 31.12.1961).

**Table 6**  
**POSSIBLE RECOURSE TO THE BANQUE DE FRANCE (end-of-month figures)**

in NF '000 million

	1958 <sup>1</sup>	1959	1960			1961				
	Dec.	Dec.	March	June	Sept.	Dec.	March	June	Sept.	Dec.
<b>I. Possible direct recourse by banks to the Banque de France</b>										
1. By rediscount (available margin under "ceilings" "ceilings" used)	4.47 3.87	4.59 3.86	4.73 3.90	4.89 4.18	5.08 4.05	5.39 4.72	5.45 4.50	6.01 5.22	6.02 5.15	6.14 5.69
Margin of which "Grands ensembles"	0.60 (0.19)	0.73 (0.22)	0.83 (0.22)	0.71 (0.20)	1.03 (0.33)	0.67 (0.23)	0.95 (0.30)	0.79 (0.30)	0.87 (0.28)	0.45 (0.16)
2. On the money market (available margin up to limits limits used)	0.63 0.59	0.65 0.50	0.65 0.49	0.65 0.64	0.65 0.64	0.65 0.68	0.65 0.46	0.65 0.59	0.66 0.65	0.66 0.73
Margin	0.04 0.22	0.15 0.34	0.16 0.26	0.01 0.26	0.01 0.33	— 0.66	0.19 0.81	0.06 0.45	0.01 0.73	— 0.66
3. In Treasury paper (surplus of holdings above "floors")										
<b>II. Possible recourse to mobilization of medium-term paper</b>										
1. By the banks with the "Crédit national" or with the "Caisse des dépôts et consignations"	0.83	4.15	4.08	3.24	3.87	2.80	4.62	4.26	5.15	5.04
<b>Total of rediscountable items in bank portfolios</b>	1.69	5.37	5.33	4.22	5.24	4.13	6.57	5.56	6.76	6.15
2. Of "Crédit national" and "Caisse des dépôts et consignations" with Banque de France	0.57	1.10	2.08	2.51	2.17	2.61	3.08	3.43	3.83	2.54
3. Of the "Sous-Comptoir des entrepreneurs", the "Crédit foncier de France" and the finance institutions	0.79	1.01	0.96	1.01	1.08	1.03	1.15	1.21	1.22	1.28
4. Of the "Caisse nationale de crédit agricole" with the Banque de France	0.12	0.16	0.18	0.21	0.25	0.15	0.19	0.23	0.30	0.30
<b>III. The Treasury's possibilities of recourse</b>										
Rediscountable "Obligations cautionnées"	0.02	2.09	1.93	2.13	2.10	2.16	2.30	2.25	2.39	2.31
TOTAL	3.19	9.73	10.48	10.03	10.84	10.08	13.29	12.68	14.50	12.58
Pro memoria										
Banks' use of "pension" facilities	0.46	—	0.01	0.17	—	—	—	—	—	0.01

<sup>1</sup> Excluding the Saar.

Source: Conseil national du crédit.

Table 7

## TRENDS IN BANQUE DE FRANCE AND MONEY-MARKET INTEREST RATES

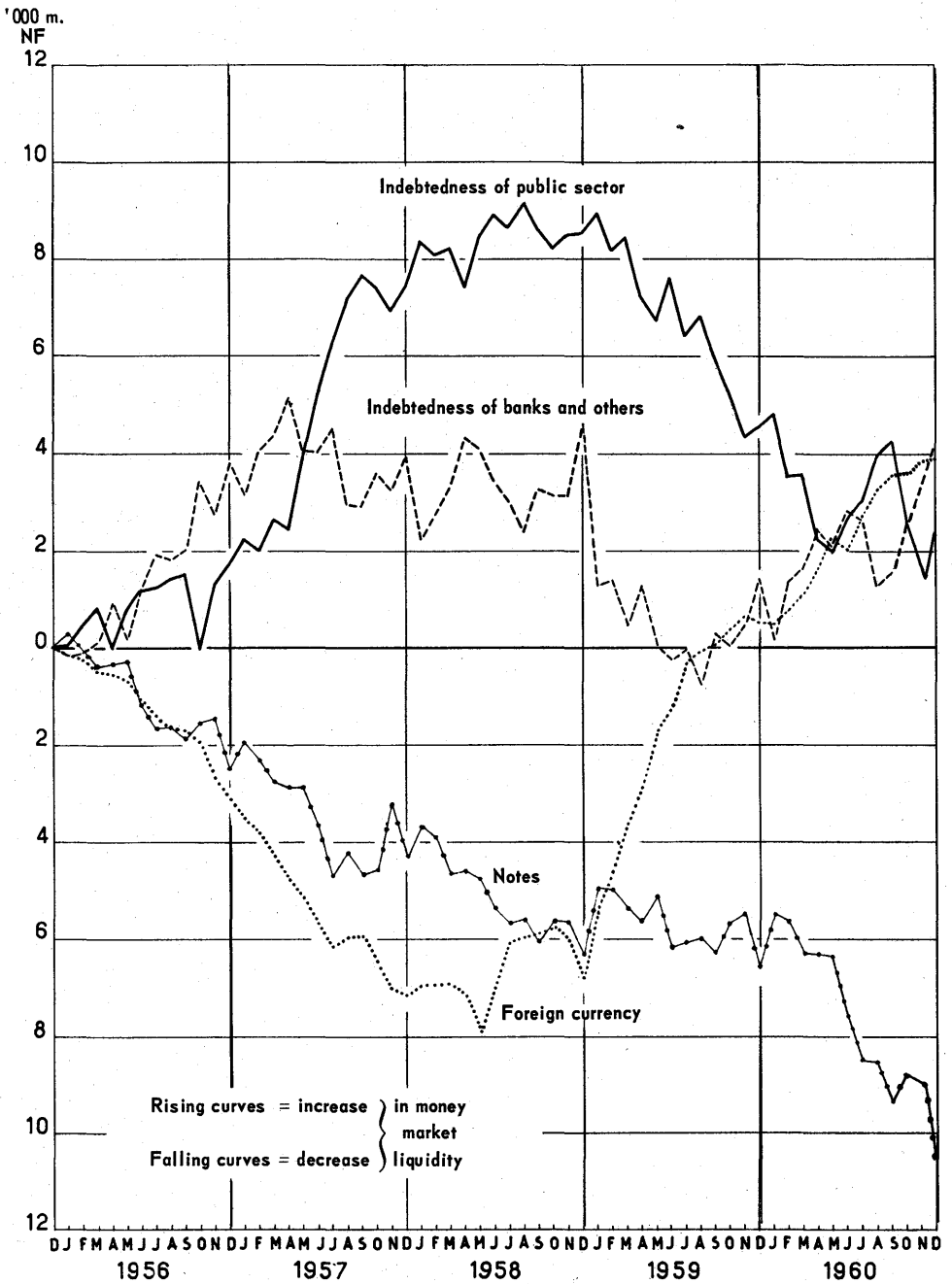
End of period	Banque de France				Yield on Treasury bills held in the form of current account entries with currency of two years	Call money rate on private paper (opening rates)			Cost of mobilizing medium-term equipment paper (private sector)
	Discount rate	Discount rate for "pension" A	Discount rate for "pension" B	30-day advances, purchases of Treasury bills 1 and discount of export paper 2		Monthly average	Lowest rate in month	Highest rate in month	
1958 Dec.	4.50	7.00	10	3	3.84	6.07	4.500	10.500	5.05
1959 March	4.25	6.00	8	3	3.84	4.36	3.000	5.250	4.80
June	4.00	5.50	7	3	3.84	3.67	3.000	4.750	4.55
Sept.	4.00	5.00	6	3	3.84	4.05	3.875	4.750	4.55
Dec.	4.00	5.00	6	3	3.84	4.07	3.875	4.750	4.55
1960 Jan.	4.00	5.00	6	3	3.84	3.90	3.500	4.250	4.45
Feb.	4.00	5.00	6	3	3.84	4.11	3.750	4.500	4.45
March	4.00	5.00	6	3	3.84	4.17	3.750	5.000	4.45
April	4.00	5.00	6	3	3.84	4.22	3.875	5.250	4.45
May	4.00	5.00	6	3	3.84	4.25	3.500	5.750	4.45
June	4.00	5.00	6	3	3.84	4.15	3.750	6.000	4.45
July	4.00	5.00	6	3	3.84	4.53	4.000	5.250	4.45
Aug.	4.00	5.00	6	3	3.84	4.05	3.500	4.375	4.45
Sept.	4.00	5.00	6	3	3.84	4.15	4.000	4.750	4.45
Oct.	3.50	4.50	6	3	3.84	3.99	3.500	5.250	3.95
Nov.	3.50	4.50	6	3	3.84	3.76	3.500	4.500	3.95
Dec.	3.50	4.50	6	3	3.62	3.70	3.500	4.250	3.95
1961 Jan.	3.50	4.50	6	3	3.62	3.65	3.000	4.500	3.95
Feb.	3.50	4.50	6	3	3.62	3.59	3.375	4.125	3.95
March	3.50	4.50	6	3	3.62	3.70	3.500	4.125	3.95
April	3.50	4.50	6	3	3.62	3.70	3.500	3.875	3.95
May	3.50	4.50	6	3	3.62	3.91	3.375	4.500	3.95
June	3.50	4.50	6	3	3.62	3.76	3.500	4.250	3.95
July	3.50	4.50	6	3	3.62	3.65	3.500	4.000	3.95
Aug.	3.50	4.50	6	3	3.62	3.52	3.375	3.750	3.95
Sept.	3.50	4.50	6	3	3.62	3.57	3.375	3.875	3.95
Oct.	3.50	4.50	6	3	3.62	3.60	3.500	4.000	3.95
Nov.	3.50	4.50	6	3	3.62	3.52	3.250	3.625	3.95
Dec.	3.50	4.50	6	3	3.62	3.58	3.500	3.875	3.95

1 Of less than 3 months' currency.

2 These are bills mobilizing export drafts.

Source : Conseil national du crédit.

**Diagram**  
**PRINCIPAL FACTORS IN THE MONEY MARKET**  
 (from Balance-sheet of the Banque de France)



**Part four**

**THE INSTRUMENTS OF MONETARY POLICY  
IN ITALY**



## CONTENTS

Introductory remarks	157
<i>The liquidity of the economy as a whole – The liquidity of the banking system</i>	
Chapter 1: Refinancing policy	164
<i>Terms for refinance credit – Efficacy of refinancing policy</i>	
Chapter 2: Open-market policy	167
Chapter 3: Minimum reserve policy	169
<i>General – Credit institutions subject to minimum reserve obligations – Calculation of minimum reserves – Minimum reserve deposits and interest – Reserve obligation for bank drafts in circulation – Reserves for non-residents' balances – Efficacy of the minimum reserve policy</i>	
Chapter 4: Cash management and borrowing of public authorities and their effects on liquidity	175
Chapter 5: Directives on credit and liquidity	180

## TABLES

1 – Liquidity of the economy	158
2 – Borrowing and monetary asset formation by non-financial sectors	160
3 – Liquidity of the banking system	161
4 – Trend of Bank liquidity and recourse by the banks (aziende di credito) to Central Bank credit	163 155



TABLES (continued)

5 - Rediscount credits and advances against security by the Banca d'Italia to credit institutions, business enterprises and individuals	165
6 - Minimum reserves	172
7 - Debit and credit position of Treasury with Banca d'Italia	177

## INTRODUCTORY REMARKS

1. Liquidity policy, in the sense of the influencing of bank liquidity and indirectly of liquidity of the economy as a whole is of minor importance in Italy in comparison with some other countries. Italy's economic development since the stabilization of the lira in 1947 has proceeded without excessive fluctuations and no critical problems have arisen with regard to the supplying or drawing off of liquidity. Consequently, the Banca d'Italia has not pursued a systematic open-market policy but merely operated occasionally on the market when medium-term Government bonds were being issued. The minimum reserve ratio was changed in January 1962 for the first time since the regulation was introduced in 1947. Manipulation of Bank rate has also been very limited – the discount rate of the Banca d'Italia has been changed only four times since the end of the war.

Influence on the liquidity of the banking system is chiefly exerted by changes in the availability of credit from the Central Bank and by Government policy in issuing Treasury bills and bonds. Certain groups of credit institutions are obliged to observe rules on liquidity and credit and this also restricts their freedom of action. In addition the credit institutions are bound by the Banca d'Italia's regulations on quantitative credit controls. This is particularly true of the banks dealing in short-term credit.

### *a) The liquidity of the economy as a whole*

2. For some years the Banca d'Italia has included in its Annual Reports a table giving the breakdown of liquid of the economy as a whole (*disponibilità liquide*). This table, which is reproduced as Table 1 (page 158), shows the short-term claims of the non-banking sector (other than the Treasury) on certain groups of credit institutions<sup>1</sup> and the Treasury. It distinguishes between primary and secondary liquidity. Primary liquidity (total money supply), as in all the other Community countries, is made up of Banca d'Italia and Treasury notes in circulation, coin, and the sight deposits of the non-banking sector with the banking system and the Postal Cheque Offices, excluding the deposits of public bodies with the Banca d'Italia and the Postal Cheque Offices.

The Banca d'Italia includes in the money supply the outstanding cheques issued by certain banks against payment which are payable at any branch of the

<sup>1</sup> Banca d'Italia, short-term deposit and credit banks, People's Banks, savings banks, pawnbrokers of the first category, and Postal Cheque Offices.

**Table 1**  
**LIQUIDITY OF THE ECONOMY**

'000 million lire

	Position at end of year		
	1958	1959	1960
<b>1. Domestic money supply (primary liquidity)</b>			
a) Notes and coins	2 109	2 298	2 501
b) Sight deposits, including bank drafts in circulation <sup>1</sup>	3 592	4 208	4 874
<b>Total primary liquidity</b>	<b>5 701</b>	<b>6 506</b>	<b>7 375</b>
<b>2. Secondary liquidity</b>			
a) Savings deposits	4 326	5 034	5 767
b) Treasury bills held by companies, individuals and special credit institutions	182	152	150
c) Balances of insurance companies and social insurance funds at the Treasury	43	68	77
d) Foreign currency balances of residents with banks	13	38	54
<b>Total secondary liquidity</b>	<b>4 564</b>	<b>5 292</b>	<b>6 048</b>
<b>3. Total liquidity</b>	<b>10 265</b>	<b>11 798</b>	<b>13 423</b>

<sup>1</sup> See text below.

*Source:* Annual Reports of Banca d'Italia.

issuing bank but can in practice be cashed at virtually any credit institution. These bank drafts (assegni in circolazione) are an instrument peculiar to Italy and at present 52 banks are authorized to issue them. They are a widely-used means of payment and are consequently included in the money supply as sight liabilities of the banks. The two former banks of issue – Banco di Napoli and Banco di Sicilia – and the Banca d'Italia also issue a similar traditional instrument of payment, the "vaglia cambiario" which performs the same function as the bank draft.

3. The secondary liquid resources include the following claims on the banking system and the Treasury :

- i) Savings deposits with the Banks (including savings banks and pawnbrokers) and with the Post Office Savings Bank
- ii) Treasury bills (with currency of 1 - 12 months - Buoni del tesoro ordinari) held by companies, individuals and special credit institutions.
- iii) Balances of insurance companies and social insurance funds at the Treasury.
- iv) Foreign currency balances of residents with banks.

4. The Annual Reports of the Banca d'Italia also include a table (Formazioni ed impiego delle disponibilità monetarie e finanziarie), which analyses the operations on the money and capital markets by categories and throws light on the factors affecting liquidity in the economy as a whole. This survey, which is reproduced in Table 2 (page 160), does more than simply examining the factors determining the changes in liquidity as shown in Table 1. Besides those factors it includes long-term claims and commitments in the capital market. Direct comparison of the two tables is therefore impossible.

*b) The Liquidity of the banking system*

5. In Italy bank liquidity consists of the banks' cash balances, their free balances and unused credit lines with the Banca d'Italia and their holdings of free Treasury bills. In addition to these assets shown in the Banca d'Italia's liquidity table the banks' holdings of Storage Agency Bills and freely convertible foreign currencies can also be included in bank liquidity.

Table 3 classifies the components of bank liquidity according to cash liquidity and potential liquidity. *Cash liquidity* is made up of holdings of coin and notes, free balances with the Banca d'Italia and balances at the Post Office Savings Bank, the Postal Cheque Office and the Treasury. The "free" balances at the Banca d'Italia are those balances which are not earmarked as minimum reserve obligations.

The banks may hold their free balances with the Central Bank on current account or on fixed deposit. Under Article 42 of its Statutes the Banca d'Italia, may accept time deposits as well as sight deposits; these time deposits are for periods of 8 or 15 days; up to 1952 it even accepted deposits for 4 or 6 months. Interest is paid at 0.5% on sight deposits, 1.5% on 8-day deposits and 2% on 15-day deposits.

6. The *potential liquidity* of the banks includes their credit margins at the Banca d'Italia, free holdings of Treasury bills, balances and money market investments abroad in convertible currency, and holdings of Storage Agency Bills. "Credit margins" are unused facilities for advances against security (bonds issued or guaranteed by the State, Treasury bills and bonds of the special credit institutions).

Table 2

**BORROWING AND MONETARY ASSET FORMATION  
BY NON-FINANCIAL SECTORS**

in '000 million lire

	1958	1959	1960
<b>I. Borrowing and changes in holdings of gold and foreign currency</b>			
1. Borrowing (+) by the Treasury:			
a) From the Central Bank and "money-creating" institutions (short-term credits)	304	17	- 20
b) From enterprises and individuals <sup>1</sup>	- 9	27	3
c) By issue of Government bonds	- 2	326	160
<b>Total</b>	<b>293</b>	<b>370</b>	<b>143</b>
2. Borrowing by the private sector:			
a) From the Central Bank and other "money-creating" institutions			
aa) short-term credits	203	678	1 186
bb) medium and long-term credits	580	691	880
b) By issue of securities	440	372	758
<b>Total</b>	<b>1 223</b>	<b>1 741</b>	<b>2 824</b>
<b>3. Total domestic borrowing (1 + 2)</b>	<b>1 516</b>	<b>2 111</b>	<b>2 967</b>
4. Net purchases (+) of gold and foreign currency by "money-creating" institutions			
a) Banca d'Italia and the Italian Exchange Office (UIC)	546	572	65
b) Banks	- 87	- 54	208
<b>Total</b>	<b>459</b>	<b>518</b>	<b>273</b>
<b>5. Total (1 to 4)</b>	<b>1 975</b>	<b>2 629</b>	<b>3 240</b>
<b>II. Monetary asset formation</b>			
1. Liquidity of the Economy			
a) Internal money supply (primary liquidity)	543	805	869
b) Secondary liquidity	690	728	756
c) Total liquidity of the Economy	1 233	1 533	1 625
2. Other resources <sup>2</sup>	211	431	522
3. Securities	531	665	1 093
<b>Total (1 to 3)</b>	<b>1 975</b>	<b>2 629</b>	<b>3 240</b>

<sup>1</sup> This item represents deposits by insurance companies and social insurance funds at the Treasury, various deposits with the Postal Cheque Office, Treasury bills held by enterprises and individuals and Treasury notes and coin in circulation.

<sup>2</sup> The other resources consist of: various bank funds, time deposits with the special credit institutions, savings certificates of the Post Office Savings Bank with a currency of one year or longer and claims of individuals in respect of contributions and premiums paid to social insurance funds and insurance companies (actuarial reserves).

Table 3

## LIQUIDITY OF THE BANKING SYSTEM

in '000 million lire

	At end of year		
	1958	1959	1960
<b>I. Cash liquidity</b>			
1. Cash in hand	105	110	116
2. Balances (free) at the Banca d'Italia	77	50	58
3. Balances at the Treasury, the "Cassa depositi e prestiti" <sup>1</sup> , and the Postal administration <sup>2</sup>	17	11	32
<b>Total cash liquidity (1 to 3)</b>	<b>199</b>	<b>171</b>	<b>206</b>
<b>II. Potential liquidity</b>			
1. Credit margins at the Banca d'Italia	249	237	250
2. Free holdings of Treasury Bills	371	580	221
3. Balances and money market investments abroad in convertible currencies	-	-	-
4. Storage Agency Bills	90	110	102
<b>Total potential liquidity (1 to 4)</b>	<b>704</b>	<b>927</b>	<b>573</b>
<b>Total liquidity (I + II)</b>	<b>904</b>	<b>1098</b>	<b>768</b>

<sup>1</sup> See sec. 32.<sup>2</sup> Includes the Post Offices Savings Bank and the Postal Cheque Office.

Source: Annual Report of the Banca d'Italia 1960, Table Q 5.

Treasury bills that the banks have not deposited with the Banca d'Italia in compliance with minimum reserve obligations or as security for advances constitute the banks' free holdings of Treasury bills. These Treasury bills can be converted into cash liquidity with the Banca d'Italia under the minimum reserve regulation (see sec. 23).

Holdings of Storage Agency Bills only, not the total commercial bill portfolio, are included in the banks' liquid assets. The banks rarely present ordinary commercial bills to the Central Bank for rediscounting. If they are short of liquid funds they prefer to have Storage Agency Bills rediscounted.

7. The Annual Report of the Banca d'Italia for 1960 gives for the first time a table (Operazioni e liquidità del sistema bancario) showing the factors 161

determining the trend of bank liquidity. This provides the basis for Table 4 ("Trend of bank liquidity and recourse by the banks to Central Bank credit" (page 163). Unlike the account of bank liquidity given on page 159, sec. 5, the figures in this table relate only to the banks' balances with the Banca d'Italia, making a distinction between free balances and minimum reserves.

The principal factors determining the trend of bank liquidity are defined in this table as :

- a) changes in the note and coin circulation,
- b) net transactions by the Treasury with the Banca d'Italia (including finance for stocks of agricultural products),
- c) advances by the Banca d'Italia to the Exchange Office – Ufficio Italiano dei Cambi – (changes are due to purchases and sales of foreign currency) and changes in the Banca d'Italia's gold and foreign exchanges reserves,
- d) transactions by the Central Bank with enterprises and individuals (including the special credit institutions).

Table 4

**TREND OF BANK LIQUIDITY<sup>1</sup> AND RECOURSE BY THE BANKS  
(AZIENDE DI CREDITO) TO CENTRAL BANK CREDIT**

(changes in '000 million lire)

	1960	1959	1958
<b>A. Flow of funds to (+) and from (-) the banks as a result of changes in the following items:</b>			
I. Note and coin circulation	- 187	- 176	- 147
II. Net position of domestic non-banking sector vis-à-vis the Banca d'Italia	- 94	- 485	- 72
of which: 1) Treasury	(- 99)	(- 522)	(- 52)
2) Others (enterprises and individuals, special credit institutions, etc.)	(+ 5)	(+ 37)	(- 20)
III. Advances by the Banca d'Italia to the Exchange Office - Ufficio italiano dei cambi - (changes are due to purchases and sales of foreign currency) and changes in the Banca d'Italia's gold and foreign exchange reserves	+ 154	+ 571	+ 608
IV. Other factors	- 9	- 16	- 22
<b>Total effect of factors I to IV</b>	<b>- 136</b>	<b>- 106</b>	<b>+ 367</b>
<b>B. Change in Central Bank credit to banks:</b>	<b>+ 33</b>	<b>+ 21</b>	<b>- 49</b>
of which: rediscounts	(+ 7)	(+ 7)	(+ 1)
advances against securities	(+ 18)	(+ 14)	(- 45)
deferred clearing payments (pagamenti prorogati)	(+ 8)	( - )	(- 5)
<b>Total effect A + B</b>	<b>- 103</b>	<b>- 85</b>	<b>+ 318</b>
<b>C. Increase (+) or decrease (-) in Central Bank balances:</b>	<b>- 103</b>	<b>- 85</b>	<b>+ 318</b>
of which: 1) Minimum reserve balances (including "M" accounts)	- 100	- 57	+ 288
2) Free balances	- 3	- 28	+ 30

<sup>1</sup> In contrast to the description of bank liquidity given in sec. 5, page 159, the figures in this table only relate to the banks' balances with the Banca d'Italia.

Source: Annual Report of the Banca d'Italia 1960, Table Q 5.



CHAPTER 1  
REFINANCING POLICY

8. Rediscount credit from the Central Bank is of little importance in Italy, if the rediscounting of Storage Agency Bills for agricultural products (portafoglio ammassi) is left out of account<sup>1</sup>. The banks prefer advances against securities; the nominal rates of interest for discounts and for advances against securities are usually the same (at present 3.5%) and the latter, unlike rediscounted bills, can be repaid at any time, if the liquidity position permits.

9. At the end of 1960, when the Banca d'Italia held bills for 442 000 million lire, 437 000 million lire was accounted for by Storage Agency Bills (see Table 5, page 165), so that ordinary trade bills in the Central Bank's portfolio amounted to about 5 000 million lire. By contrast, the Bank's advances against securities at the same date totalled 64 000 million lire, of which 61 000 million lire represented loans to banks and 3 000 million lire loans to the non-banking sector. However, the importance of trade bills as credit instruments in Italy cannot be judged by the Central Bank's portfolio, but only by the holdings of the banks. The combined balance-sheet for all the banks (aziende di credito) recorded 2 316 000 million lire of ordinary trade bills held at the end of 1960. These banks held Storage Agency Bills for only 103 000 million lire. The majority of these bills are held by the Central Bank.

*a) Terms for refinance credit*

10. The Banca d'Italia grants the credit institutions short-term credit for a maximum duration of 4 months by rediscounting trade and Treasury bills or by making advances against securities. It may discount trade bills only for the credit institutions. On the other hand advances against securities may also be made to business enterprises and individuals, though, as has already been pointed out, this occurs only on a small scale.

Under the law establishing the Banca d'Italia, bills presented for discount must bear at least two signatures of persons known to be solvent and the bills themselves must be payable at a centre where the Banca d'Italia or its correspondents have a branch or other office. For advances against security the rule is that the advance must not exceed 85% of the value of the securities or goods pledged.

<sup>1</sup> These bills are issued by the Storage Agencies; if they are not used to finance transactions in goods but only to offset losses incurred in that class of business which are finally borne by the Treasury, they represent claims on the State.

Table 5

**REDISCOUNT CREDITS AND ADVANCES AGAINST SECURITY BY THE BANCA D'ITALIA  
TO CREDIT INSTITUTIONS, BUSINESS ENTERPRISES AND INDIVIDUALS**

in '000 million lire

Heading  Holdings at end of year	Rediscounts by Banca d'Italia in favour of banks (including special credit institutions)				Advances against securities by the Banca d'Italia to:				Total (4 + 8)
	Ordinary trade bills	Storage Agency Bills	Treasury bills	Total (1 to 3)	Banks	Special credit institutions	Enterprises and individuals	Total (5 to 7)	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1950	27.2	152.3	1.6	181.1	71.8	0.4	17.2	89.4	270.5
1951	16.6	151.6	0.1	168.3	73.2	0.7	18.9	92.8	261.1
1952	12.5	180.9	2.5	195.9	104.9	0.5	16.9	122.3	318.2
1953	12.2	237.8	0.1	250.1	95.3	0.8	16.3	112.4	362.5
1954	24.0	290.3	0.1	314.4	77.1	0.4	14.3	91.8	406.2
1955	7.2	318.4	0.1	325.7	70.9	0.3	11.6	82.8	408.5
1956	25.4	396.5	0.1	422.0	97.9	0.3	9.0	107.2	529.2
1957	20.5	379.7	—	400.2	73.9	0.4	7.2	81.5	481.7
1958	3.5	382.6	0.1	386.2	28.7	0.4	4.8	33.9	420.1
1959	2.9	427.3	0.1	430.3	42.8	0.2	3.2	46.2	476.5
1960	4.9	437.4	0.2	442.5	61.1	0.3	2.8	64.2	506.7

Source: Bollettino of the Banca d'Italia.

11. No limit is set to the Banca d'Italia's refinancing. Contrary to practice in other countries, the Central Bank has not set every bank a ceiling, up to which it can draw discount credit or obtain advances. But this does not mean that the banks can automatically obtain unlimited credit from the Central Bank. Generally the Banca d'Italia makes the granting of credit to a bank dependent on its maintaining a certain ratio between the volume of its rediscounts and advances from the Central Bank on the one hand and its deposit liabilities on the other. The Central Bank also takes into account the general trend of bank liquidity.

*b) Efficacy of refinancing policy*

12. The discount rate of the Banca d'Italia has been changed only four times since 1947, whereas during the same period the discount rate of the Banque de France was changed 17 times and that of the Deutsche Bundesbank as many as 24 times. It is particularly noteworthy that the Italian bank rate remained unchanged for a period of eight years (1950 to 1958). Since 1951 the interest rate on advances against security has coincided with the Central Bank's discount rate. Previously the rate for advances sometimes differed from Bank rate by as much as 1%.

13. There is a relationship between the Banca d'Italia's discount rate and the minimum interest rates for bank advances, which are stipulated for the different types of credit in an inter-bank agreement. Since the banks generally exceed these minimum rates, and as they have little recourse to central bank credit, changes in bank rate do not necessarily affect the actual lending rates, i.e. the cost of credit to the final borrower.

As a rule the raising or lowering of Bank rate – which is nearly always followed by a corresponding change in interest rates on advances Treasury bills, and on the compulsory reserves – does not so much exert a direct influence on the lending rates of banks as modify their general attitude. They regard such measures as an official indication of changed conditions on the money market and seek to adapt their business policy – in particular the extending of credit – accordingly.

An indirect effect of changes in Bank rate on the rates charged by banks to borrowers in some cases results from changes in interest rates on deposits. Although the latter rates, which are also laid down – in this case as maximum rates – in an inter-bank agreement, are not tied to Bank rate, they are renewed and sometimes altered following a change in Bank rate. Such changes are usually made when the raising or lowering of Bank rate is coupled with a corresponding change in interest rates on short and medium-term Treasury paper and when otherwise the relationship between deposit rates and Treasury bill rates would be disturbed. The effect of the change in deposit rates on bank earnings will then have repercussions, to some extent, on the rates charged by banks to borrowers.

## CHAPTER 2

### OPEN-MARKET POLICY

14. Although under its statute the Banca d'Italia is empowered to buy and sell Treasury bills and government and government-guaranteed bonds, it does not systematically use this right to conduct an effective open-market policy. It has in its portfolio scarcely any suitable securities, such as Treasury bills, for such operations. Moreover, in Italy there is no money market similar to that of other countries on which the banks' supply of and demand for short-term credit can be balanced. The Italian money market is almost entirely an inter-bank market and its interest rates seldom change.

15. The Treasury whose issues on the money and capital markets influence the liquidity of banks and of the economy as a whole, only occasionally carries out operations for purposes of open-market policy, as for example when it issued medium-term Treasury bonds (Buoni del tesoro poliennali, with a life of 7 or 9 years) in 1959. On that occasion the Treasury drew some 300 000 million lire, which was chiefly the result of foreign exchange surpluses in that year, from the market and immobilized this liquidity in accounts at the Central Bank.

In general, however, the Treasury's intervention on the money and capital markets cannot be considered as open-market operations comparable with those of other countries. This is a result of the special situation of the Italian credit system and of the Treasury's debt policy. Thus for example Treasury bills (Buoni del tesoro ordinari - with currency periods 1 to 12 months) are usually issued on tap; in the past the interest rates for these bills have always, with one exception, been changed at the same time as the Banca d'Italia's discount rate. Since May 1952 the nominal rate for 12-month Treasury bills has coincided with the discount rate; since the rate on Treasury bills is a discount, the effective yield is higher - 3.63% as compared with a nominal rate of 3.5% at present on 12-month Treasury bills. The Treasury bills in circulation (end-1960 1 769 000 million lire) are held mainly by the banks (1 592 000 million lire) but the majority (1 350 000 million lire) are held in conformity with compulsory reserve obligations (1 213 000 million lire) and other commitments (137 000 million lire). At present the Banca d'Italia purchases no Treasury bills from the banks, while dealings in Treasury bills between the banks are insignificant.

16. Swap transactions (foreign exchange against lire) between the Exchange Office (Ufficio Italiano dei Cambi) and the banks form a kind of open-market operation. The banks buy spot currency from the Exchange Office and sell it back to the Office forward. They use the spot proceeds for foreign currency

credits to residents and non-residents, to increase their own holdings of foreign exchange and investments on foreign money markets or to repay advances obtained earlier from foreign correspondents.

Bank liquidity is partly frozen by the purchase of foreign exchange. In the period from the autumn of 1959 to the end of January 1961 the banks purchased about \$491 million of foreign exchange in this way from the Exchange Office. The effect was to reduce bank liquidity by 306 600 million lire. The policy of swap transactions by the Exchange Office is explained by the efforts of the Italian monetary authorities to induce the banks to reduce their net indebtedness abroad. In November 1959 this amounted to \$488 million, but by the end of January 1961 the position had changed to a net claim of \$19 million. The large net indebtedness of the banks was due to the fact that they had been borrowing abroad at low interest rates and lending the foreign currency so obtained to residents at higher interest rates (especially to finance imports).

## CHAPTER 3

### MINIMUM RESERVE POLICY

#### *a) General*

17. As long ago as 1926 a regulation anticipating the present minimum reserve system was introduced to protect the interests of savers and depositors. Under this regulation the banks were obliged, when customers' deposits rose to over twenty times the amount of their own capital and reserves, to place a sum equal to the excess on interest-bearing deposit with the Central Bank. Alternatively they could invest this sum wholly or partly in fixed-interest government securities to be deposited with the Central Bank.

In 1947 this arrangement was changed. Whereas previously the main object had been to protect depositors, the new regulation placed in the hands of the Banca d'Italia an instrument of monetary policy by which it could influence bank liquidity. This change was introduced by agreement with the banks.

#### *b) Credit institutions subject to minimum reserve obligations*

18. The minimum reserve regulation applies to all credit institutions except some of the specialized institutions. It first applied only to the public law credit institutions (Istituti di credito di diritto pubblico), the banks of national interest (Banche d'interesse nazionale), the ordinary credit banks (Banche di credito ordinario) and the people's banks (Banche popolari cooperative). Since 1 September 1958 it also applies to savings banks and pawnbrokers of the first category (Casse di Risparmio e Monti di I categoria<sup>1</sup>), since for some years these institutions have dealt to an increasing extent in short-term credit. The postal Cheque Offices, on the other hand, are not subject to the obligation because their funds are in any case deposited with the Treasury. The agricultural credit institutions come under a special regulation.

#### *c) Calculation of minimum reserves*

19. The calculation of minimum reserve is based on sight, time and savings deposits. The minimum reserve ratio is the same for all classes of deposit and for all banking centres. Inter-bank deposits are not subject to minimum reserve obligations. There is a special ruling for the lira balances of non-residents (see under f).

<sup>1</sup> See also footnote<sup>1</sup> on page 157.

The compulsory minimum reserve for the banks is calculated as follows :

- i) 20% of deposits which on 30 September 1947 exceeded ten times the capital and reserves of the bank at that date, but with an upper limit of 15% of total deposits ;
- ii) 40% of the increase in customers' deposits since 30 September 1947 ; if capital and reserves have increased, a sum is deducted corresponding to ten times the increase ;
- iii) under the regulation valid until the end of 1961, the total minimum reserves were not to exceed 25% of deposits (from 31 January 1962 22 ½ % see sec. 27).

Since, on the foregoing calculation, the maximum figure was soon reached, it may be said that up to the end of 1961 the banks had to hold minimum reserves of about 25% of customers' deposits and from January 1962 22 ½%. For the purposes of calculating the minimum reserve obligations, the capital and reserves of the banks mean their paid-up share or endowment capital together with ordinary and extraordinary reserves not earmarked for specific purposes.

20. The minimum reserve ratio for savings banks and first category pawn-brokers is only 20% of the increase in customers' deposits. The reserves can be deposited with the Banca d'Italia or the central credit institution of the Italian savings banks (Istituto di credito delle Casse di Risparmio); in the latter case the central credit institution must deposit half the reserves with the Banca d'Italia and comply with certain provisions regarding the employment of the other half.

Under legislation adopted in 1932 the agricultural banks (casse rurali ed artigiane) were required to invest a minimum of 10% of their customers' deposits in Government bonds or bonds of the special credit institutions and to deposit them with the Banca d'Italia or other authorized institutions. By a 1955 act the compulsory minimum ratio for agricultural banks in the form of limited liability co-operative societies was raised from 10% to 20% of customers' deposits.

21. The minimum reserves to be held by the banks are calculated in the first half of each month on the basis of the deposits subject to the minimum reserve obligation held at the end of the previous month. As a rule the banks bring their reserve commitments up to date during the month following the reference date. In the event of delay, the Banca d'Italia does not charge penalty rates of interest but defaulting banks receive a strongly-worded reminder. The banks can place surplus reserves on ordinary accounts with the bank of issue at an interest rate of between 0.5% and 2% (see page 159).

*d) Minimum reserve deposits and interest*

22. The banks can discharge the minimum reserve obligation either by holding  
170 balances on an account or by depositing Treasury bills at the Banca d'Italia.

Although Treasury bills – the interest on which is paid by discount – yield more than minimum reserve deposits bearing interest at the same rate (now 3.75%), but credited at a later date, up to the beginning of 1960 about half the reserves took the form of balances at the Central Bank. Subsequently the banks' holdings of Treasury bills under the minimum reserve system tended to increase faster than their balances with the Central Bank (see Table 6). The interest on minimum reserve balances is also borne by the Treasury.

23. A bank's preference for one type of reserve rather than another depends on its own situation and particularly on the size of its cash balances and holdings of Treasury bills. Since the reserves can only be drawn on in proportion to a fall in deposits and Treasury bills must reach maturity before they can be encashed (because they cannot be rediscounted by the Central Bank), it is in the banks interest to keep part of the reserves in balances at the Banca d'Italia; they can when necessary draw on them to meet commitments and replace the drawings by Treasury bills. They can also use this method if they need additional cash but do not wish to have recourse to Central Bank credit, or if they wish to invest surpluses. The depositing of Treasury bills and reduction of Central Bank balances is equivalent to mobilization of (free) Treasury bills before maturity, while the reverse procedure enables the banks to earn interest (now 3.75%) on their reserves without being tied to maturity dates.

24. Under this minimum reserve system the Banca d'Italia can buy Treasury bills up to the extent of the minimum reserve balances held with it by the banks; these purchases are made with due regard for the Treasury's cash requirements and are recorded under "impieghi in titoli per conto del tesoro" on the assets side of the balance-sheet of the Banca d'Italia, the corresponding item on the liabilities side being the minimum reserve balances of the banks. Whereas minimum reserve balances stood at 508 100 million lire at the end of 1955 and 676 500 million lire at the end of 1960, this item on the assets side showed a fall from 355 000 million lire at the end of 1955 to 20 000 million lire at the end of 1960.

*e) Reserve obligation for bank drafts in circulation*

25. A similar rule to that for minimum reserves applies to outstanding bank drafts (assegni circolari). Against drafts of this type issued the banks are required to deposit at the Central Bank as security part of the funds received, i.e. 40% of the amount of the drafts in circulation. If, however, this exceeds the bank's capital and reserves, the full amount of the excess must be deposited at the Central Bank. In 1947 the obligatory cover for bank drafts issued in excess of capital and reserves was reduced to 60%, but in 1953 it was again raised to 100%. Since then the cover must be held in the form of Treasury bills deposited at the Central Bank.



**Table 6**  
**MINIMUM RESERVES**

in '000 million lire

Heading	Treasury bills held by banks	Balances at Central Bank			Total Minimum reserves	As % of minimum reserves		
		Counterpart covered by investment in Treasury bills	Others	Total		Treasury bills held by banks	Counterpart covered by investment in Treasury bills	Others
End of Period	1	2	3	4 = 2 + 3	5 = 1 + 4	6 = 1 : 5	7 = 2 : 5	8 = 3 : 5
1956 December	555.8	345	155.5	500.5	1 056.3	52.6	32.7	14.7
1957 March	558.9	350	178.3	528.3	1 087.2	51.4	32.0	16.6
June	565.8	350	186.3	536.3	1 102.1	51.3	31.8	16.9
September	572.8	347	200.8	547.8	1 120.6	51.1	31.0	17.9
December	618.7	345	200.2	545.2	1 163.9	53.2	29.6	17.2
1958 March	511.1	340	362.2	702.2	1 213.3	42.1	28.0	29.9
June	554.6	330	382.5	712.5	1 267.1	43.8	26.0	30.2
September	468.3	330	503.9	833.9	1 302.2	36.0	25.3	38.7
December	617.8	325	445.0	770.0	1 387.8	44.5	23.4	32.1
1959 March	604.0	290	574.1	864.1	1 468.1	41.1	19.8	39.1
June	629.7	234	676.0	910.0	1 539.7	40.9	15.2	43.9
September	687.5	154	713.3	867.3	1 554.8	44.2	9.9	45.9
December	894.7	128	635.0	763.0	1 657.7	54.0	7.7	38.3
1960 March	892.9	98	718.6	816.6	1 709.5	52.2	5.7	42.1
June	1 061.9	74	636.2	710.2	1 772.1	59.9	4.2	35.9
September	1 051.9	40	762.7	802.7	1 854.6	56.7	2.2	41.1
December	1 285.0	20	656.5	676.5	1 961.5	65.5	1.0	33.5

Source: Bollettino of the Banca d'Italia.

*f) Reserves for non-residents' balances*

26. In respect of the lire balances of non-residents the banks must keep 50% on deposit with the Banca d'Italia on so-called "M" accounts, earning 0,5% interest.

*g) Efficacy of the minimum reserve policy*

27. The Comitato interministeriale per il credito e per il risparmio (inter-ministerial committee for credit and savings) has power to change the minimum reserve ratio. But the first time it did this since the agreement was introduced in 1947 was in January 1962, when the ratio was lowered from 25% to 22.5%. Before this reduction the actual ratio of minimum reserve balances and Treasury bills to customers' deposits at the banks<sup>1</sup> was about 23 - 24%.

Assuming the minimum reserves ratios remain unchanged as was the case from 1947 to end of 1961 bank liquidity is frozen only, when customers' deposits rise, and correspondingly bank liquidity is released, when deposits fall. Since 1947 customers' deposits with the banks have steadily increased. Bank<sup>1</sup> deposits subject to minimum reserve obligations went up from 4 511 900 million lire at the end of 1956 to 8 156 000 million lire at the end of 1960, while minimum reserve balances and Treasury bills held under the minimum reserve system rose from 1 056 300 million lire to 1 883 500 million lire.

28. The minimum reserve ratio is relatively high in comparison with other countries (the Netherlands 6% - 10%, Germany 7% - 20%), particularly when it is remembered that this ratio is applied indiscriminately to sight, time and savings deposits. However, this high ratio does not seriously impair the earning capacity of the banks, since minimum reserve balances and Treasury bills at present earn interest at 3.75%, which is still 0.25% higher than the Banca d'Italia's discount rate and rate for advances against security.

29. The effect of the Italian minimum reserve regulations on bank liquidity cannot be measured only by the total size of the compulsory reserves. It depends much more on the extent to which the banks decide to use their Central Bank balances or their Treasury bill holdings to bring their reserves into line with the minimum reserve obligation whenever their customers' deposits rise or fall. The effect will also be determined by changes made by the banks, independently of changes in their customers' deposits, in the ratio between the two forms of reserves (see sec. 23).

This ratio lies outside the influence of the Banca d'Italia for each bank can itself determine what proportion of its minimum reserve is to be kept in what form. Furthermore, it should be remembered that purchases of Treasury bills by the Central Bank in connection with the banks' minimum reserve balances

<sup>1</sup> Excluding savings banks and pawnbrokers.

can swell bank liquidity, on the assumption that the Treasury uses the proceeds from the sale of these bills to the Central Bank for payments within the country.

In January 1962 the minimum reserve ratio for banks (*aziende di credito*) was changed for the first time since 1947. It was reduced from 25% to 22.5%. This measure released about 200 000 million lire of the banks' minimum reserves, so that bank liquidity (free balances and free Treasury bills) rose by that amount.

## CHAPTER 4

### CASH MANAGEMENT AND BORROWING OF PUBLIC AUTHORITIES AND THEIR EFFECTS ON LIQUIDITY

30. The Banca d'Italia is the fiscal agent of the Treasury and manages its accounts. The most recent law of December 1960 entrusts these responsibilities to it until 31 December 1970, after which the authority must be renewed.

The Banca d'Italia collects all revenue due to the Treasury and makes payments on its behalf. Consequently the difference between the flow of income and that of expenditure influences bank liquidity. Income is particularly high on the recurrent tax payment dates. Some idea of the magnitude of the money movements on these dates can be formed from the fact that, of the annual budget revenues totalling about 3 400 000 million lire, more than 500 000 million lire is accounted for by direct taxes which fall due in the even-numbered months. During these months and particularly at the middle of each month liquidity consequently falls by about a sixth of the above-mentioned sum (about 85 000 million lire). Apart from unimportant exceptions, other taxes are collected continuously throughout the year.

31. The local and regional authorities generally keep their accounts with the banks; the cash transactions of individual budgetary authorities, therefore, do not significantly affect the liquidity of the banking system as a whole. These authorities at the moment have an annual income of the order of 1 100 000 million lire and expenditure of 1 500 000 million lire, while their indebtedness stands at about 1 500 000 million lire. The State contributes to their finances either by allotting them a percentage of the taxes collected under the central government budget, on conditions which vary according to the type of authority, or by a grant from budget funds.

Other public institutions (i.e. bodies other than the central, regional and local authorities) which for financial or administrative reasons have close ties with the government, keep their liquid funds at the Treasury (about 400 000 million lire), while others (including the above-mentioned local and regional authorities) which have less close ties with the State, deposit their funds with the banks (about 700 000 - 800 000 million lire).

32. The Postal Cheque Offices and the Post Office Savings Banks transfer their liquid funds to the "Cassa depositi e prestiti", an independent department of the Treasury, which lends them on a long-term basis to public institutions, 175

particularly local and regional authorities and co-operatives, and invests them in government or government-guaranteed securities ; the remainder is kept at the Treasury on current account. The Treasury , Postal authorities and "Cassa depositi e prestiti" are very closely linked administratively and financially and the two last-named carry out their cash transactions through the Central Bank. Consequently the effects of transactions by the Postal Authorities and the "Cassa depositi e prestiti" on bank liquidity are about the same as those of transactions by the Treasury.

At the end of December 1960 the funds held by the Postal Authorities amounted to 2 461 000 million lire (342 000 million lire savings' deposits, 1 723 000 million lire Postal Savings bonds (buoni fruttiferi) and 396 000 million lire Postal Cheque deposits, of which 228 000 million lire were from public institutions). The deposits of the "Cassa depositi e prestiti" with the Treasury stood at 1 202 000 million lire.

33. Since the end of the war the central government budget in Italy has constantly shown a deficit, which the Treasury has financed by recourse to the Central Bank and by issues of securities.

The Banca d'Italia is one of the Treasury's most important sources of credit. Under Statutory Order No. 544 of 7 May 1947 the Central Bank may allow the Treasury cash credit up to 15% of budget expenditure other than capital expenditure. On the basis of current expenditure in 1960 of 3 185 000 million lire a maximum cash credit of about 475 000 million lire is at present available to the Treasury. If the debit balance on the cash advance account exceeds the maximum, the Central Bank must inform the Minister of the Treasury. Twenty days after this has been done, the Banca d'Italia will make no more payments for account of the Treasury until the debit balance on the account brought back within the 15% limit.

34. As will be seen from Table 7, the Treasury has never yet taken up cash credits up to the ceiling authorized under the above-mentioned order. On the contrary, in 1959, thanks to the particularly favourable financial situation of the Treasury in that year, the cash credits were even paid off. The Treasury has in any case other means of recourse to the Central Bank than cash credits, as Table 7 shows :

*Storage Agency bills* : The financing of stocks is carried out through the rediscounting of bills issued by the Storage Agencies and discounted by the credit institutions. At the beginning of every harvest season, the Storage Agencies finance the harvest in this way. The balance of the debt is borne by the Treasury and has its counterpart either in stocks or in the difference between the proceeds of the sales and the higher prime costs.

*Foreign currency credits* : The item "Financing of the Treasury by the Exchange Office" shows the sales of foreign currency by the Exchange Office to the Treasury for the financing of imports on Government account ; this account

Table 7

## DEBIT AND CREDIT POSITION OF TREASURY WITH BANCA D'ITALIA

in '000 million lire

	Debtor accounts							Creditor accounts			Net Indebtedness	For information		
	Financing of Storage Agency Bills	Financing of the Treasury through Exchange Office	Government securities	Treasury Bills (minimum reserves)	Cash credits	Extraordinary advances	Other debtor accounts	Total (1-7)	Current account	Sundry deposit accounts		Total (9 + 10)	Banca d'Italia balance-sheet total	Banca minimum reserves (deposits with the Central Bank)
	1	2	3	4	5	6	7	8	9	10	11	12	13	14
1955	318	285	129	355	187	567	6	1847	-	52	52	1795	508	2471
1956	396	283	133	345	148	567	8	1879	-	35	35	1844	500	2636
1957	380	267	150	345	202	567	5	1916	-	43	43	1873	545	2841
1958	383	270	143	325	155	567	16	1859	-	35	35	1824	769	3298
1959	427	244	165	128	-	567	18	1549	162	44	206	1343	763	3557
1960	437	202	175	20	-	549	5	1388	159	38	197	1191	677	3652

Source: Annual Reports of the Banca d'Italia.

is debited with the equivalent in lire of the sales of exchange, which is credited to the current account of the Exchange Office at the Central Bank. The balance on this special account represents a liability of the Treasury.

*Government securities*: The item "Government securities" partly consists of securities transferred from the Treasury to the Exchange Office and from the latter to the Central Bank to cover liabilities from transactions similar to those mentioned above (Article 41 of the Statutes of the Banca d'Italia).

*Treasury bills (minimum reserves)*: The Central Bank buys Treasury bills on the basis of the minimum reserve balances held by the banks. As already explained in section 24, the Central Bank can purchase Treasury Bills up to the level of the banks' minimum reserve balances, which amounted to 677 000 million lire at the end of 1960. Independently of the minimum reserve rule the Banca d'Italia may, under Article 41 of its statutes, make unlimited purchases of Treasury bills.

*Extraordinary advances*: The extraordinary advances owe their origin to financing carried out during the war and post-war period and partly represent the counterpart of the bank notes put into circulation by the Allied authorities during the occupation.

35. A further important source of funds for the Treasury is the issue of short and medium-term securities. First place here goes to the Treasury bills held by the banks chiefly in conformity with the minimum reserve regulation. At the end of 1960 the banks held a total of 1 552 000 million lire in Treasury bills; 1 285 000 million lire of this consisted of Treasury bills earmarked as minimum reserves.

The Treasury also finances much of its requirements by issuing medium and long-term loans on the capital market. Here the most important issues are 7 and 9-year Treasury bonds (Buoni del tesoro poliennali), the outstanding amount of which amounted at the end of 1960 to some 2 000 000 million lire. These are bought mainly by business enterprises and individuals (end of 1960 about 1 200 000 million lire), but the banks also hold a considerable amount (end-1960 about 540 000 million lire).

In general the Treasury issued its securities on the capital market in the light of its financial requirements. Before an issue is made the Treasury and the Banca d'Italia discuss the size, timing and terms of the issue with particular reference to the aspects affecting liquidity policy. In exceptional cases the Treasury has also made issues for purposes of open-market policy. For example, as mentioned in section 15, the Treasury issued a loan of 300 000 million lire in 1959 for the sole purpose of withdrawing liquidity from the market.

36. The total effect of the Treasury's financial operations on the liquidity of the banks and of the economic system in general can be seen from the debit and credit accounts of the Treasury with the Central Bank. It has already been pointed out that the Treasury's operations are almost exclusively designed

to meet the Government's financial requirements and are only seldom carried out for purposes of monetary policy. There has been hardly any need for the Treasury to intervene in monetary policy, since Italy's general economic development has not been disturbed by violent fluctuations of the business trend since the stabilization of the lira in 1947 and no monetary tension has been felt.



## CHAPTER 5

### DIRECTIVES ON CREDIT AND LIQUIDITY

37. The legislation and directives on banking practice impose certain restrictions on lending, which are embodied in the statutes of the institutions concerned. This applies particularly to the savings banks, the first category pawnbrokers and the agricultural and craft credit institutions.

The banking law also empowers the Interministerial Committee for savings and credit to lay down regulations on:

- i) the ratio between the banks' various forms of lending and investment, either from considerations of liquidity or from the angle of the business sectors to which the advances are made ;
- ii) the ratio between capital and reserves and commitments, and the investments by which customers' deposits in excess of the amount determined by this ratio should be covered ;
- iii) guarantees which must be furnished to avoid an accumulation of risks arising from the expansion of credit ;
- iv) the obligation to obtain the Banca d'Italia's permission for certain lending and investment transactions ;
- v) the issue of bank drafts ("assegni circolari").

38. The law also provides that the Banca d'Italia can issue regulations on:

- i) the ratio between authorized capital and investments in fixed assets and securities,
- ii) Credit ceilings.

The legislation and directives further provide that deposit banks may not grant credits in excess of a fifth of their capital and reserves without first obtaining the authorization of the Banca d'Italia and that shares may be purchased for account of customers only. Investments in bonds, on the other hand, are permissible.

**Part five**

**THE INSTRUMENTS OF MONETARY POLICY  
IN BELGIUM**



## CONTENTS

Introductory remarks	185
<i>Liquidity of the economy – Bank liquidity</i>	
Chapter 1: Refinancing policy	191
<i>Conditions of discount credit (qualitative conditions – rediscount ceilings) – The role of the Institut de réescompte et de garantie (IRG) – Efficacy of refinancing policy</i>	
Chapter 2: Open-market policy	200
<i>The role of the Fonds des rentes – The structure of the money market – Efficacy of open-market policy</i>	
Chapter 3: The system of banking ratios and minimum reserves	209
Chapter 4: Cash management and borrowing of public authorities and their effects on liquidity	213

## TABLES

1 – Domestic money supply	187
2 – Near-money (secondary liquidity)	188
3 – Factors determining changes in domestic liquidity	189
4 – Volume and financing of the bill portfolio of the Institut de réescompte et de garantie	195
5 – The market for public loans, issues and redemptions and operations by the Fonds des rentes	201
6 – Principal assets and liabilities of the Fonds des rentes	205 183

TABLES (continued)

7 - Terms of issue of Treasury certificates and for dealings therein 206

DIAGRAM

Bank rate and interest rates in the money and capital markets 198

## INTRODUCTORY REMARKS

1. In their monetary policy the Belgian authorities make use mainly of discount policy; open-market policy has so far been of less significance. Since the beginning of this year the monetary authorities have also had at their disposal a minimum reserve system. It is a feature of Belgian monetary policy that two institutions – the Fonds des rentes (Securities Stabilization Fund) for open-market operations and the Institut de réescompte et de garantie (Rediscount and Guarantee Institute) for part of the discount business – to some extent take precedence of the Central Bank.

Belgian monetary policy and the way in which it is conducted by the appropriate authorities will be better understood if the following factors are borne in mind: foreign payments transactions are of relatively greater importance than in some other EEC Member States; the note and coin circulation is high; the national budget has been in deficit for many years; there is a multiplicity of authorities competent for monetary policy (Treasury, Banque nationale de Belgique, Commission bancaire and the Fonds des rentes, managed, however, by the Treasury and the Central Bank)

### *a) Liquidity of the economy*

2. In its analyses the Banque nationale de Belgique sets out not only the total notes and coin in circulation and sight deposits, but also, as is done in the Netherlands, certain other claims on money-creating institutions<sup>1</sup> and on savings banks; these are referred to as near-money (liquidités quasi-monétaires).

Apart from cash and sight deposits of firms and individuals with money-creating institutions, the *domestic money supply* includes the public sector's sight deposits (Treasury balances with the Postal Cheque Office and holdings of local authorities, mainly with the "Crédit communal").

"Near-money" includes savings accounts, time deposits and foreign exchange balances of residents at banks, savings deposits and balances with the Caisse générale d'épargne et de retraite (General Savings and Pensions Fund), and savings deposits for a term of less than two years with the private savings banks.

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<sup>1</sup> These include: Banque nationale de Belgique, Fonds monétaire belge (which issues coin only), the commercial banks (banques de dépôts), Crédit communal, Caisse nationale de crédit professionnel and the Postal Cheque Office.

3. In its monthly "Bulletin" the Banque nationale de Belgique publishes a table on the composition and distribution of the money supply (see Table 1). In its annual report the Bank further shows the composition of the near-money held at the banks and savings banks (see Table 2). It will be seen from this table that savings deposits with the savings banks constitute by far the greater part of this near-money (70% in September 1961). Since the Treasury's short-term securities are held almost exclusively by the banks and certain other financial institutions, they are not included in the calculation of overall liquidity.

On the basis of the quarterly consolidated balance-sheet of the money-creating institutions the Banque nationale de Belgique publishes a quarterly table on *the factors determining changes in domestic liquidity* (that is to say including near-money but excluding deposits kept with the General Savings and Pension Fund and the private savings banks). This survey is reproduced as Table 3.

The following are the main factors quoted as determining domestic liquidity: the granting of credit to firms and individuals, advances to public authorities, transactions with foreign countries (excluding the capital transactions of the public sector) and the creation of liquidity through the realization of public securities. The public sector's capital transactions with foreign countries and credits granted by the banks are shown in this survey under the heading "monetary financing of the public authorities".

#### *b) Bank liquidity*

4. In contrast to the Nederlandsche Bank and the Deutsche Bundesbank the Banque nationale de Belgique does not, in its analyses, publish tables on changes in bank liquidity and on the factors determining it. Nevertheless it is possible, with the help of the balance-sheets of the Banque nationale and the commercial banks and of the annual Report of the Banking Commission to picture the trend of bank liquidity and the relative significance of the various determinant factors.

*Liquid cash holdings*, which consist of cash in hand, money at call and deposits with the Banque nationale de Belgique, the Postal Cheque Office and the Caisse nationale de crédit professionnel, are relatively low. Between the end of 1957 and the end of 1960 the holdings of the banks averaged 4½% of the balance-sheets total. The cash ratio system (coefficient de trésorerie, see page 32) required the banks to maintain a certain cash liquidity in relation to their liabilities.

5. The "*potential liquidity*" of the Belgian banks consists largely of commercial bills and bank acceptances rediscountable with the Central Bank or the Rediscount and Guarantee Institute. For years the banks' holdings abroad

**Table 1**  
**DOMESTIC MONEY SUPPLY**

(Bfrs. '000 million)

Heading	Cash			Deposits					Total deposits	Total money supply	Proportion of cash in total money supply
	Treasury notes and coin	Notes of the Banque nationale de Belgique	Total cash <sup>1</sup>	Of the Treasury with the Postal Cheque Office, and of local authorities with credit institutions <sup>3</sup>	of firms and individuals <sup>2</sup>			Total			
					On current account with the Central Bank	With the Postal Cheque Office	Sight deposits (up to 1 month) with credit institutions <sup>4</sup>				
End of year	1	2	3	4	5	6	7	8	9 = 4 + 8	10 = 3 + 9	11 = 3 : 10
1957	5.4	112.7	115.5	6.4	0.9	22.0	53.2	76.1	82.5	198.0	58.3
1958	5.5	117.4	120.3	7.2	0.5	24.0	57.5	82.0	89.2	209.5	57.4
1959	5.6	118.3	121.3	7.6	0.5	25.8	61.1	87.4	95.0	216.3	56.1
1960	5.8	124.1	126.8	7.3	0.7	26.9	58.7	86.3	93.6	220.4	57.5
1961	6.0	129.1	132.2	10.0	0.6	27.9	66.7	95.2	105.2	237.4	55.7

<sup>1</sup> Less holdings of money-creating credit institutions.

<sup>2</sup> Including semi-public administrations and balances of Congo residents.

<sup>3</sup> Mainly with the Crédit communal.

<sup>4</sup> This includes commercial banks (banques de dépôts) and two special credit institutions: Crédit communal and Caisse nationale de crédit professionnel.

Source: Bulletin d'information et de documentation de la Banque nationale de Belgique (Table XIII - 4).



**Table 2**  
**NEAR-MONEY**  
**(secondary liquidity)**

(Bfrs. '000 million)

Heading	Treasury balances with the Banque nationale de Belgique	Bank deposits 1			Deposits with		Total 7 = 1-6
		in foreign exchange	in Bfrs.		Caisse générale d'épargne et de retraite 3	private savings banks 4	
			at least one month's call 2	savings books			
End of month	1	2	3	4	5	6	7 = 1-6
1957 December	0.3	3.2	11.0	12.3	66.8	17.6	111.2
1958 December	0.6	2.6	14.2	13.2	75.2	20.1	125.9
1959 December	0.5	4.3	16.1	15.4	82.2	23.5	142.0
1960 December	0.2	7.2	19.1	15.6	85.8	25.8	153.7
1958 September	0.5	2.6	14.4	12.5	69.9	19.2	119.1
1959 September	0.6	3.1	16.2	14.7	77.3	22.3	134.2
1960 September	0.3	8.0	18.1	15.6	81.9	25.0	148.9
1961 September	—	8.4	25.2	15.9	86.7 <sup>5</sup>	28.2	164.4 <sup>5</sup>

<sup>1</sup> Balances of Belgian, Luxembourg and Congo residents.

<sup>2</sup> Balances of institutional investors (sociétés financières) with banks are only included from 1958 onwards.

<sup>3</sup> Savings and current account.

<sup>4</sup> Savings and deposit accounts.

<sup>5</sup> Provisional figure.

Table 3

**FACTORS DETERMINING CHANGES IN DOMESTIC LIQUIDITY**  
(money supply + near-money)

(Bfrs. '000 million)

Heading  Period	Money supply  1	Near-money 1  2	Total money supply and near-money  3	Transactions with foreign countries 2  4	Monetary financing of public authorities			Realizing of public securities		Discount and acceptance credits to domestic firms and individuals  10	Credits to non-money-creating credit institutions and institutional investors  11	Bank bonds  12	Miscellaneous  13
					by the State through		by other public authorities  7	through purchases by money-creating credit institutions  8	through Fonds des rentes  9				
					sales of securities to banks  5	net sales of foreign exchange  6							
1957	- 0.3	+ 1.3	+ 1.0	+ 1.3	- 1.1	+ 0.7	- 1.6	+ 1.2	- 1.7	+ 3.4	+ 0.1	- 0.6	- 0.7
1958	+ 11.5	+ 3.8	+ 15.3	+ 14.9	+ 4.3	+ 1.4	- 0.1	+ 1.9	+ 2.2	- 8.4	+ 1.7	- 1.7	- 0.9
1959	+ 6.8	+ 5.8	+ 12.6	+ 0.7	+ 7.0	- 4.0	+ 1.5	+ 1.8	+ 1.4	+ 4.4	+ 0.2	- 0.3	- 0.1
1960	+ 4.1	+ 5.8	+ 10.5	+ 1.9	+ 3.0	+ 0.9	+ 1.9	+ 0.2	+ 1.9	+ 4.7	+ 0.2	- 0.7	- 3.5
1961													
1st qtr	+ 2.2	+ 3.4	+ 5.4	- 1.9	+ 5.3	+ 0.2	- 0.6	+ 1.1	- 0.5	- 1.6	+ 0.8	- 0.3	+ 2.9
2nd qtr	+ 4.7	+ 0.4	+ 4.5	+ 0.1	+ 5.9	- 6.1	+ 0.6	- 0.1	+ 0.3	+ 2.7	+ 0.7	- 0.3	+ 0.7
3rd qtr	+ 1.8	+ 3.6	+ 5.3	+ 4.0	+ 4.0	- 1.7	- 0.5	+ 0.8	+ 0.1	+ 0.5	-	- 0.2	- 1.6
4rd qtr	+ 8.9	+ 1.9	+ 10.6	+ 5.5	- 6.4	+ 1.0	+ 2.3	+ 0.9	+ 0.6	+ 6.5	+ 0.3	- 0.2	+ 0.1

1 Excl. holdings with the Caisse générale d'épargne et de retraite and private savings banks.

2 Excl. public capital transactions and government grants.

Source: Bulletin d'information et de documentation de la Banque nationale de Belgique (Table XIII - 3).

realisable at short notice have been small. As a rule, the banks are even in net debt on their short-term transactions with foreign countries; from 1953 to 1960 their net debtor position fluctuated from about Bfrs 2 500 million to nearly 7 000 million. Apart from commercial bills and bank acceptances much of "potential liquidity" consists of Treasury and Fonds des rentes paper. These are mobilizable at the Central Bank, but the system of banking ratios (coefficients bancaires) – which has been in existence since 1946 but was considerably modified in 1962 (see page 209) – means that a relatively large part of them is frozen, so that, from the point of view of the banks as a whole, they can only to a limited extent be regarded as "potential liquidity".

The following are the principal factors determining changes in bank liquidity:

- i) changes in the note and coin circulation
- ii) net changes in the foreign assets of the Central Bank
- iii) net transactions of the Government with the Central Bank
- iv) net transactions of the Fonds des rentes with the Central Bank.

6. In the past, the Banque nationale de Belgique has made much less use, in its credit policy, of measures exerting a quantitative and direct influence on bank liquidity than has been the case in the Federal Republic of Germany or the Netherlands. Until the end of 1961 there was no minimum reserve system of the classic type, nor could it very well have existed alongside the system of *banking ratios*. In the course of a reform, the salient points of which will be described below, such a system has now been introduced. Open-market policy is, in turn, not conducted by the Central Bank itself but by a special fund, the Fonds des rentes, on whose business policy the Central Bank however exerts some influence. The Central Bank's powers for influencing the credit business of the banks have therefore largely depended on its refinancing and discount terms. The provisions on banking ratios – which, it is true, have meanwhile been changed – play an important part, certainly so far as the lending and investment operations of the banks are concerned.

The following chapters deal first with the rediscount policy of the Banque nationale de Belgique and then with the open-market policy conducted by the Fonds des rentes in conjunction with the Central Bank. Part of this chapter is devoted to the structure of and operations on the money market. Then follows a chapter on the system of banking ratios as it has been in force so far, with a supplementary explanation of the newly introduced minimum reserve system. The concluding chapter will be on the effects on liquidity of relations between the public authorities and the Central Bank.

## CHAPTER 1

### REFINANCING POLICY

7. The banks call upon the credit of the Banque nationale de Belgique either directly by rediscounting commercial bills or, to a lesser degree, by obtaining current account advances against public securities, or by applying to a special institution, the Institut de réescompte et de garantie (IRG) for rediscounts, especially of bank acceptances; this institution can in turn obtain finance from the Central Bank. As a rule, the banks have been compelled to obtain finance by rediscounting because of the relatively high ratio of note and coin circulation to the money supply (56% at the end of 1961) and of the system of banking ratios; in their credit business they therefore attach considerable importance to rediscountable credits based on the drawing of a bill of exchange. At any rate, commercial bills and bank acceptances play an important part in Belgian credit business. There is a limit on the rediscounting of Treasury paper because, as has been mentioned above, the greater part of the banks' holdings of Treasury paper is frozen – in practice, if not in theory – by the system of banking ratios. If necessary the banks can, however, obtain advances against public securities from the Banque nationale de Belgique, generally up to 95% of the nominal value of the securities pledged, but in some instances only up to 80%.

#### *a) Conditions for discount credit*

8. The acceptance of bills for discount is subject to *qualitative conditions*, some of which are contained in the statute of the Banque nationale de Belgique and some of which it has itself laid down. Moreover, there are quantitative limitations implied in the system of rediscount ceilings.

#### *aa) Qualitative conditions*

Under Article 17 of the statutes of the Banque nationale de Belgique the Bank may discount bills or other paper which serve to finance trade. Under Article 19 such commercial papers must be within 120 days of maturity and bear three signatures known to be sound; however, one signature may be replaced by a pledge (of securities or goods). Under Article 19(2) of the statutes certain bills may be accepted for rediscount bearing only two signatures. The Bank itself lays down other rediscount conditions concerning the type and quality of the bills offered to it. *To promote foreign trade* it has since February 1945

applied a special procedure for rediscounting export and import bills and has frequently changed its conditions.

Also, it is the aim of the interest policy of the Banque nationale de Belgique, by applying differential rates for discount and advances on securities, to exert a *selective effect* on the transactions it is prepared to refinance. The following table shows the rates applied since 18 January 1962; it may be noted that a differentiation between rates of discount for import and export transactions was introduced for the first time since 1951 on 10 November 1960.

**RATES FOR DISCOUNT AND ADVANCES ON SECURITIES  
APPLIED BY THE BANQUE NATIONALE DE BELGIQUE**

	Percentages			
	on 31.12.1960	from 24.8.1961	from 28.12.1961	from 18.1.1962
<i>Discount credits</i>				
Acceptances domiciled with banks, warehouse receipts	5.00	4.75	4.50	4.25
Bank acceptances previously certified by the Banque nationale de Belgique :				
Imports	5.00	4.75	4.50	4.25
Exports	4.00	3.75	3.50	3.25
Acceptances without domicile visa	5.50	5.25	5.00	4.75
Non-accepted bills with domicile visa	5.75	5.50	5.25	5.00
Non-accepted bills without domicile visa	6.25	6.00	5.75	5.50
<i>Advances against security and loans</i>				
Treasury certificates and certificates of the Fonds des rentes of up to 366 days (limit 95 %)	rate of certificates + 5/16 % minimum rate 2 1/4 %			
Other public securities <sup>1</sup> (limit 80 %)	6.25	6.00	5.75	5.50

<sup>1</sup> Only public securities and bills (bearer securities) expressed in Belgian francs are accepted as cover.

9. The policy pursued by the Banque nationale de Belgique in financing internal trade can be described as a *policy of "admissible maturity dates"*. The statutes of the Central Bank authorize it to accept bills for discount which have no more than 120 days to run, which does not necessarily exclude bills drawn initially for longer periods. For many years, however, the Bank has discounted no bills of longer than 120 days' tenor. Until recently it even fixed maximum periods according to the type of goods the sale of which the bill was to finance. At present the bank is a little less rigid in this respect but continues to refuse bills drawn between companies whose interests are too closely linked.

Nor will the Banque nationale de Belgique rediscount any promissory notes for banks which serve to mobilize cash credits or, since 1939, any bills drawn to finance hire purchase.

In the hands of the Central Bank the fixing of qualitative conditions is an instrument which can be easily adapted to circumstances and enables the Bank to exert a direct influence on the supply of credit.

#### *bb) Rediscount ceilings*

10. Apart from setting qualitative rediscount conditions it is open to the Banque nationale de Belgique to influence bank guidance credit by fixing rediscount ceilings. It has laid down for its own use a rediscount ceiling for each bank. These ceilings are not officially made known to the banks and they have never been of any practical significance, as for instance in France or the Federal Republic of Germany.

If the Banque nationale de Belgique feels that the banks have too large a bill portfolio, it prefers the method of "*moral suasion*". In Belgium rediscount ceilings are of greater importance as an influence on bank management rather than as an instrument of credit policy. In practice, the Bank has never yet refused to rediscount bills which met its qualitative conditions. Moreover, the ceilings fixed have so far been reached only in exceptional cases.

11. The following procedure has been laid down for the fixing of rediscount ceilings: in the case of bills which serve to finance business in Belgium, the banks are authorized to call upon the Banque nationale de Belgique up to an amount not exceeding double their own capital and reserves. Another maximum rate (two and a half times the bank's own capital and reserves) has been fixed for bills – especially those to finance foreign trade – which the Central Bank merely certifies (see sec.12).

Purely Belgian bills may be discounted direct by the banks with the Banque nationale de Belgique, whereas bank acceptances which serve to finance foreign trade are handled via the Institut de réescompte et de garantie which only endorses these bills and passes them on to the Central Bank if it cannot

find sufficient day-to-day money. These bank acceptances are included in the maximum amount allocated to each bank in respect of bills for foreign trade transactions.

*b) The role of the Institut de réescompte et de garantie (IRG)*

12. This institution was founded in 1935 for the purpose of mobilizing bank credits up to a term of two years. It was to work as a sort of sluice-gate between the Central Bank and the commercial banks and to support the latter in financing transactions for which rediscounting with the Central Bank is not possible because of their long term. The Institute in turn obtains its finance by taking up short-term credits in the money market (see page 195) and by obtaining rediscount from the Banque nationale de Belgique for bills with a residual period to maturity of up to 120 days. The Bfrs. 600 million capital of the Institute was subscribed by the major Belgian commercial banks. The Belgian State has guaranteed the Institute's liabilities up to Bfrs. 12 000 million.

The importance of this Institute has grown since the Banque nationale de Belgique began, in 1945, to give an assurance of rediscount for bank acceptances and commercial bills relating to foreign transactions up to a certain ceiling, which it fixes for each bank. In order to obtain an assurance of rediscount from the Central Bank, exporters and importers must submit to it for examination the bills they have drawn — mainly on Belgian commercial banks and accepted by the latter. This enables the Banque nationale de Belgique to determine which export and import transactions it is prepared to finance and what period to maturity individual acceptance credits can have. If the conditions for privileged financing of a foreign trade transaction are fulfilled, the Central Bank endorses the bank acceptance with its visa, thus creating a "*certified bank acceptance*".

13. Such a visa confers two advantages. In the first place it makes the bank acceptance rediscountable with the Banque nationale de Belgique, albeit only when its residual period to maturity does not exceed 120 days. More important, however, is the further advantage conferred by the visa that the bill can be rediscounted with the Institut de réescompte et de garantie at an especially favourable rate, which for short-term acceptances, lies below the discount rate of the Central Bank.

Since, as a rule, bank acceptances have lengthy maturities which may run to two years, the advantage conferred by the visa is considerable. As a result, a special market has grown up in these bank acceptances, in which the IRG plays an important part. Since its own funds are not sufficient to finance the purchase of acceptances, the Institute obtains finance by taking up short-term credits on the money market, thereby effecting a capital conversion because its investments in certified bank acceptances have a longer period to maturity. One of the principal suppliers of money for this purpose is the Caisse générale d'épargne et de retraite, which in 1960 provided about Bfrs. 1 000 million in

day-to-day money. Table 4 below shows how the bill portfolio of the Institute is financed.

**Table 4**  
**VOLUME AND FINANCING OF THE BILL PORTFOLIO**  
**OF THE INSTITUT DE REESCOMPTE ET DE GARANTIE <sup>1</sup>**

(Bfrs. million)

Year	Call money credits taken up  1	Rediscount with the Banque nationale de Belgique  2	Bill portfolio  3
1953	2842	755	2 566
1954	2733	1414	2 513
1955	2 540	1 589	2 344
1956	2602	615	2 261
1957	2 514	2 579	1 891
1958	2 504	195	2 583
1959	2981	560	2 521
1960	3 001	380	3 173
1961	3 014	357	3 316

<sup>1</sup> The figures in columns 1 and 2 are not comparable with those in column 3. The former represent averages calculated on data available for each working day. The third contains an average calculated from end-of-month figures. The amounts in that column are lower because some of the bill holdings of the IRG have usually been rediscounted at the end of the month.

Source: Banque nationale de Belgique.

This table shows that the Institute's ability to call on the money market has fluctuated greatly so that it has been compelled to draw more or less heavily on the Central Bank according to the liquidity situation in the money market.

Since the reform of the money market in November 1957 the Institut de réescompte et de garantie markedly fewer calls on the Central Bank for credit. This may be partly due to the fact that the Fonds des rentes has ceased taking up call money as a regular practice but has even been supplying large sums of call money since its financing has been assured by placing its certificates with the banks — until the end of 1961 in part-coverage of their sight deposits (see page 202). For this reason the Institute was able in 1959 and 1960, to take up more call money.

The main reason is, however, to be found in the high degree of liquidity in the Belgian economy and of the banks during the recession of 1958 and the subsequent years.



14. Apart from the business it transacts on its own behalf the Institut de réescompte et de garantie is also, and to an increasing degree, becoming an agent for the placing of *certified bank acceptances*. Belgian and Luxembourg banks and some credit institutions under public law as well as the Caisse générale d'épargne et de retraite, to which reference has just been made, take these up when they seek an interest-bearing investment for their liquid funds. This agency business has greatly expanded over the past years. In 1953 the Institute arranged for the purchase of bank acceptances to an amount of Bfrs. 300 million; in 1959 the figure was Bfrs. 7 200 million and in 1960 8 700 million.

The distribution of bank acceptances (including Bfrs. 9700 million certified) amongst the various groups of institutions at the end of 1961 was as follows:

- Bfrs. 2 400 million with the Banque nationale de Belgique
- Bfrs. 3 000 million with the Institut de réescompte et de garantie
- Bfrs. 2 700 million with the commercial banks
- Bfrs. 6 200 million with institutions which are not in the true sense banks.

### c) *Efficacy of refinancing policy*

15. The direct influence exerted by the Banque nationale de Belgique upon the credit business of the commercial banks through its discount policy is limited in scope. The qualitative discount policy of the Banque nationale de Belgique has so far had little if any effect on bank liquidity, and the rediscount quotas have never really been operative, so that the effect of discount policy has largely been confined to influencing the business trend through *changes in interest rates*. Until the end of 1961 *some leading interest rates* were in varying degree *tied to the discount rate of the Banque nationale de Belgique*. So long as the scope for open-market operations was slight and there was no minimum reserve system, this link was of some importance for the effectiveness of discount policy. The various reforms of the Fonds des rentes, which are described in the following chapter, and the introduction of a minimum reserve system made it possible and even necessary *to loosen this tie*, in particular in the case of rates for money market securities, and to make interest rates more dependent on market conditions as determined by supply and demand. This is in particular true of the rate of interest for 'B' Treasury Certificates (see Table 7, page 206) and for certificates of the Fonds des rentes, which have a currency of four months and are issued by tender. Furthermore, the rate for time deposits, which had hitherto been bound to bank rate by a fixed scale, will in future be laid down by agreement between the Banque nationale de Belgique and the commercial banks, in the light of the money market situation, movements in the balance of payments and the general economic situation.

16. There are other interest rates which are not strictly linked to Bank rate but follow its movements more or less closely.

Since the Institut de réescompte et de garantie may at any time need to call on the Central Bank for rediscount it must adapt its own rates to the movements of Bank rate. It is interesting to note that the Institute's rediscount rate for bills with a remaining period to maturity of up to 120 days is always below the discount rate of the Banque nationale de Belgique, so that the Institute incurs a loss of interest when it takes up bills at these lower rates and rediscounts them with the Central Bank. This loss is, however, made good in the overall transaction by the Institute's having to pay only very low rates of interest when taking up short-term credits in the money market. As will be seen from the diagram on page 198, the call money rate is considerably below the discount rate. It must, however, be pointed out that no comparison is possible between the movements of the call money rate before and after the reform of the call money market in the autumn of 1959.

On the basis of the position at 31 December 1961 the Institut de réescompte et de garantie has charged the following bring rates for certified bank acceptances, Bank rate being  $4\frac{1}{2}\%$  with a preferential rate of  $3\frac{1}{2}\%$  for export bills:

**DEBTOR INTEREST RATES CHARGED BY THE IRG**  
(for bills bearing the first signature of a Belgian bank)

in %

Period to maturity	Import bills	Export bills
120 days max.	$3\frac{3}{4}$ <sup>1</sup>	$2\frac{3}{4}$ <sup>2</sup>
121 to 240 days	$4\frac{1}{2}$	$3\frac{1}{2}$
241 to 365 days	$4\frac{7}{8}$	$3\frac{7}{8}$
366 to 545 days	$5\frac{1}{8}$	$4\frac{1}{8}$
546 to 730 days	$5\frac{1}{2}$	$4\frac{1}{2}$

<sup>1</sup>  $3\frac{7}{8}\%$  for accepted commercial bills.

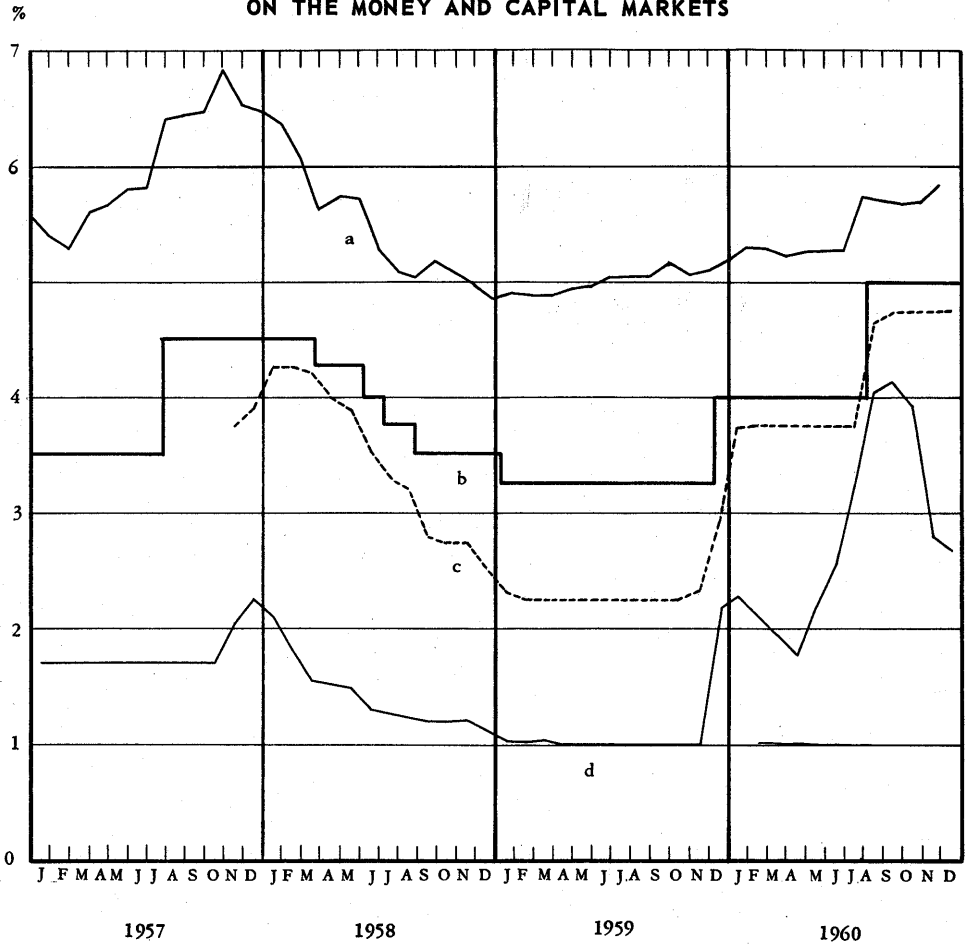
<sup>2</sup>  $2\frac{7}{8}\%$  for accepted commercial bills.

Until the end of 1957 the Institut de réescompte et de garantie adjusted its rates of interest to the prevailing balance-of-payments situation and even applied differential rates for bills according to the currency areas to which the underlying transactions related. The object was to favour exports or imports, as the case might be, or to encourage a given trend in foreign trade in relation to certain currency areas. The latter differentiation was abandoned on 6 December 1957. As can be seen from the foregoing table on the debtor rates of interest charged by the Institut de réescompte et de garantie, a distinction was still maintained between import and export business (except for a temporary interruption from 6 December 1957 to 4 February 1958).

17. The interest rates charged by the banks on advances to firms or individuals are frequently fixed in relation to Bank rate.

Diagram

BANK RATE AND INTEREST RATES  
ON THE MONEY AND CAPITAL MARKETS



- a. Government bonds (5 to 20 years)
- b. Bank rate
- c. Interest rate for Treasury Certificates (4 months)
- d. Call-money rate

Source: Bulletins d'information et de documentation de la Banque nationale de Belgique.

Finally, the rate for Treasury Certificates with period to maturity of up to 4 months is fixed by the Banque nationale de Belgique, which has responsibility for placing this paper. The interest for this short-term Treasury paper may not exceed Bank rate.

18. The effectiveness of discount policy depends on the extent to which the banks and business regard a change in Bank rate as a pointer to a change in the

liquidity situation as a whole, that is to say, it depends on whether, and to what extent, the aims of the Central Bank's discount policy can be translated into practice in the money market and perhaps also in the capital market. The direct influence of changes in discount rate on the decisions of the banks and their customers also plays a part, although probably not a very large one. These points are discussed in the following chapter on open-market policy.

## CHAPTER 2

### OPEN-MARKET POLICY

19. In Belgium, open-market operations are carried out by the Fonds des rentes which, following the latest reforms, is empowered to intervene in the money as well as the capital market. It is true that under the Law on the Activities and Organization of the Banque nationale de Belgique of 24 August 1939 (in the version of 28 July 1948) the Bank is authorized to carry out open-market transactions. Article 11(3) of this law authorizes the Bank to purchase and sell short and medium-term securities issued or guaranteed by the Belgian State, by Luxembourg, or by institutions which enjoy a State guarantee. Under Article 11(9) the Bank can also purchase and sell long-term public bonds quoted on the Stock Exchange. Since the war the Central Bank has, however, ceased operations of this nature which it has left entirely to the Fonds des rentes. On the other hand, the *business of the Fund is managed* by the *Central Bank and the Treasury, acting as equal partners* so that the Central Bank can indirectly bring its influence to bear on those operations of the Institut de réescompte et de garantie which are of monetary importance.

#### *a) The role of the Fonds des rentes*

20. When the Fonds des rentes was established in May 1945, it was given the function of regulating the market for public bonds. To this end the Fund may buy and sell medium or long-term securities issued or guaranteed by the State and it may also buy or sell securities issued by the Régie des téléphones et télégraphes, the Société des chemins de fer belges, the Crédit communal de Belgique, the local government authorities.

The Fonds des rentes accordingly supervised and influenced *the market for fixed interest securities* issued by the above-mentioned public authorities. It absorbed any excess of securities offered or satisfied excess demand, and thereby determined prices. Table 5 on the transactions of the Fonds des rentes on the capital market, in the column headed "Operations of the Fund" quotes figures showing net purchases and sales of securities in the years from 1946 to 1960 inclusive.

When the Fonds des rentes was established, its sponsors had in mind as its most important function the maintenance of normal conditions on the long-term capital market by operations of a regulatory nature. The decisions of the

Table 5

**THE MARKET FOR PUBLIC LOANS, ISSUES AND REDEMPTIONS,  
AND OPERATIONS OF THE FONDS DES RENTES <sup>1</sup>**

(Bfrs. '000 million)

	Issues	Redemptions <sup>2</sup>	Net issues	Operations of the Fonds des rentes,			Net recourse to capital market
				Sales	Buying in	Net transactions	
	1	2	3 = 1 - 2	4	5	6 = 4 - 5	7 = 3 + 6
1946	4.1	2.7	1.4			- 2.2	- 0.8
1947	9.9	3.5	6.4			- 0.9	5.5
1948	8.1	3.2	4.9			- 0.1	4.8
1949	15.7	-	15.7			0.8	16.5
1950	9.5	0.5	9.0			- 1.3	7.7
1951	11.8	4.4	7.4	1.2	0.9	+ 0.3	7.7
1952	25.7	7.4	18.3	1.4	0.6	+ 0.8	19.1
1953	20.9	3.8	17.1	1.8	1.1	+ 0.7	17.8
1954	38.2	12.7	25.5	1.5	3.0	- 1.5	24.0
1955	14.8	0.6	14.2	2.1	1.6	+ 0.5	14.7
1956	24.2	4.3	19.9	0.7	2.1	- 1.4	18.5
1957	19.0	2.1	16.9	2.5	0.7	+ 1.8	18.7
1958	26.6	5.4	21.2	2.4	1.6	+ 0.8	22.0
1959	30.3	2.4	27.9	0.5	1.8	- 1.3	26.6
1960	36.1	13.1	23.0	-	2.1	- 2.1	20.9

<sup>1</sup> This table includes loans by the State, local authorities and semi-public institutions, but not direct sales to institutional investors or rehabilitation loans.

<sup>2</sup> Redemptions by buying in on the Stock Exchange or by drawings are shown in column 5.

Fund to raise or to lower the prices of government securities certainly played an important role in Belgian interest rate policy in the post-war years. Since the Fonds des rentes conducted its policy by agreement with the Central Bank, its operations resulted in *long-term interest rates largely keeping in step with Bank rate.*

21. Apart from this the Fund has been able to exert a *direct monetary influence* by creating or absorbing bank liquidity. Up to 1957 it financed its stock of public securities by taking up very short-term loans in the money market or, if this was not sufficient, by calling upon the Central Bank. The very short-term funds taken up by the Fund until 1957 did not come from the banks, but from institutional investors such as savings funds, pension funds, etc.

Whenever the Fonds des rentes wished to promote an expansive policy it could increase its purchases of public bonds and in this way bring long-term interest rates down; it could also call upon the Central Bank which, on these occasions, widened the credit basis. The aid of the Central Bank sometimes took the form of advances, but for the greater part it consisted in discounting the cash certificates of the Fund, which were set against the State credit line, fixed at Bfrs. 10 000 million. Without this provision the Fonds des rentes could have made such heavy support purchases of State securities financed by Central Bank credits that arbitrage transactions would have been possible, which would have favoured the issue of new Treasury loans.

22. In November 1957, *with the reform of the money market, the Fonds des rentes was entrusted with a further responsibility in connection with monetary policy*; it was allowed to place its own certificates with the banks. The banks could count the certificates of the Fund amongst those assets which were taken into account in calculating the partial cover to be held in Government securities for Belgian franc liabilities of up to a month's term (sight deposits; see page 209).

To the extent that the Fund sterilized the proceeds of placing its certificates with the banks by keeping them in accounts with the Central Bank, the effect was the same as that of increasing the banks' cover ratio, the interest burden falling upon the Fund itself.

If deposits increased, the Fund did not need to issue certificates; in that event the banks had to increase the balances on their Central Bank accounts in order to ensure the partial cover of sight deposits to which reference has been made above. In such case the cost of sterilizing the funds was borne by the banks.

23. After the reform of November 1957 the Fonds des rentes was required to contribute to the stabilization of the government securities market. When deposits with the banks fell off and the banks were consequently able to cash 'B' or even 'A' Treasury certificates, the Fund was obliged in turn to purchase a

corresponding amount of Treasury Certificates in order to protect the Treasury from liquidity fluctuations.

Although under the amended banking ratio system, 'B' Treasury Certificates are now sold by tender, the Fonds des rentes must ensure that the amount outstanding does not fall below Bfrs. 9100 million (see Table 7, page 206).

The reform of November 1957 has not deprived the Fonds des rentes of all possibilities of recourse to the Banque nationale de Belgique. When the Fund must buy back its own certificates or subscribe 'B' Treasury Certificates, it can draw on a current account credit with the Central Bank if its other means are not sufficient. This current account is not included in the 10 000 million credit line.

24. *The law of 19 June 1959 has further extended the Fonds des rentes' ability to operate in the State securities market; it has been explicitly authorized to operate in the market for short-term securities.* To provide the Fund with the means to carry out this new task, additional sources of finance have been put at its disposal, apart from the proceeds from the issue of certificates. It has received from the Government the Bfrs. 2800 million proceeds resulting from the Banque nationale de Belgique's having taken over the Belgian gold subscription to the International Monetary Fund. It also has a current account credit line with the Central Bank, at present fixed at Bfrs. 2000 million. The Central Bank can, acting on its own responsibility and at its own discretion, increase this credit to meet the requirements of the economy; the credit may not be used to provide funds for the Treasury, systematically to support prices in favour of the Treasury, or to supply liquidity to the money market if conditions are tight owing to an outflow of capital to foreign countries.

To these new resources of the Fund must be added the proceeds from the issue of its own certificates, which on 30 June 1959 amounted to Bfrs. 5700 million and on 31 December 1960 to Bfrs. 5800 million.

25. *When the call-money market and the market for very short-term money were reformed on 17 November 1959, the Fund was given yet a third task; the market was unified, the liaison between lenders and borrowers as well as the formation of money market rates became more flexible. The operations of the Fund were thereby facilitated and since then it has to regulate the money market. However, it does so exclusively by granting credits in the call money market. When operating in this way, the Fonds des rentes draws on its balance with the Central Bank – in other words it repays to the commercial banks, either directly or through the Institut de réescompte et de garantie, part of the liquid funds which it has drawn from them by the issue of its own certificates.*

26. *In judging the effectiveness of the transactions of the Fonds des rentes as an instrument of credit policy, two factors must be borne in mind:*



1. The long-term interest rate policy of the Fund in the bond market ; the level of interest applied lowers or raises prices ;
2. Movements in the account which the Fund has with the Central Bank; these may result from drawing liquid funds away from the banks by issuing certificates and from the partial return of these funds to circulation in the economy when the Fund employs them in the market for long or short-term government securities or in the money market. In 1960 the Fund exerted an expansionary influence on bank liquidity for a fairly long period (see Table 6, page 205) by allowing more liquidity to reach the banks by its credit business than it withdrew from them by issuing its certificates or taking up money market credits ; of course it can pursue such an expansionary policy in the long run only by drawing on the Bfrs. 2800 million credited to its account when the Banque nationale de Belgique took over the gold subscription to the International Monetary Fund, or by drawing on its line of credit with the Central Bank.

The movements in the account of the Fonds des rentes with the Central Bank reflect the overall effect of the transactions of the Fund on the volume of liquidity (see Table 6).

*b) The structure of the money market*

27. In the Belgian money market Treasury Certificates and certificates of the Fonds des rentes, call money and commercial bills are used as credit instruments.

So far as public securities are concerned, there has not, so far, been a market in the real sense of the word. This is in part due to the banks' obligation, referred to above, to purchase these securities under the cover ratio system, and partly also to the fact that tax regulations favour the retention of government securities in the portfolio. Also, some leading rates of interest were tied to the discount rate of the Banque nationale de Belgique (see page 196).

The above-mentioned reform of the banking ratio system and the more flexible interest rates in the money market have now made it possible for these securities to be dealt in on a larger scale. Whereas until recently there was a market rate of interest only for short-term certificates (6, 9 and 12 months) issued on the basis of tenders, this now applies to 'B' Treasury Certificates and to the certificates of the Fonds des rentes as well.

As will be seen from the table on the terms and conditions of issue for the various types of certificate (see Table 7, page 206), both the short-term certificates and the 'B' Treasury Certificates as well as the certificates of the Fonds des rentes are now issued by public tender; this is done monthly for the former and weekly for the latter.

Table 6

## PRINCIPAL ASSETS AND LIABILITIES OF THE FONDS DES RENTES

(Bfrs. million)

End of period	Assets					Liabilities				
	Security holdings (nominal)			Balance with the Banque nationale de Belgique	Call-money credits granted	Circulation of own certificates (with banks)	Call-money credits taken up	Security transactions with right of repurchase	Credits taken up with the Banque nationale de Belgique	
	Quoted securities 1	Treasury Certificates							Advances	Discount of cash certificates 2
		Tranche "B"	Others							
1951	4 936	-	-	-	-	-	2 698	250	-	1 562
1952	4 112	-	-	-	-	-	2 350	1 000	-	344
1953	3 532	-	-	-	-	-	1 999	1 000	-	120
1954	5 023	-	-	-	-	-	2 248	1 000	-	1 327
1955	4 533	-	-	-	-	-	2 039	1 000	-	920
1956	5 930	-	-	-	-	-	2 631	800	-	1 998
1957	4 112	1 242	-	-	-	486	2 457	585	1 237	200
1958	3 311	1 370	-	-	-	4 059	274	-	-	45
1959 Jan.	4 298	90	-	-	-	3 893	107	-	-	45
Feb.	3 985	20	-	-	-	3 651	68	-	-	-
March	4 152	-	-	427	-	4 300	-	-	-	-
April	4 339	420	-	1 098	-	5 512	-	-	-	-
May	4 715	40	-	1 351	-	5 757	-	-	-	-
June	5 107	204	-	729	-	5 706	-	-	-	-
July	4 044	160	-	1 072	-	4 949	-	-	-	-
Aug.	4 228	50	-	4 883	-	6 021	-	-	-	-
Sept.	4 784	453	-	3 479	-	5 514	-	-	-	-
Oct.	4 292	187	300	5 056	-	6 663	-	-	-	-
Nov.	4 368	184	1 000	3 342	1 510	7 211	-	-	-	-
Dec.	4 572	623	2 700	1	-	4 608	72	-	-	-
1960 Jan.	4 908	5	1 200	719	1 922	5 421	-	-	-	-
Feb.	5 030	37	100	1 476	2 413	5 760	-	-	-	-
March	4 767	85	-	2 683	1 910	6 147	-	-	-	-
April	4 992	64	1 200	3 925	1 239	8 099	-	-	-	-
May	5 105	228	-	3 545	2 640	8 163	-	-	-	-
June	5 085	201	100	2 862	2 644	7 508	-	-	-	-
July	5 995	70	-	1 188	2 237	5 933	-	-	-	-
Aug.	5 936	6	450	3	1 211	4 242	-	-	-	-
Sept.	6 075	89	1 000	-	103	3 896	-	-	-	-
Oct.	6 097	11	600	75	1 332	4 773	-	-	-	-
Nov.	6 366	-	400	1 312	1 583	6 165	-	-	-	-
Dec.	6 661	1 403	1 200	6	15	5 812	-	-	-	-

1 Including securities sold to semi-public institutions which the Fonds des rentes is entitled to repurchase.

2 Including cash certificates discounted with institutions other than the Banque nationale de Belgique.

Source: Banque nationale de Belgique, Bulletin d'information et de documentation, Table XIV, 4.

Table 7

## TERMS OF ISSUE OF TREASURY CERTIFICATES AND FOR DEALINGS THEREIN

	Treasury Certificates		'A' Treasury Certificates <sup>1</sup>	'B' Treasury Certificates <sup>1</sup> Fonds des rentes Certificates	Special Treasury Certificates
	Very short-term	Short-term			
Currency period	1, 2, 3 months	6, 9, 12 months	1 year	4 months	varying
Interest	Fixed by Central Bank according to market conditions 3.1 - 3.6 % (Jan. 1962)	According to monthly tenders 3.8 - 4 % (Feb. 1962)	1 15/16 %	According to weekly tenders 3.99 % (Jan. 1962)	Agreed between Treasury and purchaser
Method of issue	Subscribed by Banque nationale de Belgique which places them on the market <sup>2</sup>	By monthly tenders	No new issues; only renewal of maturities	By tender; for 'B' Certificates only renewal of maturities	By agreement between purchasers and Treasury; Central Bank not involved
Dealings	Among all operators on money market		Among banks		None
Volume in circulation	Fluctuating	Fixed by Banque nationale de Belgique and Treasury	Bfrs. 19 800 m.	'B' Certificates Bfrs. 9 100 m. Fonds des rentes Certificates not limited	Fluctuating
Repurchase by Central Bank Fonds des rentes	No; but Fonds des rentes does operate on this market		No	Purchase by Fonds des rentes	None

<sup>1</sup> See page 000.<sup>2</sup> The holdings of very short-term certificates by the Banque nationale de Belgique are set against the Treasury credit ceiling of Bfrs. 10 000 m.

The very important part played by the Institut de réescompte et de garantie in the market for commercial bills (mainly bank acceptances) has already been discussed in the previous chapter on refinancing policy.

The *money market* in Belgium is the *call-money market*. This was re-organized in November 1959. Before that date money transactions were for one, five or ten days; since then only one-day transactions have been the rule. The final settlement of the call-money dealings on the market is made at a uniform rate through a central clearing office.

28. Both Belgian and foreign agencies can deal on this market. *In practice their number is limited* because – with the exception of the public authorities, whose liabilities are guaranteed by the State – dealers on the call-money market must deposit with the Banque nationale de Belgique security in the form of government paper or bills rediscountable by the Central Bank. The Belgian banks can also use for this purpose the public debt certificates which they have deposited with the Central Bank as security for advances, in which case the credit line involved will be reduced accordingly.

The Belgian banks, the Caisse générale d'épargne et de retraite, some credit institutions under public law, foreign agencies which have an account with the Banque nationale de Belgique, and the Fonds des rentes figure among those who offer call money. On the demand side we mainly find the Institut de réescompte et de garantie, secondly the Belgian banks and finally the Office national du Ducroire (export credit insurance), other credit institutions under public law, and the Fonds des rentes. Among the "other credit institutions under public law" there are the Caisse nationale de crédit professionnel, the Société nationale de crédit à l'industrie and the Crédit communal de Belgique. These institutions issue short-term cash certificates (bons de caisse) and medium-term loans; they also purchase short-term Treasury Certificates and other money-market securities. Moreover, they give call-money credits or take them up if required.

Among the credit institutions under public law the Caisse générale d'épargne et de retraite and the Institut de réescompte et de garantie hold a special position. At the end of 1960, for example, the former institution invested its surpluses from deposits on savings accounts and from insurance business in very short-term and short-term Treasury Certificates to an amount of Bfrs. 2 000 million and in bank acceptances to an amount of 2 400 million. It also granted call-money credits up to Bfrs. 800 million. The importance of the IRG has been discussed in the preceding chapter.

29. The *Banque nationale de Belgique* plays no part in the call-money market, that is to say *it does not lend or borrow at call*, although it does organize the market. Its function is merely that of an agent placing short-term Treasury Certificates in the money market.

It should be pointed out that the holdings of Treasury Certificates shown in the balance-sheet of the Banque nationale de Belgique, which rose from Bfrs. 4 200 million to 9 800 million between 22 February 1960 and 11 April 1960, are not connected with money-market operations. These figures merely reflect credits granted to the State up to the fixed ceiling.

*c) Efficacy of open-market policy*

30. As explained above, systematic open-market operations have only been possible since the fundamental reform of the Fonds des rentes, so that not much experience has yet been gained with the new system.

The *position of the Belgian Treasury* makes a flexible open-market policy in the money market difficult. The operations of the Fonds des rentes in the long-term securities market are expected to some extent to bring interest rates into harmony with the Central Bank's discount policy. The operations of the Fund in the short-term public bond market have served to cushion the effects on the Treasury of fluctuations in bank liquidity. This was particularly true at the time of the Congo crisis.

At the end of November 1960 the situation of the Fonds des rentes was as follows :

(Bfrs. '000 million)

<i>Assets</i>		<i>Liabilities</i>	
Public bonds	6.4	Certificates issued by the Fund	6.2
Short-term Treasury Certificates	0.4	Drawings on the sums made available to the Fund as a result of the Banque nationale de Belgique's having taken over participation in the International Monetary Fund	2.8
Call-money credits	1.5		
Balance with the Banque nationale de Belgique	1.3		

## CHAPTER 3

### THE SYSTEM OF BANKING RATIOS AND MINIMUM RESERVES

31. Between 1946 and the end of 1961 the banks were subject to the provisions of a Royal Decree concerning the observance of certain ratios between some assets – mainly claims on the Treasury – and the Belgian franc liabilities of the banks (banking ratios – coefficients bancaires). This system was introduced at the time in order to prevent the Treasury securities placed with the banks during the war from being turned into money. At the end of 1961 there were three ratios which applied to the major banks (banques de grande circulation) as follows :

#### *Cash ratio* (coefficient de trésorerie)

##### COMPOSITION

Cash in hand

Deposits with the Banque nationale de Belgique, the Postal Cheque Office, and the Caisse nationale de crédit professionnel, less

– unsecured call-money loans taken up  
– advances from banks

secured call-money loans granted, or loans to public credit institutions for which the State has given a general guarantee (not exceeding 2% of liabilities)

}  
4% of liabilities  
at one month's  
term or longer

#### *Solvency ratio* (coefficient de solvabilité)

Own capital and reserves

}  
Minimum rate 5%  
of liabilities

#### *Cover ratio* (coefficient de couverture)

##### A. *Liabilities expressed in Bfrs. (at up to one month)*

###### a) *Partial cover*

Balances with the Banque nationale de Belgique not already included in the cash ratio

'A' and 'B' Treasury Certificates  
Certificates of the Fonds des rentes

}  
Minimum rate 50%

b) *Diversified cover*

in addition to the items listed under a):

Cash reserves (including call money)  
All government or government-guaranteed securities in Bfrs. (maximum 3 years)  
Very short-term Treasury Certificates (maximum 4 months)  
Treasury Certificates issued by tender (6 to 12 months)

} Minimum rate 15%

B. *Liabilities (at 1 month to 2 years)*

All items listed under A and all undated government or government-guaranteed bonds in Bfrs.

} Minimum rate 65%

Whereas the major banks had to meet cover obligations of up to 65% of their deposits, these obligations amounted to 50% for the regional banks and the special banks, and to 60% for the medium-sized banks.

32. In the course of the years the *Commission bancaire*, which is the competent authority, has frequently changed the *general provisions* governing these ratios. The *reform* which took place towards the end of 1957 was particularly important as it *ended the automatic link between movements in deposits and the Treasury bill holdings of the banks*. Since that time the banks have no longer been allowed to hold Treasury paper as a partial cover for additional deposits but have been obliged to acquire Fonds des rentes certificates for this purpose. The Fund has thereby more facility for engaging in open-market or other money-market operations.

The Treasury paper issues held by the banks before this reform (to a total of Bfrs. 28 900 million) were replaced by special Treasury Certificates of the 'A' and 'B' series. It was arranged that of these Bfrs. 28 900 million the 'A' Treasury Certificates, amounting to Bfrs. 20 000 million, would remain with the banks; should deposits fall below the level as at the end of October 1957, the banks would be able, to the extent of their reduced obligations, to redeem 'B' Treasury Certificates, and in such an event the Fonds des rentes was to take up a corresponding amount of Treasury Certificates.

33. Although this system of banking ratios may in theory be regarded as a kind of minimum reserve system, practice showed that it lacked the necessary flexibility to be used as an effective instrument of monetary policy. The *basic ratios* were never changed, probably because for one thing the procedure for fixing a banking ratio was very cumbersome. The *Commission bancaire* could change the ratios only by agreement with the Ministry of Finance and the Min-

At the end of 1961 the Belgian Government introduced a *minimum reserve system* which enabled the monetary authorities to exert a direct influence on banking liquidity by changing the minimum reserve ratios as has been done for some time in the Federal Republic of Germany and in the Netherlands. By this new arrangement the previous provisions on the "*coefficient de trésorerie*" (cash ratio) and the "*coefficient de couverture*" (cover ratio) were rescinded and replaced by *transitional provisions*.

#### *Minimum reserves*

Under the new regulation minimum reserves are held in the form of special accounts with the Banque nationale de Belgique. But, acting on a considered proposal by the Banque nationale, the Commission bancaire may direct that part of the banks' reserve obligations can be met by balances with the Fonds des rentes or by the deposit of certain public securities with the Central Bank.

#### *Liabilities subject to minimum reserves*

These include all bank liabilities expressed in Belgian francs with a term of up to two years. There are three categories of such liabilities :

1. Liabilities at sight or up to one month ;
2. Liabilities with an agreed term of more than one month and up to two years ;
3. Liabilities in respect of which deposit books have been issued.

Banks whose minimum reserve obligation does not exceed Bfrs. 20 million need not keep such minimum reserves. The Commission bancaire can increase this exemption limit where one of the minimum reserve ratios for the various categories of bank liabilities exceeds two-fifths of the maximum ratios mentioned in the following paragraph.

#### *Minimum reserve ratios*

The minimum reserve ratios are fixed by the Commission bancaire on the proposal of the Banque nationale de Belgique justified by considerations of credit policy.

The highest ratio for sight deposits or deposits with a term of up to one month is 20%, that for liabilities at a term of more than one month and up to two years is 7%. If within any 30-day period the minimum reserve ratios are increased by more than three points, the approval of the Minister of Finance and of the Minister of Economics is required.



### *Basis for calculation*

The new minimum reserve provisions explicitly provide that the minimum reserve ratios may be applied either to the total of deposits or merely to the increase in deposits, or to a combination of both. The calculation of the minimum reserve obligation is based on the liabilities subject to minimum reserve as they stand on the last business day of the month. The obligation must be fulfilled in the course of 30 days beginning on the 15th day of the succeeding month.

So far the new minimum reserve regulation has only created a framework, the details of which have not yet been filled in by the monetary authorities. As banks are still required to keep large portfolios of public securities, the margin for measures of minimum reserve policy would still seem to be very limited. The transitional arrangements mentioned above provide that the banks must for the time being continue to meet their previous obligations under the system of cover ratios. However, deposit increases are no longer subject to this obligation, which need only be met on the basis of average deposits over the period from 31 January 1961 to 31 October 1961. Moreover, in observing these continuing cover obligations, the banks are free to choose from among the various acceptable forms of assets, except that they must maintain their holdings of 'A' Treasury Certificates at the level at which they stood when the new regulation was issued.

## CHAPTER 4

### CASH MANAGEMENT AND BORROWING OF PUBLIC AUTHORITIES AND THEIR EFFECTS ON LIQUIDITY

34. Under Article 32 of its statutes the Banque nationale de Belgique is entrusted with the management of the Government's cash amounts. Most of the time the Government's current account shows a relatively small balance; apart from the current account there is a special account of the Treasury which receives the proceeds of the "business cycle tax" ("taxe de conjoncture") introduced in 1959.

The Treasury makes most of its payments through the *Postal Cheque Office*, which transfers its surplus receipts to the Treasury. The Postal Cheque Office, which is not looked upon – as in the Federal Republic of Germany and in the Netherlands – as part of the banking system, plays a considerable part in payments generally. Over the past few years the balances of firms and individuals with the Postal Cheque Office amounted on the average to about 10% of the volume of money. Transfers from private accounts to public accounts with the Postal Cheque Office have no effect on the liquidity of the banks. In January and July, however, when the main taxes fall due, there are large outgoings from the banks to public authorities, with a consequent strain on bank liquidity. To relieve this the Fonds des rentes carries out corresponding open-market operations.

The budget policy of the Belgian State has a direct influence on the volume and distribution of liquid funds in the economy. The amount of the budget deficit and the method of financing it play a decisive part. The budget deficit can be covered by calling on the Central Bank or on the money market, by issuing medium or long-term loans, by taking up credits abroad or, finally, by falling back on reserves.



**Part six**

**THE INSTRUMENTS OF MONETARY POLICY  
IN THE NETHERLANDS**



## CONTENTS

Introductory remarks	219
<i>The liquidity of the economy – Bank liquidity</i>	
Chapter 1: Refinancing policy	226
<i>Terms for refinance credits – The efficacy of refinancing policy</i>	
Chapter 2: Open-market policy	230
<i>Legal foundations – Structure of the money market – The efficacy of open-market policy</i>	
Chapter 3: Minimum reserves policy	236
<i>The legal basis of the minimum reserve system – Credit institutions subject to the minimum reserve obligation – Calculation of the minimum reserves – The minimum reserve ratio – Interest and penalty interest rates – The efficacy of minimum reserve policy</i>	
Chapter 4: Other instruments of monetary policy	243
Chapter 5: Banks' money-market investments abroad and transactions of the Nederlandsche Bank on the forward foreign exchange market	245
Chapter 6: Cash management and borrowing of public authorities and their effect on liquidity	247
Chapter 7: Directives on solvency and liquidity	249

## TABLES

1 – Total domestic liquid assets	221
2 – Causes of changes in total domestic liquid assets	222 217

TABLES (continued)

3 – Easing and tightening of the money market	225
4 – Recourse of credit institutions to the Central Bank	228
5 – Short and medium-term Treasury paper in circulation	232
6 – Movements of open-market portfolio of Central Bank	235
7 – Minimum-reserve ratio and balances	241
8 – Foreign exchange balances and other foreign investments of commercial banks	245

DIAGRAM

Bank rate and interest rates on the money and capital market	229
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## INTRODUCTORY REMARKS

1. Apart from changes in Bank rate, the main instruments employed by the Nederlandsche Bank in its monetary and credit policy are those that affect the liquidity of the banking system and hence influence that of the economy and the total effective demand. Direct credit controls in the sense of a selective credit policy play no part. In the early post-war years they were in fact applied to a considerable extent, but as conditions returned to normal this method became more and more unsatisfactory <sup>1</sup> The provisions that gave the Central Bank extensive control over advances by the commercial banks were therefore rescinded at the end of 1950 and were temporarily replaced by overall quantitative credit controls (in force until the end of March 1952).

2. The concept of "liquidity policy" in the Netherlands generally means an influence exerted on the liquidity of the economy by measures taken by the Central Bank and, be it noted at the outset, the Treasury, but not so much an influence on bank liquidity itself, though this is the starting point for action by the Central Bank. To this extent, the terminology here is different from that used in the Federal Republic of Germany.

### *a) The liquidity of the economy*

3. Since 1951 the Central Bank, in its periodic surveys, has been applying a concept of liquidity that is partly at variance with that of the other EEC countries. By liquidity of the economy the Bank understands not only primary liquidity – ready money (cash and sight deposits) held by the non-banking sector (though excluding Government balances) – but also certain other claims of the non-banking sector on public authorities and money-creating institutions in so far as they can be fully realized within a very short period and at negligible expense or loss, or can be used at their face value to pay taxes (secondary liquidity).

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<sup>1</sup> Addressing the Radcliffe Committee in November 1958, Dr. Holtrop, the President of the Central Bank, explained that a selective credit policy might be feasible when the aims of general economic policy had been plainly and unequivocally defined – as in wartime or a period of reconstruction – and the public were therefore prepared to accept controls of this nature. But as the targets became less definite and the gamut of possible choices widened, it became very difficult to say what the aim of economic policy was and to judge which of several was the higher good. The criterion of the "general national well-being" was no more adequate than the distinction between "essential" and "non-essential". This distinction was dangerous in so far as it stimulated protectionist tendencies, for "essential" could easily be defined as anything that replaced imports or promoted exports, while all other goods could be called "non-essential". Any other distinction between "essential" and "non-essential" had no basis in a free economy.



For the purposes of this analysis, the components of secondary liquidity are the following:

1) short-term claims of the non-banking sector on the Treasury, generally in the form of Treasury bills; this includes balances held at the Treasury, mainly by institutional investors, though at the moment these are only small;

2) short-term claims of the non-banking sector on local authorities such as provincial and local governments and the Bank for Netherlands Municipalities (Bank voor Nederlandsche Gemeenten), mainly in the form of non-negotiable securities but at times also in the form of call money and credits in current account;

3) short-term claims of the non-banking sector on money-creating institutions in the form of time and savings deposits, foreign exchange balances and the call money that these institutions mainly take up from the non-banking sector.

4. The money-creating institutions include, apart from the Central Bank and commercial banks, the postal cheque office, Amsterdam's municipal giro transfer service, the agricultural credit institution with their short-term deposit and credit business, the security credit institutions (effectenkredietinstellingen) and the Treasury. As there is in the Netherlands a rather sharp distinction between the short-term business of the commercial banks and the long-term business of the savings banks, the latter are not counted among the money-creating institutions. Nor are savings deposits held at savings banks included as secondary liquidity in the analysis; the relatively small but growing savings deposits at commercial banks, however, are included.

Table 1, "Total Domestic Liquid Assets", which is taken from the 1961 Annual Report of the Nederlandsche Bank, gives the composition of primary and secondary liquidity as these concepts are understood in the Netherlands, and the distribution of primary, secondary and total liquidity over the most important sectors.

The sources of primary and secondary liquidity, as shown in Table 2, are essentially advances by the Central Bank and other money-creating institutions to the Government (including changes in its balances at the Central Bank) and to other public bodies and the private sector, net foreign exchange purchases by the money-creating institutions, purchases of securities by these institutions and the placing of short-term securities by public authorities outside the money-creating institutions.

#### *b) Bank liquidity*

5. Besides the *cash liquidity* of the banks, i.e. their holdings of Central Bank money, the liquidity of the banking system includes their liquid assets that can if necessary be transferred to the Central Bank or placed with it as security for advances ("potential liquidity").

Table 1

**TOTAL DOMESTIC LIQUID ASSETS**  
(Amounts at end of year, to nearest 10 million guilders)

Composition <sup>1</sup>	1958	1959	1960	1961 <sup>3</sup>
<b>1. Domestic money supply (total primary liquid assets)</b>				
a) Notes and coin	4 580	4 680	5 090	5 470
b) Sight deposits	5 560	5 910	6 220	6 710
<b>Total</b>	<b>10 140</b>	<b>10 590</b>	<b>11 310</b>	<b>12 180</b>
<b>2. Total secondary liquid assets</b>				
a) Claims on the Government	1 320	1 420	1 390	1 440
b) Claims on the local authorities	1 300	890	540	420
c) Claims on money-creating institutions	2 790	3 560	4 380	4 540
1) Time deposits and day-to-day loans	2 230	2 770	3 220	3 090
2) Foreign currency balances of residents	240	290	240	220
3) Balances on savings accounts	320	500	920	1 230
<b>Total</b>	<b>5 410</b>	<b>5 870</b>	<b>6 310</b>	<b>6 400</b>
<b>3. Total domestic liquid assets (3 = 1 + 2)</b>	<b>15 550</b>	<b>16 460</b>	<b>17 620</b>	<b>18 580</b>
<b> Holders <sup>2</sup> of:</b>				
<b>1. Primary liquid assets</b>				
a) Personal and business sector	9 840	10 320	10 930	11 790
b) Pension funds, insurance companies and other funds	150	130	140	150
c) Savings institutions	60	70	100	120
d) Local authorities	90	70	140	120
<b>Total</b>	<b>10 140</b>	<b>10 590</b>	<b>11 310</b>	<b>12 180</b>
<b>2. Secondary liquid assets</b>				
a) Personal and business sector	3 810	4 080	4 560	4 430
b) Pension funds, insurance companies and other funds	690	720	640	680
c) Savings institutions	720	840	840	880
d) Local authorities	190	230	270	410
<b>Total</b>	<b>5 410</b>	<b>5 870</b>	<b>6 310</b>	<b>6 400</b>
<b>3. Total domestic liquid assets (3 = 1 + 2)</b>				
a) Personal and business sector	13 650	14 400	15 490	16 220
b) Pension funds, insurance companies and other funds	840	850	780	830
c) Savings institutions	780	910	940	1 000
d) Local authorities	280	300	410	530
<b>Total</b>	<b>15 550</b>	<b>16 460</b>	<b>17 620</b>	<b>18 580</b>
<b>Not included above:</b>				
Sight deposits of non-residents at banks	200	210	250	230
Savings balances at savings institutions, interest included	7 680	8 800	9 930	11 190
Private sector's balances and money market investments abroad	150	390	200	180

<sup>1</sup> The domestic money supply includes notes and coin in the hands of non-residents; also the very small sight deposits of non-residents at giro transfer institutions.

<sup>2</sup> The funds that could not be included under "Pension funds, insurance companies and other funds" are comprised in "Pension and business sector", where the figures were obtained by subtraction. Savings institutions also include the savings departments of agricultural credit banks.

<sup>3</sup> Provisional figures.

Table 2

## CAUSES OF CHANGES IN TOTAL DOMESTIC LIQUID ASSETS

(in millions of guilders)

	1959	1960	1961 <sup>6</sup>
<b>1. Creation of liquidity for account of the Government</b>			
a) Money creation			
1) Net recourse (+) to the Nederlandsche Bank <sup>1</sup> (of which as the result of open market transactions)	537 (44)	- 998 (- 174)	235 (178)
2) Net recourse (+) to the other money-creating institutions	- 953	103	114
3) Special transactions mentioned in 6. a) 1)	- 421	107	- 664
Total 1) to 3)	- 837	- 788	- 315
b) Placing (+) of floating debt having the character of secondary liquidity	103	- 30	53
<b>Total a) and b)</b>	<b>- 734</b>	<b>- 818</b>	<b>- 262</b>
<b>2. Creation of liquidity for account of the local authorities</b>			
a) Lending (+) by:			
1) Nederlandsche Bank	29	- 46	-
2) other money-creating institutions	32	- 67	- 119
Total 1) and 2)	61	- 113	- 119
b) Placing (+) of floating debt having the character of secondary liquidity	- 410	- 349	- 125
<b>Total a) and b)</b>	<b>- 349</b>	<b>- 462</b>	<b>- 244</b>
<b>3. Creation of money for account of the private sector</b>			
Lending (+) by:			
1) Nederlandsche Bank	- 2	2	9
2) commercial banks	483	614	720
3) agricultural credit institutions	97	45	68
4) other money-creating institutions	24	15	37
Total 1) to 4) (of which at medium term)	602 (•)	676 (28)	834 (203)
<b>4. Miscellaneous causes of money creation</b>			
a) Net transactions of money-creating institutions on the capital market (purchases +)			
1) public market	65	103	215
2) private market <sup>2</sup>	40	126	242
b) Increase (-) in capital <sup>3</sup> and reserves of money-creating institutions, and sundry items	- 93	- 174	- 103
<b>Total a) and b)</b> (of which money creation by giro transfer institutions)	12 (74)	55 (195)	354 (102)
<b>5. Domestic creation of liquidity (total of items 1 to 4)</b>	<b>- 469</b>	<b>- 549</b>	<b>682</b>

Table 2 (continued)

	1959	1960	1961 <sup>6</sup>
6. Net purchase of foreign exchange by the money creating institutions from the private sector and public authorities - used for:			
a) Special transactions of			
1) the Government:			
- Transactions with the I.M.F.	131	66	442
- Increase (+) of net consolidated claims arising from payment agreements, so far as taken over from the Nederlandsche Bank	119	- 173	39
- Accelerated repayment of external Government debt	171	-	183
Total	421	- 107	664
2) the banking system: purchase <sup>4</sup> of Netherlands Government bonds from the I.B.R.D.	207	-	-
b) Increase (+) of gold and foreign exchange holding			
1) Nederlandsche Bank	- 497	1 514	- 199
2) authorized banks	855	- 400	- 611
c) Lending (+) by authorized banks to non-residents	284	664	483
d) Increase (+) of other net claims on non-residents <sup>5</sup>	106	38	- 63
Total a) to d)	1 376	1 709	274
7. Changes in total domestic liquid assets (total of 5 and 6)			
a) Domestic money supply	453	717	867
b) Total secondary liquid assets			
1) Claims on money-creating institutions (of which balances on savings account)	761	822	161
2) Claims on the public authorities	(172)	(421)	(314)
Total a) and b)	- 307	- 379	- 72
Total a) and b)	907	1 160	956

<sup>1</sup> Includes drawing down of credit balances.

<sup>2</sup> This is deemed to include granting of private loans to local authorities.

<sup>3</sup> Other than by issue of own shares and bonds.

<sup>4</sup> Cf. paragraph 34 on page 239.

<sup>5</sup> Including consolidated claims arising from payments agreements which have not been taken over by the State, foreign bonds denominated in foreign currency and statistical errors.

<sup>6</sup> Provisional figures.

Source: Annual Report of the Nederlandsche Bank 1961.

The cash liquidity of the banks is, as with the banks of the Federal Republic, almost completely controlled by the required minimum reserve ratio. At all events, apart from a few exceptions, there are hardly any excess reserves worth mentioning, since the banks can use their minimum reserves as working balances.

*Potential liquidity*, which is the real measure of the liquid position of the banking system, mainly includes :

- a) short-term securities,
- b) call-money credits to brokers, (see sec. 21)
- c) balances and other money-market investments abroad,
- d) commercial bills that can be rediscounted at the Central Bank, though these are of minor importance.

In the graphs published by the Central Bank in its Annual Reports, however, the liquid assets include only Treasury bills with currency periods of one year or less and short-term claims in foreign currency; commercial bills are not regarded as forming part of the liquidity of the banks.

6. If the special measures of liquidity policy taken by the Central Bank are disregarded, the cash liquidity of the banks is essentially determined by the following factors :

- a) changes in notes and coin in circulation ;
- b) net foreign exchange transactions between banks and the Central Bank ;
- c) net transactions of the Treasury with the Central Bank affecting domestic liquidity ;
- d) changes in the minimum reserve requirements as a result of changes in deposits ;
- e) Central Bank advances to local authorities, these credits are of minor importance, except in periods of tight conditions on the money market.

The net transactions of the Central Bank with business firms and private customers are also of little importance. The Act governing the Central Bank does not prohibit such transactions; the Bank could certainly lend to business concerns and private individuals. But its policy is to leave the financing of the private sector to the commercial banks.

To illustrate the factors determining bank liquidity, the Central Bank publishes in its Annual Report a table headed "easing and tightening of the money market", which consists of broadly the same elements – though in a rather different order – as the corresponding tables published by the Bundesbank. The Netherlands Bank's table is reproduced on a later page (see Table 3).

7. The credit policy of the Central Bank influences the cash liquidity of the banks almost entirely by means of open-market transactions and changes in the minimum reserve ratio of the commercial banks. But these operations of the Central Bank are closely bound up with its discount policy. They serve the purpose of so influencing the state of the money market that market rates adapt themselves to the discount rate of the Central Bank. On the following pages the refinancing policy of the Central Bank is first examined, then its open-market policy and its minimum reserve policy. Finally, the occasional dealings of the Central Bank in the forward foreign exchange market, the Bank's relations with the public sector, particularly the Treasury, and its powers of supervision over the banking system are discussed.

Table 3

## EASING AND TIGHTENING OF THE MONEY MARKET

Causes of change in the average <sup>1</sup> ease or tightness of the money market Easing (+) / tightening (-) (rounded off to the nearest 10 million guilders)	Comparison between reserve-ratio periods ending on the 21st of the month		
	1959 Jan. 1960 against Jan. 1959	1960 Jan. 1961 against Jan. 1960	1961 Jan. 1962 against Jan. 1961
<b>1. Autonomous factors</b>			
a) Transactions of the Government, other than placing and repayment of Treasury paper (excess of expenditure (+)/excess of receipts (-))	- 640	- 970	- 370
b) Contraction (+)/expansion (-) of the bank note circulation	- 90	- 360	- 350
c) Fall (+)/rise (-) in obligatory cash reserves because of fall/rise in deposits	- 80	- 50	- 60
d) Sundry causes	- 20	-	-
Total	- 830	- 1380	- 78
<b>2. Purchase (+)/sale (-) of gold and foreign exchange by the Nederlandsche Bank</b>	+ 150	+ 1360	+ 510
<b>3. Net result of the autonomous factors and of net purchase of gold and foreign exchange by the Nederlandsche Bank</b>	- 680	- 20	- 270
<b>4. Credits granted by (+)/repaid to (-) the Nederlandsche Bank to/by local authorities</b>	+ 10	-	-
<b>5. Net repayment (+)/placing (-) of Treasury paper by the Government to/on the market</b>	+ 790	+ 180	- 130
<b>6. Open-market operations and reserve-ratio changes</b>			
a) 1) Fall (+)/rise (-) in obligatory cash reserves because of lowering/raising of the required reserve ratios	+ 220	- 80	+ 210
2) Blocked by purchase of bonds from I.B.R.D. <sup>2</sup>	- 210	-	-
b) Open-market operations	- 80	- 60	+ 110
Total	- 70	- 140	+ 320
<b>7. Easing (+)/tightening (-) of the money market (= 1 to 6) reflected in:</b>	+ 50	+ 20	- 80
a) Increase (+) of the banks' average free cash reserves	+ 50	+ 10	- 30
b) Decrease (+) in the average extent of recourse to the Nederlandsche Bank by:			
1) Banks	- 10	+ 10	- 50
2) Billbrokers	+ 10	-	-
<b>8. Average level of the surplus (+)/deficit (-) on the money market reflected in:</b>	40	60	- 20
a) The banks' average free cash reserves	50	60	30
b) Average extent of recourse (-) to the Nederlandsche Bank by:			
1) Banks	- 10	-	- 50
2) Billbrokers	-	-	-

<sup>1</sup> The averages are daily averages for the reserve-ratio period.

<sup>2</sup> See page 239.

## CHAPTER 1

### REFINANCING POLICY

8. When banks and brokers wish to finance their requirements by recourse to the Central Bank (see sec. 21), they generally do so by taking up credits in current account against pledges of Treasury bills or – to a lesser extent – other securities. They can also discount short-term securities (Treasury paper, commercial bills and bank acceptances) at the Central Bank as long as they have no more than 105 days to run to maturity.

#### *a) Terms for refinance credits*

9. In the Netherlands, as opposed to Germany, France and Belgium, the discounting of commercial bills and bank acceptances is only of minor importance. Under an agreement concluded between the Central Bank and a number of other banks in 1922, however, certain bills used to finance foreign trade are automatically discountable if they satisfy certain conditions (no more than four months' tenor; amount of discount credit no more than one million guilders) and are notified to the Central Bank. At the request of a bank, bills drawn to finance other types of transaction may by special arrangement also be declared discountable. Discountability enables banks to negotiate these bills on the money market, but little use is made of this facility.

There are no fixed limits to the eligibility as collateral and discountability of Treasury paper issued by the Government. However, within the framework of its credit policy in relation to the Treasury the Central Bank is free to decide whether or not to discount such paper or to accept it as security for an advance (see also page 247).

Short-term securities issued by local authorities can also be declared discountable or eligible as collateral by the Central Bank, but only up to a given ceiling fixed by the Bank – in general 15% of the current revenue shown in the last budget of these authorities. As a result of a sharp rise in the floating debt of these authorities in 1957 (a development that was unwelcome to the Central Bank), these facilities have since been subject to certain conditions; the Nederlandsche Bank established the principle that it would grant rediscount facilities up to the promised ceiling only if the local authorities observed the standard limits on floating debt recommended by the Government (25% of current revenues); but in order to prevent hardship, the Bank laid down the following

rules: the normal rate of 15% of current revenue would continue to be granted only to those public authorities whose net floating debt did not exceed 25% of current revenue. Half of this rate would be granted to authorities whose net floating debt was between 25% and 50% of current revenue. Public authorities whose floating debt exceeded 50% of current revenue would be denied the facility altogether. The appreciable fall in the local authorities' net floating debt caused the Bank in the middle of 1961 to bring its refinance facilities into line with the above-mentioned directives of the Government. Since then only local authorities whose net floating debt does not exceed 25% of their revenues can make use of the Bank's credit facilities.

10. The banks generally endeavour to manage their cash liquidity in such a way that they need have no recourse to the Central Bank. This policy is partly based on the Central Bank's conception that banks should be able to count only temporarily on the assistance of the Central Bank. The Nederlandsche Bank regards access to its refinance facilities as a privilege and not a right. Banks are not expected to be permanently indebted to it.

11. The rate charged to banks for credits in current account against pledging of securities or other paper is one-half per cent above Bank rate. But as the banks as a rule only call on the Central Bank for very short periods, advances against security are asked for more often than rediscount credits.

Moreover, in September 1957, when credit expansion was particularly strong, the Central Bank introduced for a time a penalty interest rate; this had to be paid by all banks having recourse to the Central Bank which, in its view, were not exercising sufficient restraint in granting credit. This rate was 1% above the official discount rate.

#### *b) The efficacy of refinancing policy*

12. Any change in the discount rate of the Central Bank generally affects the debtor and creditor interest rates fixed by the banks; although the banks have a free hand in fixing their interest rates (the Act on Supervision of the Credit System is silent on this matter), the rates they charge to borrowers are often linked to the official discount rate. The banks, however, will not usually lend at less than 5%, so that, as a gap of 2% between Bank rate and the lending rate of the banks is normal, changes in Bank rate below the 3% level have little if any effect on the cost of credit.

Changes in Bank rate, as the President of the Nederlandsche Bank informed the Radcliffe Committee, affect the demand for credit in varying degree according to circumstances, though the general view is that their influence on demand is only slight. The real efficacy of discount policy, however, lies more in the fact that business and banking circles regard a change in Bank rate as a pointer to the tightening or easing of credit, and take steps accordingly. As a



Table 4

RECOURSE OF CREDIT INSTITUTIONS<sup>1</sup> TO THE CENTRAL BANK

(in millions of guilders)

Monthly average		Total credits	Advances in current account
1958	First quarter	5	3
	second quarter	13	10
	third quarter	9	3
	fourth quarter	6	4
1959	First quarter	3	3
	second quarter	3	3
	third quarter	2	2
	fourth quarter	18	16
1960	First quarter	3	2
	second quarter	7	7
	third quarter	3	3
	fourth quarter	2	2
1961	First quarter	3	3
	second quarter	3	3
	third quarter	10	10
	fourth quarter	50	23

<sup>1</sup> Commercial banks, central institutions of the agricultural credit banks and security credit institutions ("effectenkredietinstellingen").

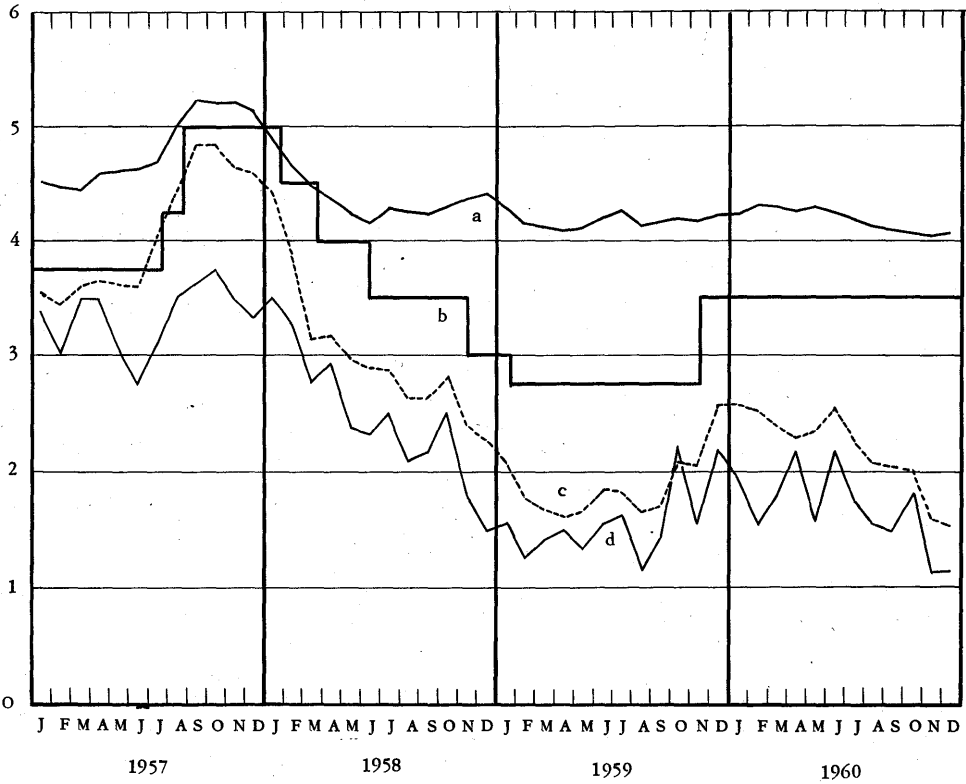
Source: Annual Reports of the Nederlandsche Bank.

rule, a change in Bank rate is not an isolated event; it is made in relation to the aims of the Central Bank's money-market policy. In the normal course of monetary and credit policy in the Netherlands the Central Bank takes simultaneous measures directly affecting bank liquidity even if money-market rates are expected to be in line with Bank rate, since, as stated above, it is only in exceptional cases that Dutch banks – in contrast to those in France, Belgium and Germany – are indebted to the Central Bank through rediscounting. (see Table 4).

13. In the early post-war years, the Central Bank did not yet have the necessary instruments of money-market policy at its disposal, so that money-market rates were well below Bank rate for several years, although the latter was only 2½%. When a large increase in bank credit took place during the Korean crisis, restrictive measures were called for and the Central Bank raised its discount rate first to 3% and then to 4%. In order to make these rates effective in spite of the high level of bank liquidity, the Central Bank used certain powers that had been conferred upon it during the currency reform of 1945 – powers that authorized it to direct the commercial banks not to allow their liquid reserves,

Diagram

BANK RATE AND INTEREST RATES ON THE MONEY AND CAPITAL MARKETS  
%



- a. average yield of 9 Government loans at 3%, 3¼% and 3½%
- b. Bank rate
- c. market discount rate for three-month Treasury bills
- d. call-money rate

Source : Annual Reports of the Nederlandsche Bank.

including Treasury bills, to fall below a certain limit or, alternatively, not to extend their lendings beyond a certain limit without having recourse to the Central Bank. Consequently, although the banking system remained very liquid, it was forced "in the Bank" and Bank rate was thus made effective.

The experiences gained in that period led in 1952 to an agreement between the Treasury and the Central Bank, enabling the latter to effect its own open-market transactions. The Bank took a further step towards an active money-market policy in 1954 by concluding a gentlemen's agreement with the most important commercial banks and the central institutions of the agricultural credit banks which enabled the Bank to institute a system of minimum reserves.

## CHAPTER 2

### OPEN-MARKET POLICY

14. For the purposes of its open-market transactions the Central Bank uses only short and medium-term Treasury bills. The Bank Act of 1948 does authorize the purchase and sale of Government or Government-guaranteed bonds quoted on the Stock Exchange, but the Central Bank has no stock of such securities.

#### *a) Legal foundations*

15. The right of the Central Bank to conduct open-market business is laid down by the Bank Act of 23 April 1948, in which the bank is authorized to buy and sell the following securities :

a) Bills accepted by banks and bankers established in the Netherlands and drawn at a tenor which conforms with customary usances ;

b) Treasury bills ;

c) Government bonds, or bonds for which the Dutch Government has guaranteed payment of interest and amortization, provided that such bonds are officially quoted on the Amsterdam Stock Exchange.

16. Although the Central Bank has been empowered to conduct open-market transactions since 1937 (on the basis of the earlier Bank Act), it has only been able to apply this policy itself since 1952. Previously it was the Treasury that operated on the money market through its own agent, even when its cash balances were sufficient to cover current financial needs ; to that extent it was the Treasury's task rather than the Central Bank's to mop up surplus bank liquidity.

In the 1952 agreement between the Treasury and the Central Bank, responsibility for open-market policy was transferred to the Central Bank. Since then Treasury policy has been to limit the issue of Treasury paper basically to renewals of paper falling due. It does happen, of course, that the Treasury supplies to the market a greater or lesser quantity of short-term paper than falls due. In such cases there is close co-operation between the Treasury and the Central Bank.

17. At the time when the agreement was concluded, the Central Bank had claims totalling 2 100 million guilders on the Treasury, arising from the transfer of its old Reichsmark balances to the Treasury, 800 million guilders of which

was in the form of Treasury bills, while the rest was a book claim. In the course of its first open-market operations, the Central Bank had already sold a large part of its stock of Treasury bills; it was able to continue its open-market operations thanks to the Government's readiness to convert the remaining book debt into Treasury bills as and when the Bank needed them. But in 1956 the Treasury discharged the rest of its debt to the Central Bank by using counterpart funds from Marshall Aid. The strategic reserve of the Central Bank was later supplemented by the transfer of its claims on the EPU and Argentina to the State.

These repayments left the Central Bank in some doubt as to whether its portfolio of open-market paper would still suffice to control the money market effectively, particularly in view of the increasing liquidity arising from foreign exchange surpluses. It was mainly these considerations that prompted the agreement with the banks on the introduction of a minimum reserve system.

*b) Structure of the money market*

18. Dealings on the money market in the Netherlands are mainly in short and medium-term securities issued by public authorities. However, only Treasury bills and bonds are of any importance to the Central Bank's open-market policy. Treasury bills (promessen) are registered securities with a currency of up to a year; Treasury bonds (biljetten) on the other hand are bearer securities with a period of over a year and up to five years. Half-yearly interest coupons are attached to these bonds.

From Table 5 (page 232) - "Short and medium-term Treasury paper in circulation" - it will be seen that the greater part of money-market paper consists of Treasury bonds with original currency periods of one to five years. This proportion of longer-term Treasury paper has become even larger in recent years as a result of the Treasury's general funding policy.

19. Table 5 also throws light on the structure of the money market and shows that - in contrast to the situation in Germany - it is not only the banks that buy Treasury paper. In 1953 the commercial banks' share of the short and medium-term Treasury paper in circulation was as much as 68%, but it had dropped to 41% by the end of 1956 and has changed only slightly since then. The proportion held by the agricultural credit banks on the other hand, increased considerably - from 8% at the end of 1953 to 21% at the end of 1961. Other investors are official and semi-official bodies, institutional investors - mainly savings institutions - as well as brokers, business concerns and private individuals.

20. Through its own agent the Treasury is the most important issuer of Treasury paper on the money market. Whereas the Treasury used to sell Treasury bills at rates fixed before-hand, since 1956 issues have been made by public

**Table 5**  
**SHORT AND MEDIUM-TERM TREASURY PAPER**  
**IN CIRCULATION**

(in millions of guilders)

	End 1953		End 1956		End 1960		End 1961	
Treasury bills (schatkistpro- messen - dated one year)	958		114		228		434	
Treasury bonds (schatkistbil- jetten - dated one to five years) <sup>1</sup>	3 625		2 679		2 666		2 439	
	4 583		2 793		2 894		2 873	
<i>Held by:</i>								
Commercial banks	3 099	68 %	1 140	41 %	1 228	42 %	1 169	41 %
Agricultural credit banks and their central institutions	395	8 %	257	9 %	585	20 %	621	21 %
Central Bank, under "repur- chase agreements" <sup>2</sup>	-	-	-	-	64	2 %	-	-
<b>Banks</b>	<b>3 494</b>	<b>76 %</b>	<b>1 397</b>	<b>50 %</b>	<b>1 877</b>	<b>64 %</b>	<b>1 790</b>	<b>62 %</b>
Public and semi-public bodies	307	7 %	347	13 %	285	10 %	1 083 38 %	
Institutional investors	239	5 %	309	11 %	307	11 %		
Others	543	12 %	740	26 %	425	15 %		
	4 583	100 %	2 793	100 %	2 894	100 %	2 873	100 %
Treasury certificates (dated more than 5 years) <sup>3</sup>			1 200		1 200		1 200	
<i>Held by:</i>								
Commercial banks			1 127	94 %	1 125	94 %	1 125	94 %
Agricultural credit banks and their central institutions			73	6 %	75	6 %	75	6 %

<sup>1</sup> Generally 2, 3 and 5 years.

<sup>2</sup> See page 233.

<sup>3</sup> Subscribed by the banks under the gentlemen's agreement of 1954; dated 8, 10 or 12 years.

tender only. The Treasury's agent offers the market Treasury bills with fixed periods to maturity; dealers on the market announce the rates at which they are prepared to take up given amounts; the Treasury determines the rate in the light of the tenders received. All applicants who tendered at a lower rate receive a full allocation; those who tendered at the rate agreed by the Treasury have their applications allotted in full or in part, as the case may be. For issues of Treasury bonds, on the other hand, the agent fixes as formerly, without holding tenders, the interest rate at which applicants can buy.

21. Treasury bills and call and short-term money are dealt in only by telephone through independent brokers (*wisselmakelaars*), who give quotations for the various periods to maturity. The function of these brokers can best be understood from historical developments. Before 1926 they functioned only as intermediaries in money market and exchange business. They were brokers who held no stocks of money-market paper for their own account. In 1926, however, the Central Bank recognized them as discount brokers and also accorded them special facilities for borrowing against security. Since then the brokers have held their own stocks of bills and Treasury paper. They finance these stocks, which since 1945 have consisted mainly of Treasury bills by taking up call money at the banks. If liquidity difficulties oblige the lenders to call in their loans, the brokers can obtain cash from the Central Bank by selling it Treasury bills or bonds or by borrowing on security. The Central Bank has given the brokers the special facility of discounting a given proportion of their bill holdings at the old rate on the day of any change in Bank rate.

The brokers act as a buffer between the banks and the Central Bank. But they have nothing like the importance of the discount houses in England, which alone have access to rediscount credit at the Bank of England.

*c) The efficacy of open-market policy*

22. The Central Bank's open-market transactions over longer periods influenced the situation on the money market only in a passive sense since the Bank limited itself to buying or selling money-market paper at market rates according to the needs of the market. From 1952 to 1955 and in 1958, for instance, the Bank mopped up the surplus liquidity resulting from its purchases of foreign exchange. This policy was applied flexibly. Such temporary shortages on the money market as arose during long periods of abundant liquidity were eliminated by the Central Bank's purchase of short-term securities.

In order to alleviate short-term liquidity difficulties on the money market – resulting, for instance, from seasonal fluctuations in tax revenue and payments falling due at the end of the accounting year – the Bank has also taken up money-market securities in accordance with "repurchase agreements", under which the banks undertake to buy back after a stipulated period securities sold to the Central Bank.

23. The Central Bank's money-market policy, however, has also at times had an active influence on the situation of the money market and on the money-market rate. At the beginning of 1956 the Bank caused a rise in the money-market rate by selling five-year Treasury bonds at increasing rates. From 1956 to 1957 the Bank took no securities from the market, despite the contraction of the money market resulting from a deficit on the balance of payments, and consequently it did not arrest the considerable rise of money-market rates (see diagram on page 229 and Table 6 on page 235). Only by reducing the minimum reserve ratio – and that with some hesitation – did the Central Bank ease the market.

Table 6

**MOVEMENTS OF OPEN MARKET PORTFOLIO OF  
CENTRAL BANK <sup>1</sup>**

(in millions of guilders)

	Treasury bills and bonds					Holdings of Treasury bills and bonds at end of year
	Bought from Treasury <sup>2</sup>	Redeemed by Treasury (-)	Bought on open market	Sold on open market	Total changes	
	1	2	3	4	5	6
1952	-	- 700	-	- 649	- 1349	151
1953	+ 600	-	-	- 235	+ 366	517
1954	-	-	+ 98	- 255	- 157	360
1955	-	-	+ 141	- 179	- 38	322
1956	+ 275	-	-	- 135	+ 138	460
1957	+ 68	-	-	-	+ 68	528
1958	+ 156	- 52	+ 348 <sup>3</sup>	- 799	- 347	181
1959	+ 402	- 290	+ 296	- 234	+ 174	355
1960	+ 146	- 246	+ 55	- 126	- 171	184
1961	+ 451	- 343	+ 425	- 161	+ 336 <sup>4</sup>	520 <sup>4</sup>

<sup>1</sup> Excluding movements under repurchase agreements (see page 233).<sup>2</sup> Bank's purchases from Treasury:

a) In pursuance of the agreement as to the taking-over by the Government of the consolidated claim on Argentina: 1957: fl. 68 million, 1958: fl. 56 million, 1959: fl. 40 million 1960: fl. 20 million;

b) The exchange of State ledger debt for Treasury bills in accordance with agreement of 26 February 1947: 1958: fl. 100 million;

c) The taking-over of consolidated net claims on EPU countries in accordance with an agreement: 1959: fl. 362 million, 1960: fl. 126 million; 1961: fl. 161 million; the 1960 and 1961 figures refer to paper redeemed on maturity by the Treasury, which the Central Bank had sold on the open market from its own portfolio.

d) Partly representing funds for IMF-drawing of Great Britain in guilders.

<sup>3</sup> Including fl. 100 million bought abroad.<sup>4</sup> Taking into account fl. 36 million representing Treasury paper bought by foreign Central banks for investment of guilder balances held with the Nederlandsche Bank.

Source: Annual Reports of the Nederlandsche Bank.



## CHAPTER 3

### MINIMUM RESERVE POLICY

24. A minimum reserve system was introduced into the Netherlands for the first time in 1954. The Central Bank concluded a gentlemen's agreement in that year with the most important commercial banks and the two central institutions of the agricultural credit banks, according to which these banks declared their readiness to maintain minimum balances at the Central Bank at a level to be determined by the Central Bank within certain limits. The explanatory memorandum stated that the banks were thus participating in financing the Central Bank's gold and foreign exchange reserves.

The conclusion of this agreement must be viewed against the background of the liquidity situation in 1952 and 1953. In 1952 1.700 million and in 1953 another 800 million guilders in cash had accrued to the banks as a result of sales of foreign exchange to the Central Bank. The Treasury and the Central Bank did, it is true, skim off this surplus liquidity by selling Treasury bills and bonds. But the rates for twelve-month Treasury bills dropped to 0.4% in 1953. The Central Bank was thus faced with the question how it could continue to control the money market without losing its holdings of Treasury paper too quickly.

25. The banks were all the more ready to accept certain minimum reserve requirements since they were allowed to convert some of their short and medium-term Treasury bills into higher-yielding Government bonds. The banks that were party to the agreement could take 8, 10 or 12-year certificates (schatkist-certificaten) yielding interest at 2 5/8%, 2 3/4% or 2 7/8% in return for their almost interest-free Treasury paper. They had to undertake, of course, not to sell or pledge these Government bonds other than to the Central Bank or banks participating in the agreement. The restriction on the sale or pledging these papers ceases once the Nederlandsche Bank has acquired them.

The Central Bank also declared its readiness to grant advances, if needed, to the parties to the agreement against pledges of these Treasury certificates under certain circumstances and up to certain limits. When the loans taken up in this way run without interruption for more than a year, the borrowing bank can sell the paper to the Central Bank.

*a) The legal basis of the minimum reserve system*

26. Article 10, paragraph 5a of the Act of 18 January 1952 on the supervision of the credit system – passed to implement Article 9 of the Bank Act of 23 April 1948 – gives the Central Bank the right to ask the banks registered with it to hold balances on current account at the Central Bank in a given proportion to the deposits accepted by them.

On this basis the Central Bank could have issued a regulation to the desired effect, but it preferred to conclude with the banks a gentlemen's agreement on the holding of minimum reserves, because the 1952 Act stipulates that such measures shall be valid only for a year, with the possibility of extension for at most another year, and the Act itself was due to expire on 1 January 1955. In point of fact, it has always been extended and is still valid today; the most recent text is of 21 June 1956 (where the relevant passage is Article 10, paragraph 7a).

*b) Credit institutions subject to the minimum reserve obligation*

27. The agreement on the maintenance of minimum reserves was concluded with thirty-nine commercial banks and the two central institutions of the agricultural credit banks. Deposits at these thirty-nine banks at the end of 1954 accounted for 97% of all deposits held at commercial banks, while the other eighty or so commercial banks shared the remaining 3%.

Since July 1957 the postal cheque and giro transfer service has also been obliged to hold minimum reserves at the Central Bank. Its minimum reserve ratio was originally decided by the Ministers of Finance and of Transport and Waterways some little time after changes were made in the reserve ratios for the banks participating in the gentlemen's agreement. With effect from 1 January 1959 the general regulation applies also to the postal cheque and giro transfer service, but with the restriction that changes in the minimum reserve ratio do not come into force for this institution until one month later.

The so-called security credit institutions (*effectenkredietinstellingen*), which also accept deposits, were not included in the minimum reserve system because of their relatively low total deposits. As they only accept savings deposits, the savings banks are not subject to minimum reserve requirements. The agricultural credit banks affiliated to the two central institutions participating in the agreement are indirectly subject to minimum reserve obligations.

*c) Calculation of the minimum reserves*

28. The basis for the calculation of the required minimum reserves (*verplichte kasreserve*) consists in certain deposits and other liabilities (*toevertrouwde* 237

gelden) accepted by the commercial banks and the two central institutions mentioned above. These are the following items on the liabilities side of bank balance sheets :

- a) Customers' sight and time deposits ;
- b) Sight and time deposits of credit institutions not participating in the agreement and savings banks ;
- c) Other short-term liabilities in the nature of deposits.

Foreign currency liabilities and savings deposits do not come under the minimum reserve obligation.

In calculating the minimum reserves of the two central institutions of the agricultural credit banks, the balances held with them by their member associations are reduced by an amount corresponding to the proportion of savings deposits in the total deposits held by those associations. The savings deposits of the agricultural credit banks are thus excluded from all minimum reserve obligations, direct or indirect.

29. In the case of institutions with relatively low total deposits the first fl. 10 million of liabilities subject to the minimum reserve obligation are exempted and a further fl. 50 million are only subject to half the current minimum reserve ratio.

For the commercial banks the average minimum reserve to be held is computed on the basis of the volume of the above-mentioned deposits and liabilities at the end of each month. The minimum reserve commitment thus calculated must be discharged as an average over a period beginning on the first business day after the 21st of the month and ending on the 21st of the following month. (If, for instance, the volume of deposits subject to minimum reserve obligation is determined at the end of March 1961, average minimum reserve balances calculated on this basis must be held at the Central Bank from 22 March to 21 April 1961). The minimum reserves of the agricultural credit banks are calculated on the basis of the calendar month.

The obligation to hold minimum reserves only on monthly average enables the banks – just as in Germany – to compensate for falling short of the minimum reserve requirements on some days by exceeding them on others. The minimum reserve balances are thus to some extent comparable with Central Bank balances that can be withdrawn on demand.

*d) The minimum reserve ratio*

30. The minimum reserve ratios apply without distinction to all banks deposits and liabilities subject to the minimum reserve obligation. The February 1954 agreement fixed a ceiling of 15%, but the Central Bank has announced that it

will not raise the minimum reserves above 10% of the relevant liabilities without first selling a considerable part of its open-market holdings and consulting the banks. The need for this has never yet arisen, however.

*e) Interest and penalty interest rates*

31. The balances held as minimum reserves on current account at the Central Bank bear no interest. On the other hand, there is no provision in the Dutch minimum reserve regulations for a penalty interest rate for failing to meet minimum reserve obligations.

*f) The efficacy of minimum reserve policy*

32. Under the terms of the agreement between the Central Bank and the banks subject to minimum reserve regulations the Central Bank fixes the percentage of minimum reserves in the light of the movement of gold and foreign exchange reserves and the reasons for that movement. The President of the Central Bank told the Radcliffe Committee that this could mean, for instance, that a drop in gold and foreign exchange reserves would justify a reduction in the minimum reserve ratio if it were accompanied by a fall in customers' deposits, but that a loss of foreign exchange accompanied by credit expansion would be no incentive to reduce minimum reserves.

33. Certain structural factors in the Dutch economy give rise to sharp differences between the minimum reserve system – and open-market operations – in the Netherlands and the corresponding measures of Central Bank policy in larger countries such as the United States. In his memorandum presented to the Radcliffe Committee the President of the Netherlands Bank stated that in larger countries foreign trade had slight influence on bank liquidity, whereas in the Netherlands – where foreign trade played a very important part in the economy – any excessive credit expansion resulted immediately in a deficit on the balance of payments, since about one third of national expenditure went abroad. Any credit expansion therefore had a powerful direct effect on the liquidity of the banks, whose deposits increased much less than their lendings and which therefore very soon got into liquidity difficulties. Nevertheless, the minimum reserve system performed a useful service even in a small country like Holland. But the differences between Holland and a country such as the United States had to be borne in mind. It would otherwise be difficult to understand why the Netherlands had kept its minimum reserve ratio high even when the business trend was quiet but reduced it in periods of excessive expansion and increased it again during a recession, whereas the United States rightly pursued the opposite policy.

34. Table 7 on page 241 shows that the Central Bank, during the period of stable or only slightly rising foreign exchange reserves in 1954 and 1955, kept

the minimum reserve ratio unchanged at 10% almost until March 1956, after having increased it gradually during the early months after the agreement came into force. From April 1956, when both foreign exchange reserves and bank deposits were dwindling, the reserve ratio was gradually reduced until it touched bottom at 4% in October 1957. From February 1958 it was again increased by stages, reaching 10% in August 1958. When in April 1959 the banks party to the agreement took over from the World Bank the outstanding bonds (fl. 207 million) of a World Bank loan granted to the Dutch Government in 1947, the Central Bank supported the transaction by lowering the reserve ratio to 7%. The net effect of these operations was to leave the liquidity of the money market undisturbed. A further reduction to 6% was made in July 1959, but only for one monthly accounting period, in view of the issue of a Government loan. From July 1960 the ratio was put up three times (July 1960, January and April 1961), finally reaching 10%, to absorb the bank liquidity resulting from foreign exchange surpluses. In August 1961, however, the Central Bank again cut the ratio to 8% to facilitate the placing of a Government loan, among other reasons; in October 1961, in view of the tightening of the money market, resulting from heavy tax payments, the ratio was brought down as low as 6%.

As can be seen from Table 7, the Central Bank in every case but one increased the minimum reserve ratio by 1% only of the liabilities subject to the minimum reserve obligation, but often reduced it by larger percentages. As the minimum reserve ratio for technical reasons can only be altered once a month, this device is not suitable for cushioning short-term fluctuations, but it can be used to skim off or inject a certain amount of liquidity, beyond which recourse is had to the more flexible open-market policy.

Table 7

## MINIMUM-RESERVE RATIO AND BALANCES

(in millions of guilders)

End of month	Deposits at banks (1)	Minimum- reserve ratio (2)	Minimum- reserve balances (3)	Reserve balances as percentage of deposits (4 = 3:1)
February 1954	5 259	-	-	-
March	5 330	5	222	4.2
April	5 388	6	270	5.0
May	5 517	7	319	5.8
June	5 720	8	373	6.5
July	5 806	9	439	7.6
August	5 683	10	493	8.7
September	5 642	10	481	8.5
October	5 688	10	478	8.4
November	5 761	10	487	8.5
December	5 641	10	495	8.8
January 1955	5 651	8	387	6.8
February	5 612	10	483	8.6
March	5 677	10	481	8.5
April	5 659	10	485	8.6
May	5 689	10	482	8.5
June	5 845	10	485	8.3
July	5 975	10	500	8.4
August	5 885	10	514	8.7
September	5 931	10	505	8.5
October	6 079	10	508	8.4
November	6 186	10	526	8.5
December	6 066	10	537	8.9
January 1956	5 975	10	525	8.8
February	5 975	10	516	8.6
March	6 014	10	516	8.6
April	5 914	8	415	7.0
May	6 066	9	459	7.6
June	5 947	9	460	7.7
July	5 951	9	461	7.7
August	5 935	9	457	7.7
September	5 783	9	446	7.7
October	5 652	7	338	6.0
November	5 622	7	334	5.9
December	5 664	7	338	6.0
January 1957	5 650	7	337	6.0
February	5 671	7	339	6.0
March	5 707	6	294	5.2
April	5 712	6	292	5.1
May	5 785	6	297	5.1
June	5 777	6	295	5.1
July	5 860	6	300	5.1
August	5 543	6	282	5.1
September	5 296	6	270	5.1
October	5 168	4	174	3.4
November	5 213	4	176	3.4
December	5 303	4	180	3.4

Table 7 (continued)

End of month		Deposits at banks (1)	Minimum- reserve ratio (2)	Minimum- reserve balances (3)	Reserve balances as percentage of deposits (4 = 3 : 1)
January	1958	5 487	4	187	3.4
February		5 744	5	247	4.3
March		5 832	6	302	5.2
April		5 797	6	301	5.2
May		5 892	7	353	6.0
June		5 837	8	402	6.9
July		6 040	9	467	7.7
August		6 143	10	534	8.7
September		6 030	10	522	8.7
October		5 880	10	506	8.6
November		6 200	10	537	8.7
December		6 303	10	547	8.7
January	1959	6 683	10	586	8.8
February		6 739	10	594	8.8
March		6 890	10	607	8.8
April		6 989	7	433	6.2
May		6 983	7	432	6.2
June		6 845	6	360	5.3
July		6 998	7	429	6.1
August		7 087	7	435	6.1
September		6 930	7	426	6.1
October		6 788	7	416	6.1
November		7 042	7	430	6.1
December		7 106	7	435	6.1
January	1960	7 332	7	451	6.2
February		7 290	7	450	6.2
March		7 455	7	463	6.2
April		7 482	7	464	6.2
May		7 460	7	458	6.1
June		7 506	7	463	6.2
July		7 686	8	543	7.0
August		7 920	8	561	7.1
September		7 790	8	550	7.1
October		7 680	8	543	7.1
November		7 759	8	549	7.1
December		7 630	8	540	7.1
January	1961	8 111	9	650	8.0
February		8 246	9	660	8.0
March		8 284	9	664	8.0
April		8 259	10	736	8.9
May		8 193	10	727	8.9
June		8 268	10	733	8.9
July		8 282	10	736	8.9
August		8 421	8	601	7.1
September		8 209	8	583	7.1
October		7 640	6	405	5.3
November		7 731	6	413	5.3
December		7 718	6	410	5.3

## CHAPTER 4

### OTHER INSTRUMENTS OF MONETARY POLICY

35. Apart from those described in previous sections, the Central Bank has several other means of influencing bank liquidity and lending.

These are based on gentlemen's agreements concluded with the banks in pursuance of the Act on the supervision of the credit system passed in 1952 and extensively amended in 1956. Under this Act the Central Bank can in fact:

- a) issue regulations on minimum liquidity, i.e. on the ratio of liquid assets to deposits ;
- b) issue regulations on maximum credits and/or investments ;
- c) prohibit or restrict certain forms of credit.

This legislation assumes, however, that the Central Bank will first attempt to conclude gentlemen's agreements with the banks on any measures to be taken. Only if agreement is not reached can the Bank issue the general directives mentioned above, and they must have the approval of the Finance Minister and be presented for ratification by Parliament within three months. Their validity is limited to a year, and they may be extended once only.

36. In 1954, then, after the lapse of the authorization mentioned at the beginning of this report (see page 219) for the imposition of overall quantitative restrictions, the Central Bank concluded two agreements with the banks concerned. One of them related to the maintenance of a certain ratio between the liquid assets of a bank and its customers' deposits; the other enabled the Central Bank, if circumstances so required, to ask the banks not to lend above a certain ceiling to be fixed later.

These directives were not to be hard and fast, but if the banks fell short of the minimum ratio or went above the credit ceiling they would have had to cover the difference by recourse to the Central Bank.

37. In the event, the directives were never applied. In May 1960 the Central Bank signed a new agreement with the banks and agricultural credit institutions under which they could be required to hold supplementary balances at the Central Bank. Whereas minimum reserves are normally calculated on customers' deposits and other liabilities, this agreement introduces a broader regulation under which a further reserve can be required in relation to credits granted. 243



In short, the system now adopted provides the power to control banks, whenever they lend above a certain fixed ceiling, to maintain a given percentage of this excess as a non-interest-bearing deposit at the Central Bank,

The arrangement is as follows: the Central Bank can advise the commercial banks and the agricultural credit institutions not to allow their short-term advances to business concerns and private individuals to rise by more than a given percentage ( $x$  %) per annum. A bank will remain within this norm, if the average of its short-term lendings, calculated from the last three monthly balance sheets submitted to the Central Bank,

a) has not risen by more than  $x$  % per annum over the average for the corresponding months of a reference year to be decided;

b) or has not risen by more than  $x/12\%$  per month over the average for three months of a reference quarter to be decided.

If the banks that are parties to this agreement do not as a whole keep to these norms, the Central Bank can require those of them which have failed to observe either norm to hold a non-interest-bearing balance with the Central Bank in addition to the normal minimum reserve. The amount of this balance will be fixed as a percentage (not more than 100) of the smallest amount by which one of the norms has been exceeded.

However, the first fl. 100 000 of the excess is to be exempt from the obligation; one quarter of the full percentage rate will be applied to a further fl. 400 000 in excess, and half the percentage to the next fl. 500 000. The amount of the balance to be kept at the Central Bank will be adjusted each month to the amount by which the norms are overstepped.

Should special circumstances make the basis for the credit expansion rate of a bank particularly low, the Central Bank may change the reference period. In addition, when lending increases by more than the average as a result of exceptional factors but can be expected to revert to normal in a short time, the Central Bank can, at the request of the bank concerned, postpone the obligation to pay the whole or part of a deposit. In the agreement the Central Bank undertook to discuss with the banks the possibility of waiving its application if total lending within a period of three months did not exceed a norm previously fixed.

38. In July 1961 in view of the rise in bank credit, this agreement was applied by arrangement – as stipulated – between the Central Bank and the other banks. Having regard to the expected growth rate of the gross national product, the banks were required not to increase their total lendings in 1961 by more than 15% in relation to the fourth quarter of 1960, or in any given month in relation to the corresponding month of the previous year.

## CHAPTER 5

### BANKS' MONEY-MARKET INVESTMENTS ABROAD AND TRANSACTIONS OF THE NEDERLANDSCHE BANK ON THE FORWARD FOREIGN EXCHANGE MARKET

39. Whereas the banks that under the 1954 gentlemen's agreement had been authorized to invest abroad largely confined themselves until about 1957 to holding working balances to finance foreign trade, they later – especially after the return to convertibility and in view of the increasing foreign exchange reserves at home and rising money rates abroad, particularly in the United States – began to increase their foreign money-market investments for reasons of interest arbitrage. Table 8 below shows that the commercial banks had already increased their investments on foreign money markets from about fl. 600 million to fl. 700 million in 1958 and up to fl. 1 800 million by the end of 1959.

Table 8

#### FOREIGN EXCHANGE BALANCES AND OTHER FOREIGN INVESTMENTS OF COMMERCIAL BANKS

(in millions of guilders)

End of year	Total	Foreign exchange balances	Investments in money markets
1956	551	376	175
1957	639	466	173
1958	731	564	167
1959	1845	1090	755
1960	1823	1448	375
1961	1444	1243	201

*Source:* Annual Reports of the Nederlandsche Bank.

The interest rate policy of the Central Bank in recent years has aimed at making the investment of funds abroad attractive to the banks; special incentives for the export of money by offering banks swap facilities thus became unnecessary. However, the Central Bank intervened once in recent years on the forward foreign exchange market in order to exert an indirect influence on the liquidity of the banking system and on conditions on the money market. This was in September 1957, when there was heavy speculative buying of

forward exchange by bank customers and the banks were buying spot currencies to cover their own forward commitments, and these two factors led to a reduction in central foreign currency reserves and to sharp strains on the money market. At this time the Central Bank agreed to conclude forward foreign exchange transactions with the banks as cover for their forward sales. In August and September 1957 the Bank sold the equivalent of fl. 390 million, including \$78.5 million and DM 103 million, to the banks. This intervention by the Central Bank was an exceptional measure taken in view of the special circumstances obtaining at that time.

## CHAPTER 6

### CASH MANAGEMENT AND BORROWING OF PUBLIC AUTHORITIES AND THEIR EFFECTS ON LIQUIDITY

40. The 1948 Bank Act makes the Central Bank the Treasury's fiscal agent and keeper of its accounts. The balances of local authorities are kept almost entirely at other banks.

The centralization of the Treasury's cash resources at the Central Bank is an important factor in determining the short-term movement of liquidity on the money market, particularly as the Treasury is by far the biggest receiver of tax proceeds. Apart from small local taxes, the Finance Ministry is the only collector of taxes. At the dates when most payments fall due (mainly in the months of August to December) the banks part with considerable amounts of cash because of payments by their customers to the Treasury. The Central Bank takes account of the resultant influences on the money market by pursuing a flexible open-market policy.

The Treasury's quarterly payments to municipalities, moreover, alleviate the consequences of these tax payments on bank liquidity.

41. The cash credits that the Central Bank makes available to public authorities to finance deficits are of importance from the liquidity policy aspect. The 1948 Bank Law, as amended in 1955, allows the Treasury credit from the Central Bank up to fl. 150 million. Below this limit the Treasury can at any time take up interest-free advances, which must be covered by deposits or pledges of Treasury paper. Above the limit the Bank can decide freely and is not obliged to make cash advances to the Treasury or to take over Treasury paper direct from the Treasury. The same also applies to the taking up of Government paper as part of the Bank's open-market policy.

Between the Central Bank and the Treasury there is a general understanding that the Treasury will refrain from inflationary financing and that credit should therefore not be granted for current budget expenditure. However, if the Treasury's needs were the result of difficulties in renewing its short-term debt on the money market, the Central Bank, as its President told the Radcliffe Committee, would have to regard the wishes of the Treasury in a different light. In 1951, for instance, when the renewal of Treasury bills met with difficulties (and it was experience at that time that led to the concept of secondary liquidity being developed), the Central Bank gave extensive assistance to the Treasury.

42. In recent years Treasury borrowing has also had a strong influence on bank liquidity; it has often floated long-term loans beyond its current need for funds and has either applied the proceeds to repaying foreign debts or deposited them with the Central Bank.

## CHAPTER 7

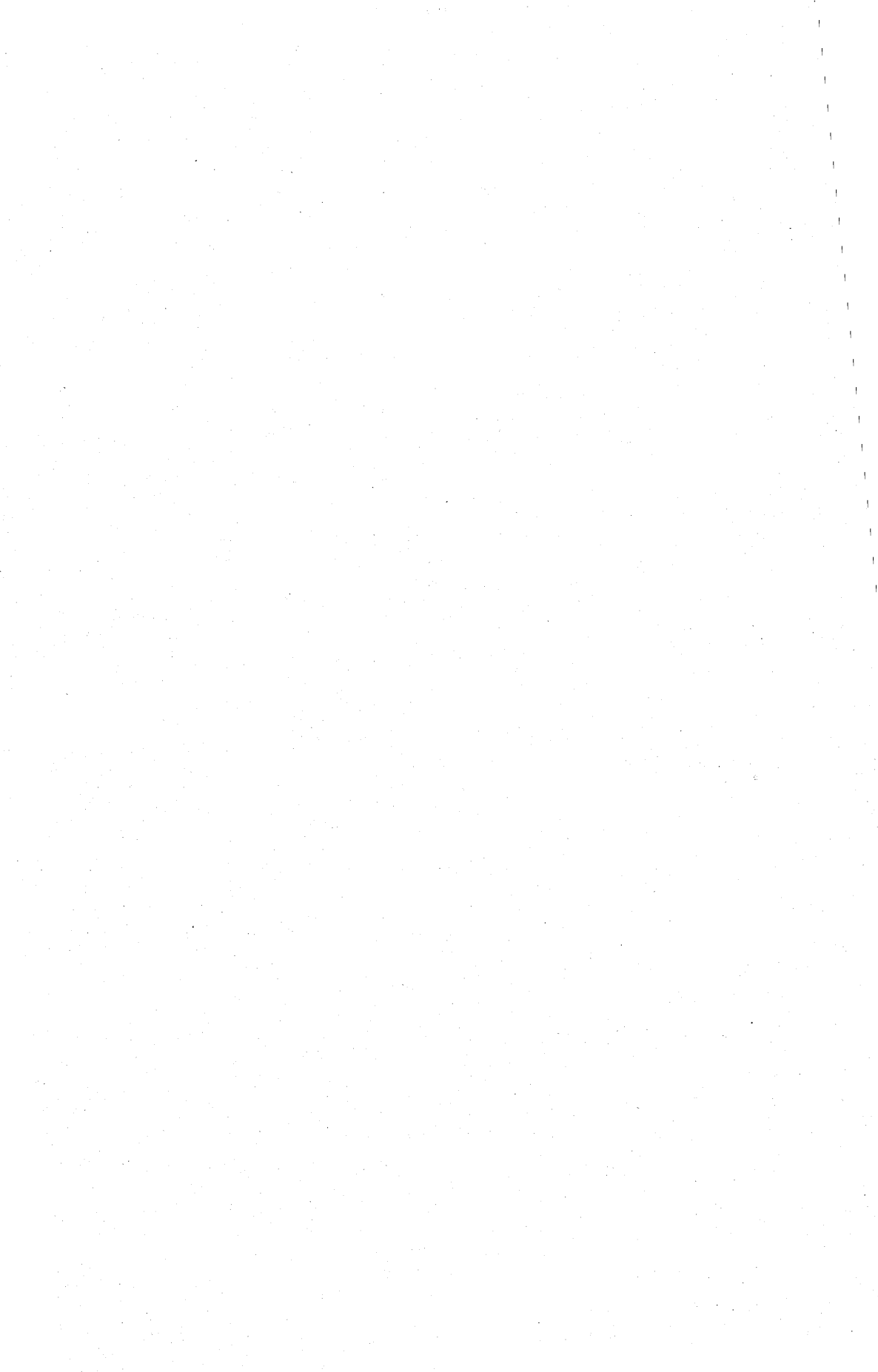
### DIRECTIVES ON SOLVENCY AND LIQUIDITY

43. To protect the depositor the Central Bank may issue certain directives on solvency and liquidity. These are :

- a) regulations on the minimum of liquid resources in relation to deposits accepted or to particular categories of deposits ;
- b) regulations on the maximum volume of credit granted or investments made in relation to own capital and reserves ;
- c) bans or restrictions on the grant of certain types or forms of credit or of credit above a given figure ;
- d) bans or restrictions on certain types or forms of investment or on investment above a given figure.

*Coefficient of solvency:* Certain advances and investments involving a considerable risk element may not exceed five times the banks' capital and reserves ; others carrying less risk may not exceed ten times the capital and reserves.

*Coefficient of liquidity:* Liquid resources must cover 10% of time deposits and equivalent liabilities and 30% of other liabilities – mainly sight deposits. For time deposits with a term of 3 to 10 years the ratio is 5%.



**Part seven**

**THE INSTRUMENTS OF MONETARY POLICY  
IN LUXEMBOURG**





## CONTENTS

Introductory remarks	255
<i>Liquidity in the economy as a whole – Liquidity of the banking system</i>	
Chapter 1 : Interest rate policy, the money and capital markets	261
Chapter 2 : Cash management and borrowing of the State and their effects on liquidity	266
Chapter 3 : Cash and liquidity ratios	267

## TABLES

1 – Domestic liquidity	258
2 – Liquidity of the banking system	259
3 – Selected balance-sheet items of Luxembourg banks, at 31.12.1960	264
4 – Credit institutions in Luxembourg	268

## DIAGRAMS

1 – Interest rates in Belgium and Luxembourg	262
2 – Capital market rates in Belgium and Luxembourg	265



## INTRODUCTORY REMARKS

1. In 1922, the Grand Duchy of Luxembourg concluded a fifty-year treaty of economic union with Belgium. Under this treaty trade and services between these two countries are – with a few exceptions – freed from customs duties, charges and quantitative restrictions on imports or exports. Belgium assumes responsibility for external trade policy (with Luxembourg co-operation) and concludes trade and payments agreements on behalf of the Economic Union. In 1944, a jointly administered institution – (Institut belgo-luxembourgeois du change) – was set up to deal with payments transactions with foreign countries.

2. The treaty on the Belgo-Luxembourg Economic Union, and subsequent Protocols, contain regulations on the issue of bank notes by the Luxembourg authorities. These form the basis of a currency association between Belgium and Luxembourg. As Luxembourg has no Central Bank, it is not in a position to pursue its own monetary policy in the strict sense of the term.

Since the Luxembourg banks regularly invest their liquid surpluses in call money and short-term paper in the Belgian money market, it follows that the money and credit policy of the Banque nationale de Belgique has some, though evidently not a very large, influence on credit conditions in Luxembourg.

3. There are several factors which favour the participation of Luxembourg banks in the Belgian money market. In 1935, for instance, the Banque nationale de Belgique set up a branch office and a discount office in Luxembourg. The branch office can carry out all credit and deposit transactions in accordance with the law establishing the Banque nationale de Belgique; in fact, however, its activity is limited to supplying Luxembourg with Belgian notes and coin. Occasionally Luxembourg banks have transfers to Belgium made through this branch office.

It is the function of the discount office to guarantee bills to make them negotiable at the branch office of the Banque nationale de Belgique. In practice, however, the activities of the discount office are without much significance since it does not guarantee bills payable in the Grand Duchy, whether they are made out in Luxembourg or Belgian francs or in any other currency.

The Luxembourg banking system has its own clearing arrangements for settling inter-bank claims. These settlements are cleared through the Caisse d'épargne de l'Etat (State Savings Bank), with whom the Luxembourg banks keep accounts; the branch office of the Banque nationale de Belgique in Luxembourg

takes no part in this. For this reason, transfers from Luxembourg private banks to Belgium are made through the Caisse d'épargne de l'Etat within the clearing system; the Caisse d'épargne de l'Etat effects these transfers to the debit of the accounts with its Belgian correspondents and the Belgian Postal Cheque Office or, when necessary, via the branch office of the Banque nationale de Belgique in Luxembourg.

4. The Luxembourg banking system proper comprises the Caisse d'épargne de l'Etat (a public corporation), two large banks and a number of less important credit institutions. The Caisse d'épargne de l'Etat, which carries out the financial transactions of the State as well as all other normal banking business exerts a certain influence on the other credit institutions because its volume of business is as large as that of all the other banks put together. Since the State Savings Bank has no capital, it has no interest charge to meet under this head, but it has to make considerable appropriations to general and special reserves. It tends to set the pace for competition between banks, especially with regard to credit terms.

The two large banks are the Banque internationale and the Banque générale du Luxembourg. The capital of both is linked to that of Belgian banks, especially that of the Banque générale du Luxembourg which was formerly a branch and is now a subsidiary of the Société générale de Belgique. These two large banks account for some 35% of the total deposits held by Luxembourg banks; the State Savings Bank holds some 50% of total deposits, so that these three major credit institutions account for about 85% of all the money deposited with Luxembourg banks (these figures refer to the situation at the end of 1960).

No great importance attaches to the other Luxembourg banks or to the branches of foreign banks in Luxembourg; they account for some 15% of total deposits.

*a) Liquidity in the economy as a whole*

5. In Luxembourg, as indeed in the other Community countries, deposits with the banks withdrawable within a month or less and deposits with the Postal Cheque Office are reckoned, together with the note and coin in circulation, as money supply (domestic liquidity) or the primary liquidity of businesses and private individuals. The money circulating in Luxembourg as legal tender consists of Luxembourg and Belgian Treasury notes and coin, as well as Luxembourg and Belgian bank notes. Under an agreement of 15 April 1952 (so far ratified by neither the Luxembourg nor the Belgian Parliament) the Luxembourg authorities may issue Treasury notes and coin only up to a certain limit, which is at present 308.6 million francs. Luxembourg's entitlement to issue at any given time is calculated on the basis of the Belgium-Luxembourg population ratio (at present

notes and coin (that is, excluding bank notes), which is at present Bfrs. 7 500 million, plus an absolute figure of 50 million francs. In the past two years the actual circulation of Luxembourg notes and coin has been about 200 million francs.

Luxembourg notes and coin are issued by the Caisse générale de l'Etat and the Banque internationale de Luxembourg. This bank is authorized to issue its own notes up to a value of 20 million francs. In an agreement with Belgium concluded in 1935 it is laid down that Luxembourg notes must not be of a denomination higher than 100 francs.

6. Most of the money in circulation in Luxembourg consists of Belgian notes and coin, which are legal tender and equivalent to Luxembourg notes and coin, whereas Luxembourg currency is not legal tender in Belgium.

The total amount of Belgian notes and coin circulating in Luxembourg is not known. A rough calculation based on the population ratio between Belgium and Luxembourg gives the following result: on 31 December 1960 Belgian notes and coin circulating in the Belgo-Luxembourg Economic Union totalled 126 800 million francs and Luxembourg money circulating in Luxembourg amounted to 200 million francs, so that the total money in circulation was 127 000 million francs. At that time the population of Belgium was 9 178 000 and that of Luxembourg 323 000, making a total of 9 501 000. Dividing the total note and coin circulation by this total, we arrive at a figure of 13 367 francs per head. On this basis the total money in circulation in Belgium at the end of 1960 was Bfrs. 122 700 million and in Luxembourg 4 300 million (4 100 million in Belgian and 200 million in Luxembourg notes and coin).

At the end of 1960, sight deposits with Luxembourg banks, in Luxembourg francs and to a small extent in Belgian francs, amounted to about 5 000 million and balances with the Postal Cheque Office which, like those of the Caisse d'épargne de l'Etat, are expressed only in Luxembourg francs, amounted to about 1 000 million francs. Thus the total deposits reckoned in the money supply amounted to about 6 000 million francs (see Table 1 - Domestic Liquidity).

The notion "near-money" is also known in Luxembourg. In Dutch terminology, these could be described as secondary liquidity. They include deposits for periods longer than 30 days, amounting to 3 400 million at the end of 1960, savings deposits at 6 700 million, and to some extent the liabilities of Luxembourg banks in respect of sight and time deposits in foreign currency, amounting to about 1 800 million<sup>1</sup>.

<sup>1</sup> This includes deposits of non-residents, which ought to be excluded, but their amount is probably not very large. It is not possible to isolate them because no distinction can be made between the resident holders of foreign currency deposits and the non-resident holders.

**Table 1**  
**DOMESTIC LIQUIDITY**

in million frs.

	31.12.1958	31.12.1959	31.12.1960
<b>I. Domestic money supply</b> (Primary liquidity)			
Money in circulation:			
Luxembourg notes and coin	191	198	234
Belgian notes and coin <sup>1</sup>	3 912	3 952	4 084
Cash less holdings at Luxembourg banks	-251	-240	-258
Total	3 852	3 910	4 060
Sight deposits <sup>2</sup>	4 530	4 704	4 975
Postal Cheque Accounts	888	929	987
Total	9 270	9 543	10 022
<b>II. Secondary liquidity</b>			
Time deposits	2 744	2 983	3 395
Savings deposits	5 794	6 337	6 736
Short and medium-term Government paper	132	114	101
Sight and time deposits in foreign currencies with Luxembourg banks <sup>2</sup>	566	977	1 815
Total	9 236	10 411	12 047
<b>I + II - Total domestic liquidity</b>	18 506	19 954	22 069

<sup>1</sup> Estimate.

<sup>2</sup> Including deposits of Belgians and other non-residents, which ought to be excluded, but it is not possible to segregate them.

Source: Statistical Yearbook of the Office de la statistique générale, and commissariat au contrôle des banques.

The secondary liquidity of the economy also includes short and medium-term government securities such as "Bons du Trésor" or "Bons de la reconstruction" held by business firms or private individuals (101 million francs at the end of 1960).

8. In its Year-book the Statistical Office of Luxembourg publishes a table on the supply of money. This does not, however, include the Belgian notes and coin circulating in Luxembourg. A further table shows customers' deposits on time and savings accounts. Further information must be sought from internal sources.

No analysis is published of the factors affecting the liquidity of the economy as a whole, but some factors such as the granting of credit and external transactions can be determined.

Table 2

## LIQUIDITY OF THE BANKING SYSTEM

in million frs.

	31.12.1958	31.12.1959	31.12.1960
<b>I. Cash liquidity</b>			
Notes and coin	251,1	240,0	258,0
Balances with the Banque nationale de Belgique 1	431,6	408,6	297,2
Total	682,7	648,6	555,2
<b>II. Potential liquidity</b>			
Balances with foreign banks	1 048,1	2 280,5	2 389,9 } 1 782,0 } 2
Commercial bills (rediscountable)	2 902,2	2 509,7	3 055,8
Treasury bills and other mobilizable paper	327,3	432,4	560,6
Total	4 277,6	5 222,6	7 788,3
I + II	4 960,3	5 871,2	8 343,5

1 The figures for 1958 and 1959 include balances with the Postal Cheque Office and the Caisse d'épargne de l'Etat, which should not be incorporated since they represent inter-bank liabilities.

2 In 1960, for the first time, broken down into sight and time deposits abroad, including Belgium; the figures for 1958 and 1959 include only foreign currency holdings other than Belgian francs (in 1960: 3 275 million francs).

Source: Commissariat au contrôle des banques, Luxembourg.

*b) Liquidity of the banking system*

9. Usually the cash liquidity of the banking system is understood to denote the banks' holdings of Central Bank money (notes and coin and balances at the Central Bank), and potential liquidity means those assets of the banks which can be changed into money by recourse to the bank of issue. As Luxembourg has no Central Bank, its conception of liquidity of the banking system differs from that of other countries.

10. The banking system's cash liquidity comprises holdings of notes and coin and balances at the Banque nationale de Belgique. Moreover, Luxembourg statistics also include among liquid resources the commercial banks' deposits with the Postal Cheque Office and the Caisse d'épargne de l'Etat.

11. Potential liquidity includes balances at foreign banks plus call money credits granted and commercial and Treasury bills which can be encashed by discounting at Belgian banks. The Luxembourg banks invest a large part of their liquid funds in Belgian commercial bills which are certified by the Banque nationale de Belgique and can be discounted at any time by the Institut de 259



réescompte et de garantie (Rediscount and Guarantee Institute)<sup>1</sup>. The holdings of Belgian Treasury bills are included in the calculation of potential liquidity because they can be sold on the Belgian money market.

Luxembourg Treasury bills can be included in potential liquidity inasmuch as, with the approval of the Ministry of Finance, they can be cashed at the Luxembourg Treasury before maturity; Luxembourg commercial bills cannot, however, be included, as the Banque nationale de Belgique does not discount either them or Luxembourg Treasury bills. The Banque nationale de Belgique refuses to discount Luxembourg commercial or Treasury bills on the grounds that, in view of Luxembourg's right independently to alter its currency parity, it is not prepared to accept the exchange risk involved.

12. Although Luxembourg has no Central Bank and the Luxembourg money and credit market is to some extent influenced by the policy of the Banque nationale de Belgique, the Luxembourg authorities nevertheless have powers to determine the business policy of the banks. This is done largely through the interest rate policy of the Caisse d'épargne de l'Etat and the liquidity ratio, which is always a convenient instrument. The following chapters deal with interest rate policy, the money market, Government handling of public funds and borrowing, and the cash and liquidity ratios.

---

<sup>1</sup> See Instruments of Monetary Policy in Belgium, page 194.

## CHAPTER 1

### INTEREST RATE POLICY, THE MONEY AND CAPITAL MARKETS

13. Though Luxembourg has no real Central Bank it can be said, in a limited sense, that the policy of the Caisse d'épargne de l'Etat on interest rates has a certain effect on the business policy of the other banks. It is true that the commercial banks can rediscount bills with the Caisse d'épargne de l'Etat or take up loans against security from it; but they hardly avail themselves of these facilities because the high surplus of foreign currency keeps them sufficiently liquid and they have no need to obtain funds in this way.

It is rather by its volume of business, which is approximately as large as that of all the other Luxembourg banks put together, that the Caisse d'épargne de l'Etat exerts its influence over the other banks; it has a commanding position on the credit market, that is to say in the fixing of the interest rates charged to borrowers. Similarly the deposit business and borrowing of the Caisse d'épargne de l'Etat have an effect on the other banks. The interest rates charged by the Caisse d'épargne de l'Etat can, therefore be considered as representative of all Luxembourg credit institutions.

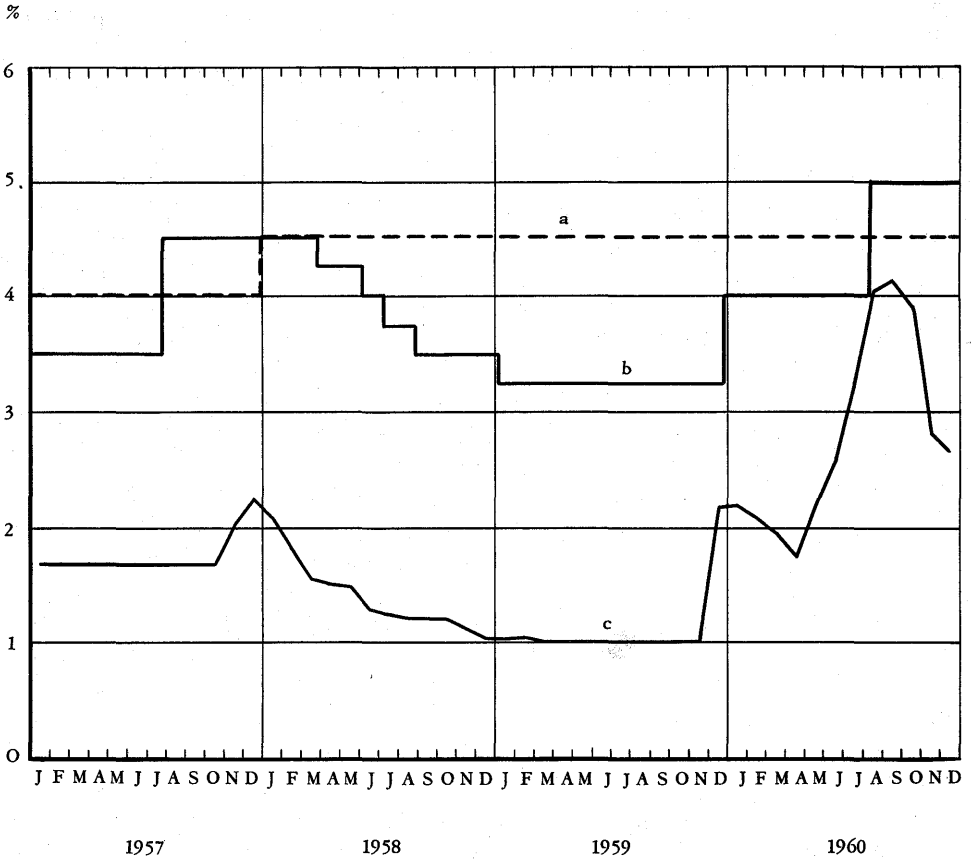
14. Foreign influence, especially that of the Banque nationale de Belgique, must be taken into consideration in connection with the interest policy of the Caisse d'épargne de l'Etat. This bank has a current account overdraft facility at the Banque nationale de Belgique of up to 100 million francs (at an interest rate equal to the prevailing Bank rate) but it has never yet availed itself of this facility.

15. The discount policy of the Banque nationale de Belgique has therefore no direct influence on the interest policy of the Caisse d'épargne de l'Etat or, in consequence, on that of any other Luxembourg bank. The diagram on page 262 shows that in fixing its lending rate the State Savings Bank is quite independent of the discount rate of the Banque nationale de Belgique. No firm comparison is however possible between the two rates of interest because the Luxembourg lending rate corresponds to that charged by the Belgian banks which, though it is not publicized, is thought to be some  $1\frac{1}{2}\%$  higher than the Central Bank's discount rate.

In view of the close economic ties between Luxembourg and Belgium it might be expected that Belgian borrowers would raise money in Luxembourg at a rate of interest which is sometimes much lower than in Belgium. In general, 261

Diagram 1

INTEREST RATES IN BELGIUM AND LUXEMBOURG



- a) Interest rate of the Caisse d'épargne de l'Etat (Luxembourg) for short-term advances.
- b) Discount rate of the Banque nationale de Belgique.
- c) Call money rate in Belgium.

however, the Caisse d'épargne de l'Etat and other Luxembourg banks grant credits to residents only. For the Caisse d'épargne de l'Etat this is a matter of principle, the object being to keep interest rates low in Luxembourg. The other banks which are large enough to contemplate lending to non-residents follow the same line, probably because they are under the influence of Belgian banks, which presumably have no inclination to provide Belgian borrowers with cheaper credit through their Luxembourg subsidiaries.

16. The Luxembourg banks keep most of their liquid reserves abroad especially in Belgium in the form of sight and time deposits with banks, call money credits and money-market securities. Only a very small proportion is kept with the branch of the Banque nationale de Belgique in Luxembourg, the Luxembourg

Postal Cheque Office, the Caisse d'épargne de l'Etat and in cash. Balances at other banks are unusually high, at 4 582 million francs, as will be seen from Table 3 deposits with banks. This figure includes the call-money credits granted. Of the items mentioned above more than two-thirds are expressed in currencies other than those of Belgium or Luxembourg, which indicates that they are kept to a large extent with foreign (not Belgian) banks or as money-market investments in foreign countries other than Belgium. If this item is broken down into sight and time deposits and for the various banks we are led to conclude that the Banque générale du Luxembourg and the Kredietbank in Luxembourg, place most of their liquid surpluses in sight deposits with their parent companies in Brussels, whereas the Banque internationale de Luxembourg, in which apart from Belgian there is also French capital, places some of its liquid resources in foreign countries. The Caisse d'épargne de l'Etat has only comparatively small sight deposits with other banks.

Of the total of 3 223 million francs worth of commercial bills at the end of 1960, Belgian commercial bills accounted for 3 056 million. They represent the remainder of the Luxembourg banks' money-market investments in Brussels, largely in certified bank acceptances rediscountable with the Institut de rées-compte et de garantie (IRG - Rediscount and Guarantee Institute) in Brussels. Of the total of 3 798 million commercial and other bills, the Caisse d'épargne de l'Etat has 2 473 million, chiefly bank acceptances rediscountable in Belgium. Evidently the Caisse d'épargne de l'Etat places most of its liquid reserves in these bank acceptances (19% of its assets at the end of 1960). The other large banks have a relatively small holding of bills in comparison with their deposits with banks.

17. Through the investments of Luxembourg banks, especially the Caisse d'épargne de l'Etat, on foreign money markets, the terms and conditions prevailing on these markets to some extent affect the Luxembourg money and credit market. The certified bank acceptances rediscountable with the IRG - to which reference has been made above - are of particular importance in this connection; with a life of 120 days, their yield is  $\frac{1}{4}\%$  lower than the discount rate of the Banque nationale de Belgique. It may therefore be said that developments on the money market in Belgium - or in other words indirectly the credit policy of the Banque nationale de Belgique - partly determine the earnings of the Caisse d'épargne de l'Etat. However, this Bank is not much guided by interest rate movements in other countries, in particular Belgium; it can always keep its rate of interest below the level obtaining in Belgium. One explanation for this independence is that Luxembourg depositors - even in the frontier areas - do not deposit their money with Belgian banks even if this means a higher rate of interest, but prefer Luxembourg franc deposit accounts with Luxembourg banks, especially the Caisse d'épargne de l'Etat, the more so as deposits with the latter are guaranteed by the Luxembourg State.

18. There is between the capital market rates in Luxembourg and Belgium a difference similar to that between the rates of interest for short-term credit.

Table 3  
**SELECTED BALANCE-SHEET ITEMS OF LUXEMBOURG BANKS, AT 31. 12. 1960**

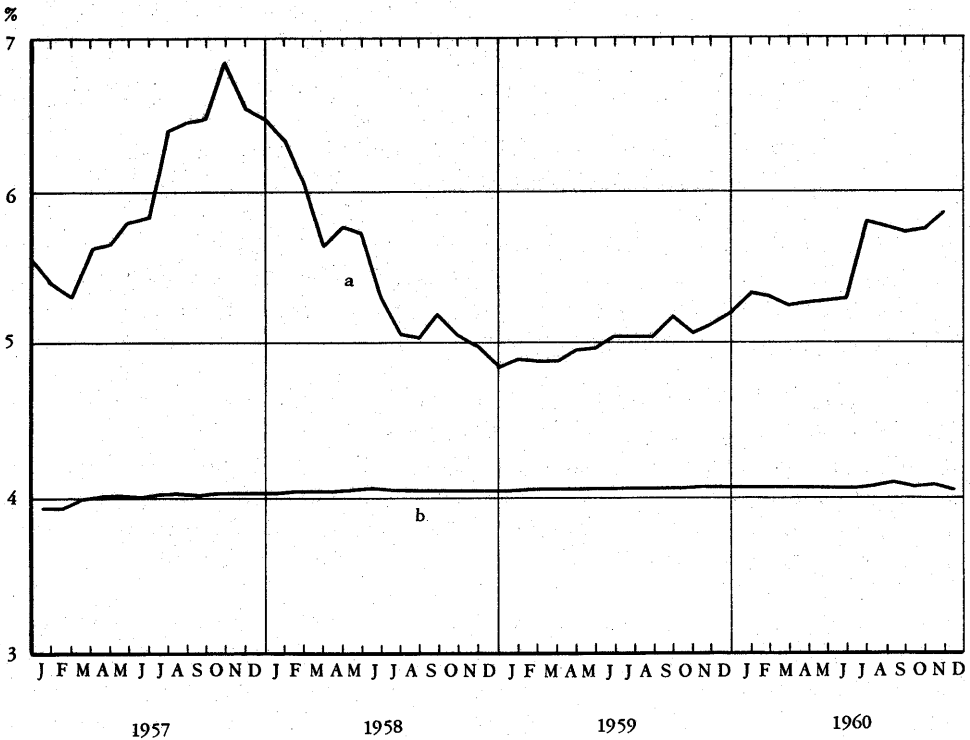
in million frs.

Items	Caisse d'épargne de l'Etat 1	Banque Internationale à Luxembourg 2	Banque générale du Luxembourg 3	Total 1 + 2 + 3 4	Kreditbank S.A.L. 5	Other banking establ. 6	Grand Total 7
<b>Assets:</b>							
Cash Reserves	252	298	95	645	31	342	1 018
a) Notes, coin, (incl. foreign)	80	135	54	269	11		
b) Balances at Postal Cheque Office	17	163	40	375	20		
c) Balances at Banque nationale de Belgique	155						
Sight deposits with banks (up to 30 days)	277	729	1 073	2 079	118	} 1 347	4 582 incl. for- eign exch. 3 275
Time deposits with banks	20	825	76	921	118		
Bills	2 473	521	533	3 527	72	199	3 798
a) Commercial							3 223
b) Treasury and other securities							575
Securities	2 447	237	236	2 920	68	228	3 215
a) Luxembourg public securities	946	72	79	1 097	24		1 192
b) Foreign public securities	1 500	3	1	1 504	36		} 2 023
c) Other fixed interest securities		123	112	235	7		
d) Equities	1	39	44	84	1		
<b>Liabilities:</b>							
Liabilities towards other banks	376	127	126	629	52	509	1 190
Deposits and current accounts	3 197	2 664	1 983	7 844	515	1 826	10 185
a) Sight deposits	1 342	1 864	1 296	4 502	372	1 272	6 145
b) Time deposits (at more than 1 month)	1 855	8 800	687	3 342	143	555	4 040
Savings deposits	4 739	647	532	5 918	10	808	6 736

Sources: Annual Reports of the above-listed banking establishments and the Commissariat au contrôle des banques.

Diagram 2

CAPITAL MARKET RATES IN BELGIUM AND LUXEMBOURG



- a) Belgian Government Debt Certificates (5 - 20 years).
- b) Luxembourg Government Loans (40 years).

Since the end of the war the Luxembourg State and local authorities have paid 4% interest on all loans on the Luxembourg capital market – with the exception of one loan floated in US dollars and £ sterling. These loans are taken up by the Luxembourg social insurance institution, private insurance companies, the Luxembourg banks and, to a smaller extent, private individuals. In so far as they are dealt in at all on the Luxembourg stock market, their quotations remain close to par, so that during the past fourteen years the yield has nearly always been close to 4%. The nominal rate of interest on loans floated by the Belgian State or other public authorities since the end of the war has on the other hand been between 5 and 6%. Stock exchange quotations have often fluctuated widely, as will be seen from the diagram on page 265 showing the yield of Government debt certificates with a life of from 5 to 20 years.

19. The lower rate of interest for Luxembourg securities seems to be largely due to the fact that most of these are taken up by the Luxembourg social insurance institution which is prepared to accept a rate below that offered on Belgian securities.

## CHAPTER 2

### CASH MANAGEMENT AND BORROWING OF THE STATE AND THEIR EFFECTS ON LIQUIDITY

20. The Luxembourg Government keeps its balances at the Caisse d'épargne de l'Etat which acts as agent of the Caisse générale de l'Etat and therefore carries out all the State's financial transactions. The Caisse d'épargne de l'Etat also lends money to the Luxembourg Government.

Another source from which the Luxembourg Government can borrow is the Banque nationale de Belgique; under an agreement of 1952 it can draw credit up to 333 million Bfrs. This borrowing facility, which has in fact never yet been used, was fixed in the light of the population ratio between the two countries and the volume of credit the Belgian Government can obtain from the Banque nationale de Belgique.

21. In addition, the Luxembourg State has at its disposal other normal means of financing such as the issue of Treasury bills and bonds. Although the banks are not obliged to purchase these they nevertheless hold considerable portfolios of them. At the end of 1960 their holdings of Government securities amounted to 1200 million Luxembourg francs or about 5% of their total assets. (The outstanding total of these securities is about 5200 million, but as has been pointed out above, the bulk of them is held by the social insurance institution). This is the more remarkable as it is difficult to mobilize these securities in practice.

## CHAPTER 3

### CASH AND LIQUIDITY RATIOS

22. The Luxembourg credit institutions and savings banks – with the exception of the Caisse d'épargne de l'Etat – must observe certain cash and liquidity ratios laid down by the Commissariat au contrôle des banques (Bank Control Commission). The cash ratio is the ratio between the sight and time deposits of a bank and its primary liquidity, which consists of cash and balances with the Postal Cheque Office, the Caisse d'épargne de l'Etat and the Banque nationale de Belgique. In accordance with a recommendation made by the Bank Control Commission the cash ratio should not be allowed to fall below 6% of the above mentioned liabilities. On 31 December 1960 it was 11.5%.

23. The liquidity ratio, likewise recommended by the Bank Control Commission, is the ratio between liabilities in respect of sight, time and savings deposits and assets in the form of balances with banks in the territory of the Belgo-Luxembourg Economic Union, short-term advances and credits, rediscountable Belgian commercial and other bills and mobilizable Luxembourg and Belgian public securities. The Bank Control Commission recommended a liquidity ratio of 30%; in fact it was 50.6% at the end of 1960.



**Table 4**  
**CREDIT INSTITUTIONS IN LUXEMBOURG**

*I. Institutions under Luxembourg law*

a	Public corporation	1	Caisse d'épargne de l'Etat
b	Joint stock companies	8	Banque internationale à Luxembourg Banque générale de Luxembourg Kredietbank, Luxembourg Banque commerciale, Luxembourg Cofhylux, Luxembourg La Luxembourgeoise, Luxembourg Caisse hypothécaire, Luxembourg Banque centrale, Luxembourg
c	Co-operatives	2	Caisse centrale des associations agricoles, Luxembourg "Fortuna ", Luxembourg
d	Unlimited mercantile partnership	1	Banque Mathieu Frères, Luxembourg

*II. Institutions under foreign law*

a	Institute enjoying special privileges	1	Banque nationale de Belgique, Luxembourg
b	Joint stock companies	2	Crédit Lyonnais, Luxembourg Crédit industriel d'Alsace et de Lorraine, Luxembourg

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