

**European
Investment
Bank**

**Investment
in the
Community
in 1973
and its Financing**

Research Department

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CONVERSION OF NATIONAL CURRENCIES

All statistical data published in this Report are provisional for 1973 and often for 1972 as well. Throughout this Report data for the Community as a whole refer to the present nine member countries ; statistics for years prior to 1973 have been adjusted to add data for the three new member countries to those of the original "Six".

The equivalent in units of account of amounts in national currencies has been calculated at exchange parities or central exchange rates as appropriate. For currencies which began floating in 1972 exchange parities declared to the International Monetary Fund were replaced as from mid 1972 initially by the middle closing rate on 29th December 1972. For these currencies as well as those which began floating independantly in early 1973 the relevant conversion rates or exchange parities were replaced by the middle closing rate on 19-20 March, as appropriate. The conversion rates for currencies with floating exchange rates were subsequently altered whenever the monthly average of market rates varied by more than 5% from the conversion rate in use. The conversion rate for the EURCO which consists of the sum of fixed amounts of the currencies of all the member countries of the European Community, was taken to be that in force when the first EURCO issue was made in September 1973.

These conversion rates were applied to the available statistical material in the following manner :

- for individual operations and for amounts outstanding at any particular time, the conversion rate appropriate to the period was used
- for annual totals (such as for Gross National Product, or Gross Fixed Investment), a weighted average of conversion rates in force during the year was used.

INTRODUCTION

The national economies of the newly expanded Community achieved a rapid rate of growth in 1973, reaching the crest of the economic cycle during the course of the year. The totals for the Community in Chart 1 nevertheless indicate that for 1973 as a whole, the composite real growth rate calculated at exchange rates mentioned at the beginning of this report was slightly less than in 1972. Capital investment, however, did not advance to the same extent in all the member countries.

The upsurge of price inflation and rising interest rates were features common to all member countries, with the erosion of money values the focus for primary concern. With most economies approaching full industrial capacity-utilization, the policy response of the public authorities differed widely from country to country although the need to restrain rising prices was universally recognised.

The economic situation as it evolved in 1973 could be separated into two distinct periods :

a) The first half of the year during which there was a high rate of economic growth in the Community, relatively stable interest rates and a generally sound trade position in most member countries. This strong domestic and external position was reflected in the 10% devaluation of the U.S. dollar in February and the subsequent floating upwards in value of the Community currencies vis-à-vis the U.S. dollar.

b) The second half of the year when many of the trends evident earlier in 1973 were slackening or being reversed. Even before the energy crisis, some Community countries began to experience difficulties in their external trading positions and interest rates were sometimes forced higher in order to attract short-term capital inflows. In the fourth quarter the onset of the world energy crisis overshadowed the economic and financial scene. The fact that a slackening of economic growth had already commenced in the second half of the year in many Community countries was only reinforced by the uncertainties, shortages and restrictions brought about by the energy crisis. However the massive increase in oil prices announced in October and December had not begun to be fully reflected in cost-of-living indices by year-end. In this deteriorating situation the U.S. dollar regained much of the ground lost to the Community currencies in the early part of the year.

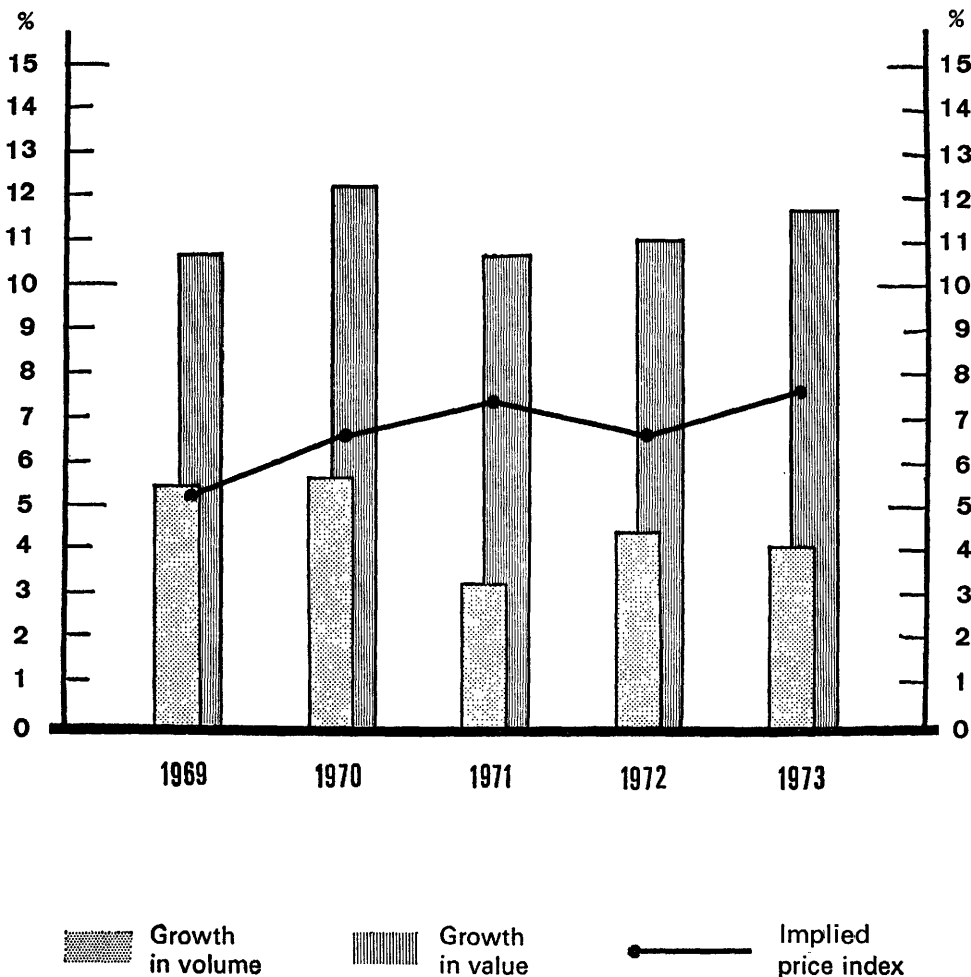
It was at this turning-point in the economic cycle during the second half of 1973, that monetary and fiscal policies were adapted to the changing circumstances more quickly in some countries than in others. While price inflation had assumed serious dimensions by mid-year in nearly all member countries, the priority of maintaining economic growth and full employment sometimes delayed the introduction of less stimulative policies. The monetary and fiscal postures adopted by the authorities were significant in promoting or restricting the level of capital investment expenditures in the member countries.

As a whole, the upsurge in economic activity in the first half of 1973 was sufficient to secure an increased flow of savings and an improved availability of funds to finance capital investment. However, the widely anticipated "peaking" of the economic cycle cannot but have influenced investment intentions in certain member countries towards the end of the year.

* * *

The entry into the European Economic Community of the three new member countries on January 1, 1973 undoubtedly provoked an increasing awareness both before and after the beginning of the year of the opportunities and challenge offered by the new ties with the existing Community. As a result there was an additional stimulus to economic growth and investment in all three new member countries and rates of expansion in 1973 exceeded those prevailing in recent years. At the same time there was a need, in the changed circumstances, to attune national policies and procedures so as to encompass the new "Community" dimension. Nevertheless, the increased pressure on available resources resulting from the economic upswing accentuated the problems of high rates of price inflation and worsening external trade balances—problems not unknown elsewhere in the Community but of particular relevance in the new member countries.

Chart I — Growth in Gross Community Product, 1969-1973
(percentage change from previous year)



INVESTMENT

1.1. INVESTMENT : GENERAL

As can be seen from Table 1 and Chart 2, there was a wide difference among the Community countries in the growth of capital investment in 1973. Differing rates of economic growth, price inflation and government policies all contributed to this divergent pattern of investment. Total investment in the Community increased in 1973 by about 4.5% in volume terms which, though an improvement on the 1972 performance, was still some way below the peak activity experienced in earlier years.

The tendency since 1969 for the annual increase in the volume of gross fixed investment in *Germany* to decline continued into 1973. Under the influence of a number of fiscal measures which last year had been introduced to moderate cyclical pressures, fixed investment scarcely grew at all in volume. The pattern varied, however, as between the first and second halves of the year and as between different forms of investment. In the first half of the year when a backlog of orders for investment goods was being worked off and restrictive measures had scarcely begun to have an impact, investment activity was comparatively buoyant. In the second half the downturn in such activity was so marked that some easing of the restrictive measures proved to be necessary before the year's end.

The volume of investment in *Germany* in machinery and equipment although on a declining trend from the first quarter onwards, continued at a higher level than in 1972 right into the third quarter, and resulted in an increase of 1.8% in 1973 on an annual basis. In part the momentum of investment in this sector was carried forward by the long order backlog, with deliveries related to orders placed much earlier. In contrast, investment in buildings fell by 0.6% in volume, all of this decline being concentrated in non-residential construction whether undertaken for businesses or for the public authorities.

In the *Netherlands* the economic outlook improved during the first three quarters of the year, recovering from the depressed level of activity that existed in 1972. This recovery was centred on an expansion of exports and of investment by business enterprises in labour-saving equipment, though a small rise in domestic consumption was also a contributory factor. The better performance during the first nine months was sufficient to encourage a revival of investment activity. Following a decline of about 1% in volume in 1972 gross fixed investment rose by approximately 7% in 1973 with investment by business enterprises accounting for most of the increase. Capital expenditure on housing reached a peak in the first quarter and then fell away, while capital expenditures by the public authorities continued to decline throughout the year.

Table 1 — **Gross fixed capital formation in the Community** ⁽¹⁾ ⁽²⁾
Percentage change from previous year

	In Value						In Volume					
	1968	1969	1970	1971	1972	1973	1968	1969	1970	1971	1972	1973
Germany	9.0	17.2	23.9	12.2	6.1	5.2	7.9	11.9	11.4	4.5	1.9	0.5
France	8.5	17.5	13.9	10.6	12.2	15.4	5.5	11.0	6.7	5.5	7.6	8.7
United Kingdom	8.3	5.0	9.0	9.5	11.8	20.7	4.5	1.0	2.0	0.5	1.7	4.5
Italy	12.0	14.8	15.0	3.1	5.6	27.2	9.7	8.1	3.4	- 3.5	0.4	9.9
Netherlands	12.9	3.5	18.9	12.3	5.2	12.5	11.0	- 2.1	10.6	1.5	- 1.8	6.9
Belgium	0.1	10.2	19.0	5.7	8.6	17.5	- 1.5	5.6	8.8	- 2.2	4.9	8.0
Denmark	4.3	18.5	12.4	6.1	12.2	23.0	- 0.5	13.2	6.0	1.6	2.5	12.5
Ireland	17.0	29.0	8.1	19.8	12.5	27.5	13.2	20.4	- 0.9	8.9	2.5	13.0
Luxembourg	0.9	16.7	27.5	18.8	11.5	20.4	- 5.6	7.6	16.4	8.0	5.0	4.0
Total Community	6.0	12.8	17.2	9.9	10.3	14.1	3.6	7.4	7.9	2.7	4.1	4.5

⁽¹⁾ The percentages for 1973 are approximations based on orders of magnitude.

⁽²⁾ For individual countries, percentages are based on amounts in national currencies. For the Community total, currencies are converted into units of account at the rates prevailing in the appropriate years.

The *French* economy, which had suffered less than others in the European Community from a slowing of activity in 1972, quickly regained an annual real rate of growth of rather more than 6% in 1973 as against 5.7% in 1972. Output rose in response to the increase in demand and was soon impinging upon the limits of productive capacity in a number of industries, thus encouraging the maintenance of a high growth rate of investment of about 8.7% in real terms for the economy as a whole compared with 7.6% a year earlier. These developments gave rise to official concern over the increase in inflationary pressures and monetary policy was made more restrictive from the end of 1972 onwards. The rise in the cost of borrowing resulting from the change in stance of monetary policy had only a slight impact on investment, as the degree of liquidity in the economy, particularly among enterprises, remained high for the greater part of the year.

The recovery in economic activity in *Italy* which began around the middle of 1972 continued into 1973, although there was a temporary interruption in the first quarter owing to industrial disputes in the engineering industries. The economy recovered its poise during the remainder of the year and this encouraged a growth of fixed investment during 1973 at an annual rate of 9.9% in real terms, compared with virtual stagnation the previous year. The decision taken by the government in mid-June, to ask banks to increase their holdings of bonds of institutions involved in financing development or of State loans and bonds issued by public enterprises, provided an additional stimulus to investment through making finance more readily available. The business sector led the way in the revival in the volume of investment with housing construction also contributing but there was a reduction in real terms of investment works carried out by the public authorities.

The growth of economic activity in *Belgium* accelerated further during 1973, continuing the process of recovery which had begun in the early part of the previous year. The main sources of growth were a sharp increase in demand for Belgian exports and in fixed asset investment by business. As a result of the response of industry to the expansion of demand, reserve productive capacity tended to be reduced and the incentives for industry to invest in new plant increased. Investment in dwellings maintained its momentum but public authorities felt constrained to modify

their investment plans anti-cyclically. These developments led to an overall increase of about 8% in the volume of gross fixed investment.

In *Luxembourg*, the strength of demand for iron and steel products (the principal industrial base) in neighbouring countries contributed significantly to the growth of the overall economy in 1973. Steel output rose by 11% last year compared with 1972 and the value of total exports benefited both from the improved production and the higher prices obtained. Capital investment expenditures are estimated to have increased moderately in value last year, but with price inflation contributing most of the gain. The volume of total capital investment is estimated to have increased by about 4% in 1973. Permits for all types of building increased by only 5.5% last year, a sharp contraction from the 46% annual increase in 1972. However, the number of permits issued remained at a level more than double that of only 3 years previously, a noteworthy achievement in itself.

The attempt by the *United Kingdom* government to fashion policies so as to break through persistent constraints on economic growth came face-to-face by the end of last year with the recurrence of the problem that, after a short period of expansion, the current account of the balance of payments tends to deteriorate sharply, resulting in weakened confidence in the Pound Sterling.

These features were exacerbated by the worsening in the terms of trade as a result of rising commodity prices. Furthermore, in the fourth quarter, the onset of the world oil crisis and the more general energy problems in the United Kingdom, induced by industrial disputes, resulted in a State of Emergency being declared in mid-November. Until mid 1973, however, the policy of actively promoting and stimulating growth met with reasonable success although the problem of supply constraints had begun to emerge. The overall economy as represented by Gross Domestic Product at current prices expanded by 14% in 1973 compared with the previous year. While price inflation figured prominently in this expansion, the rate of real growth at constant prices of 5% was the highest for almost a decade. Most of this expansion was generated in the first half of 1973 and the economy did little but maintain this momentum for the remainder of the year.

A primary policy objective of the British Government during 1973 was to revive the confidence

of the business sector so that new investment could provide the productive capacity to satisfy the increased domestic demand that was foreseen. As a result, the corporate sector led the rise in economic activity with sharply increased production, profits and new investment. Private sector investment at current prices increased by 21% in 1973 compared with the previous year, although much of this gain was attributable to price inflation. However figures delineating the growth of investment for 1973 as a whole tend to mask the deterioration in economic circumstances that took place towards the end of the year.

The surge in economic activity in *Ireland* in the first half of 1973 slackened towards the end of the year. Nonetheless, the momentum in the economy was sufficient to enable a very rapid increase in most economic indicators on an annual basis. Gross National Product at constant prices is estimated to have increased in 1973 by approximately 7% compared with the previous year. There was a noticeable increase in the value of capital investment expenditures while both export and import trade expanded by over 30% in 1973. The volume of industrial output achieved substantially higher levels in 1973, being about 10% above the previous year. But, in common with most other Community countries, price inflation accelerated during the year and consumer prices in the fourth quarter 1973 were 12.6% above a year earlier. Total capital expenditures rose by 27.5% in 1973 although a high degree of price inflation disguises the real rate of increase in fixed asset formation which was in the region of 13% last year.

Denmark's important agricultural sector was a major beneficiary of her new status within the

Community. It will be recalled that the new member countries broadly conformed to Community agricultural policies and procedures almost from the outset, in contrast to the lengthy adjustment period for the industrial sector. Gross Domestic Product increased in 1973 by about 16.5% over the previous year's level, although this performance, the strongest in over a decade, was perhaps overstated by the very high rate of price inflation which provided about 11.5% of the gain. Capital expenditures rose strongly in 1973 particularly in the industrial and agricultural sectors, stimulated by increased domestic business activity and improved export opportunities. The fact that Denmark is the only Nordic country to have assumed membership of the Community may have been advantageous in promoting additional investment. At the same time, the phasing-out between last year and 1975 of the previously favourable tax allowances on depreciation, inventory and pre-purchase commitments may initially have speeded up investment decisions. By the fourth quarter of last year, the cost-of-living index had risen over 10% compared with a year earlier. A particular problem in attempting to reverse the upward spiral of price inflation is that many wages and salaries in the industrial and commercial sectors of the economy are tied to a special cost-of-living index. Reflecting this, average wage costs in manufacturing increased by 25% in the 12 months to December 1973.

1.2. BUSINESS INVESTMENT⁽¹⁾

The improved economic climate in 1973 formed the basis for a generally strong expansion of

⁽¹⁾ In this report investment by public enterprises and its financing is included under business investment and not under public authorities, except for Table 11.

Table 2 — Gross fixed capital formation in the Community: by sector ⁽¹⁾

Sectors	In milliard units of account at current prices						% share of total	
	1968	1969	1970	1971	1972	1973	in 1968	in 1973
Business investment	65.7	75.5	90.3	100.1	107.7	120.7	58.9 %	60.4 %
Housing	28.1	31.0	34.3	37.6	44.3	51.0	25.2 %	25.5 %
Investment by public authorities	17.7	19.3	22.8	24.3	25.7	28.1	15.9 %	14.1 %
Total Community	111.5	125.8	147.4	162.0	177.7	199.8	100.0 %	100.0 %

⁽¹⁾ The statistics for 1973 are estimates of orders of magnitude.

business investment in the Community last year. While monetary and fiscal measures restrained the growth of investment by enterprises in some countries, on average the increase in value of such investment last year was 12%.

In *Italy* industrial enterprises sought to compensate for a period of stagnation in 1972 by a very high rate of investment in 1973. The greater part of this increase in investment took the form of additions to plant and equipment, including transport equipment. The expansion of investment activity in transport and communications, and in commerce was only a little less marked than that in manufacturing industry. In agriculture, forestry and fishing, investment growth was resumed in 1973 after contracting in 1972. For the business enterprise sector as a whole the volume of capital investment rose by over 13% last year. This surge in investment activity by a wide range of enterprises in an already inflationary situation accounted for an increase in 1973 in capital expenditures at current prices of the order of 31%.

In *France*, investment by the business sector rose during 1973 by over 13% in value of which 6.6% represented an increase in volume. Much of capital expenditures by businesses was devoted to the improvement of existing plant and equipment or its speedier replacement by new machinery than hitherto, both of which helped to sustain a marked rise in productivity in industry. More resources were, however, being applied to the reduction of pollution. Some slowing in the rate of investment towards the end of the year might have been occasioned by the oil crisis, but France was less affected by shortages of supply than other member countries of the European Community.

In *Denmark*, the value of industrial investment planned in 1973 was estimated to have risen by about 23% compared with the previous year. Greater than average growth was estimated to have occurred in the wood, paper and furniture industries, the iron, steel and machinery industries, as well as the electrical and transport equipment industries. Investment in agricultural equipment also increased appreciably in response to the improved farming returns available. Total non-residential investment by the private sector increased in 1973 by about 17% in volume terms, a reflection of the buoyant economic conditions prevailing.

Investment by business enterprises in *Ireland* expanded rapidly in 1973, showing an improvement over the previous year of about 32% at current prices. While price inflation figured prominently in this apparent growth, the increased costs of imported capital goods which comprise about 40% of non-residential construction and equipment spending, no doubt contributed their share to inflationary tendencies. Imports of capital goods rose by 39% in 1973 indicating a strong inflow of machinery and equipment for new investment.

Business capital investment at current prices in the *United Kingdom* rose by 17% last year, although a considerable proportion of this expansion was attributable to price inflation and expenditures rose by only 4% in real terms over the previous year. The sector of business investment showing the largest growth was that of mining, petroleum and natural gas extraction, with expenditures at current prices rising by over 80% in 1973 from a fairly low base. In addition, the manufacturing industries registered a particularly strong gain with capital expenditures at current prices moving ahead progressively even into the fourth quarter of the year when they were 26% above a year earlier. The impact of price inflation on this sector was perhaps less than in some other areas of investment, as manufacturing expenditures at constant prices rose by 14% over this same period.

Belgian manufacturing enterprises which had recommenced their investment expansion during the second half of 1972, continued up to the onset of the oil crisis in late 1973 to enlarge their productive capacity which was in a number of instances being stretched to its limits. In terms of value, gross fixed investment by manufacturing industry probably increased by over 10% in 1973 in contrast to a small decline the previous year. In the services sector, fixed investment by financial intermediaries rose by 14% in 1973 compared with 10% in 1972.

In *Luxembourg* non-residential building permits issued in 1973 declined by 5% from the previous year and construction activity has turned more towards residential building. However, the emphasis on developing the non-steel industrial base of the country remains an important objective.

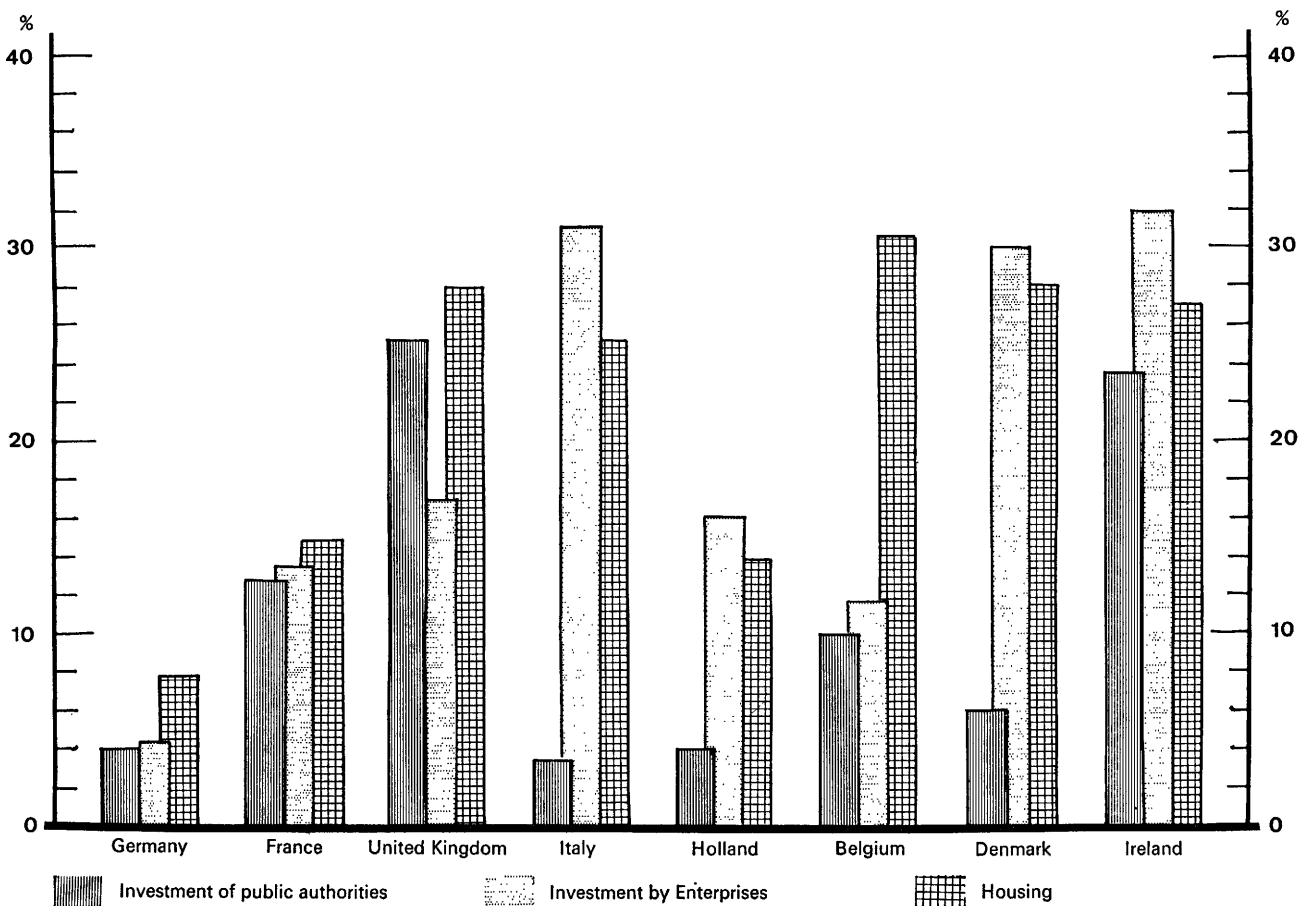
A good deal of the investment by the business sector in the *Netherlands* consisted of additions to equipment forming part of large scale projects,

some of these being notably in the petroleum industry. As industrial output continued to rise during 1973 at an annual rate of about 8%, accompanied by some further reduction in numbers employed by the private sector, there was again a substantial increase in productivity towards which the additions to productive capacity probably contributed. Non-residential investment by business enterprises increased by about 15% at current prices in 1973, with the growth in volume being about 8%. This movement towards a more capital-intensive basis of production helped to modify the impact of a 15% average increase in wages during 1973 and to maintain competitiveness in export-markets. Nevertheless, businesses found themselves squeezed by the rising costs of raw materials which some manufacturers were unable to pass on in full in their product prices. Under the restrictive price policies followed by the government during 1973 profit margins in money terms were fixed. On the other

hand in September, certain investment allowances against taxable profits which had previously been available only in some regions of the country, were extended to cover all areas.

The investment intentions of the business sector in *Germany* were clearly curtailed during the course of 1973 by a number of counter-cyclical fiscal measures. The Federal Government announced in February that as from 1st July it would, inter alia, impose a 10% stability surcharge on corporation tax as well as on income tax and that it would suspend depreciation allowances according to the diminishing balance formula on certain buildings. Under a second stability programme announced in May, the Federal Government introduced an 11% investment tax and suspended favourable depreciation allowances both on movable assets and on residential buildings. The increase in value terms in businesses' expenditure on gross fixed investment other than housing in 1973 of about 4% was no more than half that

Chart II — Elements of gross fixed capital formation ⁽¹⁾
Percentage Change 1973/1972 at current prices, based on amounts in national currencies



(1) Estimates based on orders of magnitude

planned earlier but nevertheless was more than the 2.9% achieved in 1972.

1. 3. HOUSING CONSTRUCTION

Price inflation, speculative influences and rising interest rates played important roles in the pattern of housing investment in the Community last year. While the nominal value of investment rose quite appreciably in most member countries, the volume of housing construction was sometimes not much more than in 1972. Towards the second half of the year higher interest rates began to take their toll, although it is difficult to assess the extent to which the volume of new investment, at the margin, was deterred by this factor.

Nominal expenditures on residential construction in the *United Kingdom* increased by 28% in 1973 compared with the previous year, but growth in real terms was only 4%. The housing sector came under increasing pressure during the course of the year from many adverse influences resulting finally in a severe decline of confidence at the turn of the year. These adverse pressures took a number of forms: the steep rise in the cost of mortgage financing and the dearth of funds; an end to the speculative rise in property values; the very high cost of dwellings in relation to current incomes; and the growing pressure to legislate against the profits of property companies.

In *Ireland* a rather different picture emerges though subject to roughly the same interest rate pressures as in the U.K. There was an appreciable upsurge in housing construction with a total of almost 24 000 new houses being completed during 1973. This compares with about 15 000 new houses constructed only two years earlier in 1971. Two factors primarily contributed to this increase—expanded mortgage loan activity and the rapid growth in incomes during 1972 and 1973.

Denmark's investment in housing increased moderately in the first half of last year but building activity reached a plateau during the last six months of the year. Although overall housing expenditures were therefore expected to have had the momentum to increase in 1973 by about 15% in real terms, the trend of activity in this sector was not auspicious at the turn of the year.

In increasing by 25% in value over the preceding year, housing construction in *Italy* benefited from the improved economic climate in 1973, though

a large part of this increase represented a rise in price, as the growth in volume was 5.3%. The corresponding increase in value in 1972, when volume rose by 1.9% was 7%. With prices rising rapidly in 1973, some difficulties in financing were encountered, as a decline in completions from the previous years' total suggests.

The various incentives introduced by *Belgian* authorities in 1972 to encourage the construction of dwellings ensured that the momentum generated in this sector during 1972 carried on into the following year. Residential building permits in the first three quarters of 1973 were about 20% higher than a year earlier. However, the process of tightening the conditions of access to mortgage credit which was completed in late summer by curbs on subsidised housing, accentuated the problems of financing housebuilding and permits issued in the fourth quarter were 17% down on the previous year. Nevertheless these difficulties had little impact on housing investment itself.

As in Belgium, the volume of housing construction in *Luxembourg* increased in 1973. Building permits for residential construction continued to rise last year, particularly for apartment type dwellings which sustained a rise of 30% in permits issued compared with 1972.

The rapid growth in housebuilding activity recorded in the *Netherlands* during 1971 and 1972 reached a peak in the first quarter of 1973 and then fell sharply. The volume of housing investment in 1973 was only 3% higher than in the previous year, while in 1972 the annual increase was 15%. At the same time there was a shift in emphasis away from public authority and subsidized housing, towards increased private sector housing which rose by perhaps 30% in value in 1973. The volume of public sector housing declined during the year.

Under the stimulus of strong demand arising partly from inflationary expectations, housing construction in *Germany* continued to increase rapidly in the first half of 1973. By mid-year, however, the expansion slowed. In some localities the construction of new dwellings appeared to have outstripped demand. In addition, the suspension of favourable depreciation allowances on residences and other difficulties in financing began to take effect. By November subsidies had been introduced to encourage home-ownership by low-income groups, through a lowering of the effective interest rate payable. In December it was

Table 3 — The share of capital investment in the economies of the Community countries ⁽¹⁾

Countries		Gross national product at current market prices	Gross fixed capital formation				
			As % of gross national product	Sector shares in %			Total
				Investments by enterprises	Housing construction	Investments by public authorities	
Germany, DM milliards	1972	829.7	26	61	25	14	100
	1973	926.2	24	60	26	14	100
France, FF milliards	1972	1,006.4	26	61	26	13	100
	1973	1,143.8	26	60	27	13	100
United Kingdom, £ millions	1972	62,423	18	64	18	18	100
	1973	71,173	19	62	20	18	100
Italy, Lit. milliards	1972	68,976	19	63	29	8	100
	1973	80,574	21	65	28	7	100
Netherlands, Fl. milliards	1972	147.8	24	55	27	18	100
	1973	166.8	24	57	27	16	100
Belgium, BF. milliards	1972	1,583.1	21	59	22	19	100
	1973	1,796.8	21	57	25	18	100
Denmark, Kr. milliards	1972	147.0	21	47	26	27	100
	1973	172.0	22	49	27	24	100
Ireland, £ millions	1972	2,232	22	37	23	40	100
	1973	2,674	23	39	23	38	100
Total Community, u.a. milliards	1972	770.3	23	61	25	14	100
	1973	860.7	23	61	25	14	100

⁽¹⁾ The table is based on estimates, at current prices, of orders of magnitude. In a strict sense, comparisons of gross fixed capital formation cannot be made because of differences of definition and composition from one member country to another.

announced that special depreciation allowances on residential buildings would be reintroduced in the New Year. This latest step had, of course, no impact on the out-turn for 1973 during which the value of fixed investment in housing increased by 7.7% compared with 21.2% in 1972.

Rising prices and difficulties in obtaining finance exercised a restraining influence on housing construction in *France* during 1973 which nevertheless rose about 6% in volume from a year earlier. However, price inflation was responsible for an increase of about 15% in the value of this form of investment.

1.4. INVESTMENT BY PUBLIC AUTHORITIES

With inflationary pressures everywhere evident, most public authorities followed policies of restraint in their capital expenditures. As a result the value of public authority investment in many Community countries rose by around 5% in 1973

which would imply a decline in expenditures in volume terms. The two notable exceptions to this low growth of public sector investment were the United Kingdom and Ireland.

In *Germany*, during 1973, the share of the national product contributed by the gross fixed capital formation of the public authorities declined further. Civil engineering orders placed by public authorities increased by only 2.9% in value in 1973 after rising by 22.6% in the previous year. It would seem that expenditure on infrastructure has been among the main categories to suffer cut-backs in the interests of promoting economic stability. One way in which this occurred, was the stretching of some public authority programmes over a longer period of time.

In *France*, investment expenditure by the public authorities rose during 1973 by nearly 13% in value compared with the 10.7% increase in 1972. In volume terms expenditures rose by 6.3% in 1973, a slight improvement on the previous year's

performance. Some postponements of and cuts in investment plans were introduced late in the year as a result of the oil crisis but probably had little influence on the out-turn for 1973. The high rates of increase in both 1972 and 1973 reflected the effort made to overcome earlier shortfalls in implementing the Sixth plan.

After declining by 2.9% in 1972, investment expenditure by the *Italian* public authorities rose in value by 3.4% last year. In terms of volume, however, such investment continued to decline (by 5% last year) if less rapidly than in 1972. The slowing down in investment on the part of the authorities has been concentrated in public works and construction which accounts for the bulk of their capital expenditure. Expenditure on plant and equipment in both 1972 and 1973 was generally rising as rapidly as similar investment in other sectors.

In the *Netherlands* the public authorities' investment at constant prices fell by about 6% last year compared with a decline of 8.7% in 1972. The slight improvement was mainly the result of government "pump-priming" construction projects. However, in an inflationary situation of rising costs, the clash of competing priorities within a fixed ceiling for government expenditures often put a constraint on the ability to expand capital expenditure projects, the value of which increased by about 5% in 1973.

In *Belgium* the investment programmes of public authorities were cut-back in the interests of con-

trolling inflation through restricting construction. A reduction of 25% in expenditure ceilings had a particular impact on road-construction. The indications are that the total of public authorities expenditure on fixed investment rose only slightly in 1973.

Capital expenditures on building and equipment by the public authorities in *Denmark* are estimated to have increased in 1973 by about 6% in value terms. This represents a degree of restraint in comparison with previous years which is perhaps indicative of the new era of awareness as to the size of the Government share in the economy.

Public authority capital expenditures in *Ireland*, excluding expenditures on dwellings, increased by about 24% in the 1973-74 fiscal year, an indication of the expansionary fiscal policy pursued by the authorities. Within this overall figure, a sharp increase of about 70% took place in loan finance for agricultural and industrial capital projects.

In the *United Kingdom* public authority sector, non-residential capital expenditures at current prices progressed steadily upwards throughout the year, rising by 24% compared with 1972. A substantial portion of this apparent growth was contributed by higher prices since the volume of capital expenditures rose by approximately 6% last year. The stimulative fiscal policy of the British authorities during the first eleven months of 1973 stands out in contrast to the restrictive policies followed by most other Community countries.

FINANCING OF INVESTMENT

2. 1. FINANCING : GENERAL

Financial markets were rather unsettled in 1973 under a combination of currency fluctuations, accelerating price inflation and rising interest rates. A second devaluation of the U.S. dollar in February proved insufficient to discourage currency speculation and in March, the Deutsche-mark having been revalued by 3%, the Community currencies commenced a joint float. The exceptions to this were the Pound Sterling, the Irish Pound and the Italian Lira which floated separately.

Further currency pressures developed at mid-year, when the Deutschmark was revalued upwards by 5.5%, and towards the end of the year when the U.S. dollar rose rapidly against other currencies. Defensive measures taken by national authorities to contain exchange rate fluctuations contributed significantly to the upwards movement of interest rates, as did the restrictive monetary policies applied in some countries. Interest rates, particularly for the shorter term, in general rose sharply during the year and ended 1973 at much higher levels than in January. At the same time the prospect of the diminishing value of money as a result of price inflation was slowly eroding the confidence of investors. The "time horizon" of willingness to enter into financial commitments began to shorten in some instances and there was an increased tendency at the close of the year towards holding a liquid position. The difficulties in assessing the extent of the world oil crisis and its impact on European economies created a great deal of uncertainty in financial markets. However, the problems posed by the "re-cycling" of oil funds had not yet had an impact by the end of 1973.

The weakness of share markets when faced with the prospect of possible interruptions to oil supplies and/or a severalfold multiplication of their cost had serious implications for the structure of company financing. As can be seen from Table 6, the total amount of shares issued during 1973 actually contracted, although in a number of countries such as France, Italy, the Netherlands and Denmark the amount of share issues was still rising. Some consolation may be derived from the flattening out in 1973 of the recent sharp rise in net credits made available to the economy, as set out in Table 9. The total of financial resources raised against bond issues by enterprises, shown in Table 7, on the other hand rose strongly by about one-fifth in 1973, continuing a trend

established in recent years. Thus while there was probably a further deterioration in the ratio of debt to equity in the capital structure of enterprises, taken as a group, during 1973, the additions to debt would in the main have been of a long-term, funded, character.

In *Germany* special problems in the field of controlling liquidity were posed for the authorities in the early part of 1973 by currency uncertainties involving massive purchases of U.S. dollars by the Bundesbank, by a heavy inflow of foreign capital, and by an increase of foreign as well as domestic demand for German products. As a result the Bundesbank's control over the monetary situation was weakened until it was released in mid-March, under a decision taken jointly with the other member countries of the European Community, from the obligation to support the U.S. dollar.

The Bundesbank took a further step to improve its monetary weapons by establishing a direct control over Central Bank money, instead of relying as in the past on an indirect control via the banks' free liquid reserves. In reinforcement of this step, the Bundesbank withdrew normal Lombard credit facilities at the beginning of June. Short-term money rates which had risen sharply in March/April, increased further as a result of this action before stabilising fairly quickly at a high level, and without evoking an undue response in long-term capital markets. However, the Bundesbank introduced special Lombard facilities at end-November to reduce interest rate fluctuations in the money market. The inflow of capital into Germany continued even after the 3% revaluation of the currency against Special Drawing Rights in March but fell away after the second revaluation of 5.5% in June. The stabilisation policies pursued by the German authorities in 1973 were the most thorough in recent years.

Following the change in the value of the Deutschmark in June, the *Netherlands* Guilder experienced increasing upwards pressure in subsequent months which culminated in a 5% revaluation on September 17. Because of the constraints placed on profit margins by the public authorities, the need for external financing by business was increased last year. This requirement was fully met by increased short-term bank borrowing, while new capital issues and new long-term borrowing played lesser roles in the pattern of financing in 1973. To some extent the reduced

role of new long-term borrowing last year reflected the contraction in both supply and demand for funds as compared with the high level of activity prevailing in 1972. Higher interest rates in 1973 were in recognition both of inflationary trends and of competing rates in neighbouring countries.

The primary aim of monetary policy in *Belgium* during 1973 was to slow down the expansion of credit. The banks were asked to observe a voluntary ceiling of 14% in their lending to the private sector and the system of reserve requirements against deposit liabilities was extended to include insurance companies. Around the middle of the year the Belgian National Bank raised its discount rate in three stages from 5% to 6.5%. In addition the Bank's rediscount quotas were cut. These measures had the effect of moderating the expansion of credit and their impact was reflected in a general rise in the structure of interest rates. However, further increases in the discount rate to 7.75% were implemented in October and November.

There appears to have been an adequate supply of funds in *Luxembourg* in support of the moderate increase in the capital expenditure programme. The annual rate of increase in retail prices at 6.1% in 1973 was the lowest of all Community countries and some credit for this can be attributed to anti-inflationary measures taken by the authorities during the year.

The general increase in demand in *France* during 1973 gave rise at an early stage to concern over inflation and steps were taken both to reduce the volume of new credit and to increase its cost. In May the credit ceilings imposed on banks were lowered. The reinforcement of monetary policy was accompanied by successive increases in the Bank of France's discount rate which took it from 7.5% to 11% during the course of the year. Interest rates on all forms of bank credit to enterprises, as represented by changes in the base rate, increased by 3.30%. In most instances this would have made bank credit temporarily more expensive than bond finance and there was some evidence of a shift of borrowers to the bond market which was, however, caused by credit restrictions rather than by considerations of cost.

Official policy in *Italy* during the whole of 1973 was oriented towards encouraging economic recovery, particularly in the field of investment. To this end the Banca d'Italia resorted to a

substantial expansion of liquidity with the aim of stimulating lending operations on the part of the banks and other financial institutions. The banks were required to add to their portfolios specifically those bonds issued by institutions which financed investment as well as to make additions to their holdings of bonds issued by borrowers in the public sector. As a result of the comparative ease of monetary policy, most interest rates remained relatively low until August when conditions deteriorated abruptly under the threats posed first by inflation and then by the oil crisis. A change of monetary policy in regard to short-term finance was signalled by the imposition in July of a ceiling on this form of lending. An increase in September in the Banca d'Italia's discount rate from 4% to 6.5% reflected the changed monetary climate at home and abroad.

In the *United Kingdom*, there is every indication that funds were abundantly available—at a price—in support of the capital expenditure programme last year, with the possible exception of the housing sector. There was a considerable degree of ease last year in certain aspects of monetary policy, a principal objective being to provide a sufficient flow of funds to finance capital investment by industry and to sustain the expansion of the economy. However, the high rate of growth in the monetary aggregates, particularly the wider-based money supply, was partly illusory in that the banks were re-acquiring business that they had lost while credit ceilings were in force. In addition, non-banking institutions were taking advantage of temporary differentials between interest rates on bank loans and those on deposits, to engage in arbitrage transactions.

Retail prices in the U.K. which in the first quarter of 1973 were 7.9% above those of a year earlier, were rising at an annual rate of 10.3% by the fourth quarter, even before the surge in oil prices towards the end of the year had begun to have a major effect. Interest rates were held to fairly moderate levels for the first six months of 1973 although rates were rather higher than those prevailing in the previous year. By mid-year, however, competing rates in other financial centres were exceeding those in London. This development, together with a worsening trade balance, led to an effective depreciation in the external value of the £ Sterling of about 7.5% between mid-June and early September. Corrective action by the monetary authorities was required which was reflected in a sharp upwards move-

ment in Treasury Bill rates in July. Subsequently, interest rates edged higher with 3-month Treasury Bill rates ending the year at 12.42%, over 4 percentage points higher than in January.

The *Irish* authorities pursued expansionary monetary and fiscal policies during the year. With the Irish Pound linked to the Pound Sterling, there were clearly some aspects of events in 1973 that had a similar but less intensified impact and reaction in Ireland as in the U.K. Although there was a substantial increase in the money supply and bank lending throughout 1973, interest rates pushed ever higher with 3-month fixed deposits in the Inter-Bank market reaching over 16% in December. These high interest rates were in response to similar high rates prevailing in the United Kingdom and the soaring rate of price inflation.

The indications are that a fairly stringent monetary policy was followed in *Denmark* for most of 1973, at least in relation to the burgeoning need for investment funds by the business sector. This policy was instrumental in promoting corporate borrowing in money markets abroad: at the same time the inflow of this capital tended to counter-balance the heavy deficit on external trade transactions. Interest rates on most categories of funds ended the year two to three percentage points higher than at the beginning of 1973.

2.2. PERSONAL AND CORPORATE SAVINGS

The expansion of economic activity in 1973 provided the setting for increased personal and corporate savings in most countries of the Community. However, the inflation of prices and the higher plane of interest rates induced shifts in the pattern of personal savings. There was increased emphasis in some countries on the holding of real goods and property. Also, the awareness of high interest rates being offered on time and deposit accounts led to a greater use of these facilities.

The flow of personal savings in the *United Kingdom* last year evidently owed much to the rapid increase in money incomes, the extent of the rise in the latter being influenced by the climate of inflation. Personal disposable incomes are estimated to have expanded by 15% in 1973 compared with the previous year, a rate of growth somewhat larger than that of consumer expenditures. As a result, the flow of personal savings is estimated to have increased last year by about 26%. This was partly reflected in reduced bank

borrowing by the personal sector in comparison with the previous year. At the same time the funds increasingly available in the personal sector were also directed towards raising the total of bank deposits and towards capital expenditures which were appreciably higher than in 1972. In the context of the high interest rates offered by deposit accounts in the second half of the year, there is no doubt that some portion of the increase in personal savings was directed to these accounts, to the detriment of current accounts and building society deposits. The depressed state, towards the end of 1973, of many traditional havens for personal savings, such as the property, stock and bond markets was conducive to a further movement of resources into deposit accounts.

There was an upwards surge in corporate profits in the U.K. in 1973, due almost entirely to stock appreciation, despite the controls on prices in force during the year. Gross trading profits of private and public corporations rose by 26% last year, but with stock appreciation (partly the result of rising commodity prices) the major element in this increase.

The flow of new funds into deposit accounts with the banking system in *Ireland* more than trebled in the year to December 1973 compared with a gain of 13% in the previous year. Between January and December of 1973, the rate of return on deposit accounts of less than £ 5 000 with the Associated Banks doubled from 4% to 8%. This increase in interest rates paid by the banks tended to draw funds away from alternative means of saving, such as government-sponsored savings schemes. Corporate cash flow in the form of profits and depreciation increased significantly in 1973. Depreciation allowances are estimated to have risen last year by almost 14% compared with 1972. Corporate profits are estimated to have increased at an even faster pace, spurred by the strength of domestic and foreign demand for industrial products together with the passing on of higher costs in the form of higher prices.

The rise in personal incomes in *France* during 1973 was rapid but its impact on prices was softened by increases in productivity. The scope for personal saving was therefore increased and, in contrast to the previous year, a substantial proportion of such saving was accumulated in time and savings deposits even though interest rates offered on such deposits remained unchanged throughout 1973. After increasing by 3.9% in 1972, personal savings in the form of time and

addition to raising personal incomes. It is estimated that there was a relatively modest increase in personal spending in 1973 and as a result the flow of savings expanded strongly. Indicative of this trend was the substantial increase in new savings and term deposits with the commercial banks, the flow of which more than trebled in 1973 compared with the previous year.

There was a substantial shift in the pattern of savings in the *Netherlands* last year owing to the changed interest rate structure, with new deposits in savings accounts being neglected in favour of time deposits and an increased investment in fixed interest-bearing savings instruments. The flow of funds into savings accounts with the banks and other institutions slowed in 1973 to only two-thirds the flow in the previous year. However, the fall in this type of saving was more than compensated by the increased rate of expansion of time deposits. Also it is possible that rising prices persuaded some savers that investment in real goods, property and commodities was a more realistic hedge against inflation.

It is evident that the business sector was experiencing difficulties with rising costs of labour and raw materials, through its inability to pass all of these on to customers in the form of higher output prices, because of price controls and a fear of losing competitiveness. The increased need of corporations for external finance was reflected in the sharp increase in short-term bank borrowing.

In *Germany* the decline of 7.7% in the flow of new savings and time deposits held by the personal sector in 1973 contrasts with the 23% increase in 1972, when private savers benefited from the repayment of an anti-cyclical tax surcharge levied the previous year. The ratio of households' saving to disposable income correspondingly fell to 13.6% from 14.4%. In the second half of 1973 personal saving received a stimulus from a general increase in interest rates, including those on savings and time deposits, the rates for which were raised on several occasions during the year. For instance, there was a large increase in June, following two increases in the Bundesbank's discount and Lombard rates in May-June which raised discount rate to 7% and the Lombard rate to 9%.

The net retained earnings of enterprises improved rapidly in the first few months of 1973 but then became negative in the second half of the year

when business activity slowed and wage increases began to make inroads into profits. Nevertheless, over the year as a whole, the internal resources of enterprises, including depreciation and investment grants as well as net retained earnings, were 9.7% higher than in 1972. The self-financing ratio (or the proportion which these resources form of gross fixed investment) accordingly rose to 76.5% from 75.4%. The greater resort to internal financing in 1973 partly reflected the difficulties in obtaining external finance during a period of credit restriction.

The very rapid increase in money wage rates in *Denmark* during 1973 did not follow through into a comparable increase in the total of new bank deposits. However, there was a tendency, as interest rates rose, to shift away from demand deposits and into time deposits paying a higher rate of return. Thus, the flow of new time deposits with the banking system increased by 34% in 1973 compared with a rise of 59% in the previous year. In the climate of renewed growth of the economy in 1973 there can be little doubt that the corporate sector fully shared in the expansion. Certainly the agricultural sector experienced a sharp improvement in incomes in 1973 as a result of the higher prices obtainable for produce.

2.3. NEW ISSUES ON DOMESTIC CAPITAL MARKETS

The principal feature of issue markets last year was the upwards march of interest rates (except in Italy) under the impact of growing price inflation and currency defence measures. The corresponding weakening of bond prices, and the expectations of further weakening, did little to sustain issue markets. Moreover the borrowing requirements of public authorities in some countries continued at a relatively high rate sometimes as a result of expansionary fiscal policies. There was thus an element of market saturation from time to time in certain countries.

The decline in share values on almost all the world stock exchanges, partly in anticipation of the slackening of economic growth, created some difficulties for raising new equity capital. The uncertainties of the world oil crisis added a further dimension to the existing problems of domestic issue markets.

Italy was a major exception from many of the trends noted above. The pursuit of a cautiously

expansionary monetary policy in 1973 resulted in the persistence of favourable conditions in the bond market for most of the year, with yields on existing securities ranging between 7.4% and 8%. In addition, the prospect of the re-imposition of withholding tax on issues made from 1st January 1974 onwards and of the introduction of new taxes on the capital operations of corporations as from the same date provided a strong stimulus to activity on capital markets in 1973. Business enterprises were able to raise a record volume of financing through bond issues, some 125% higher than in the previous year. This was of considerable assistance in financing their enlarged capital investment programmes. The public authorities also took advantage of favourable conditions to borrow approximately 19% more than in 1972. The Italian Government itself, however, reduced its own borrowing in the form of bonds. In contrast to most other member countries, prices on the share market in Italy ended 1973 about 13% higher than at the beginning of the year, despite a decline from July onwards. Corporations thus found it possible to raise about 60% more share capital than in 1972.

The increase in net new borrowing by the *French* authorities was the main feature on the bond market in 1973. The French Government, after an interval of several years, launched a very large loan in January. Local authorities, although remaining net borrowers (under the influence of the inflationary rise in prices), reduced the scale of their operations compared with 1972.

Net new issues of bonds by enterprises rose sharply by 31% in 1973 after a contraction of nearly 5% the previous year. Financial institutions, both private and public, together with other public enterprises, shared in the 1973 increase. Private non-financial enterprises, on the other hand, raised much the same amount on the bond market, despite the possibilities for borrowing at a cost temporarily lower than under credit agreements.

The reduction in bond issues by such enterprises was more than offset by a larger volume of share issues in 1973 which rose by 13% compared with a year earlier, though this was less than the increase of close on 16% achieved in 1972. Not too much importance, however, should be attached to these developments because share issues were largely taken up, as in previous years, by parent or associated companies, by a few other

large investors or by existing shareholders. Share prices rose until May in an expansionary business climate and remained fairly buoyant until November. They were then seriously affected by the foreseeable consequences of the oil crisis and closed the year about 4% down from the level 12 months earlier, although industrials fared better than the average.

Conditions for new issues on the *German* capital market became increasingly difficult until about August 1973 but then improved slightly by the end of the year. Offering yields began the year averaging 8.6% but rose to 9.9% before falling back to 9.4% in November, followed by a minor increase to 9.5% in December. The high cost of borrowing was undoubtedly an influence in the 20% reduction in the net total borrowed on the market against fixed interest securities by private and public enterprises during 1973. Within this overall figure, net new issues by public enterprises suffered the greater decline by 31% during the same period. In contrast new issues by the public authorities rose by 72% in 1973. This was counterbalanced by a sharp reduction of more than DM 1 000 million in Federal Savings Bonds outstanding, due to the structure of higher interest rates prevailing during 1973 which increased the attractiveness of competing savings instruments. Bond issues by non-residents on the German capital market likewise suffered from the generally difficult conditions prevailing in 1973.

The value of share issues during 1973 was also lower than in 1972 but here the extent of the decline was a relatively modest 13%. Share prices rose until April 1973 and then fell sharply to end the year about 17% lower than the begin-

Table 5 — **Net domestic public issues of securities**
(milliard units of account)

Type of Securities	1970	1971	1972	1973
Shares	4.82	5.37	7.01	6.70
Bond issues by public authorities	2.69	14.88	6.64	12.23
Bond issues by enterprises (including financial institutions and public enterprises)	10.58	15.84	20.28	24.57
Total Community	18.09	36.09	33.93	43.50

Table 6 — Share issues by country

(billion units of account)

Country	1970	1971	1972	1973
Germany	0.98	1.29	1.18	1.08
France	1.56	1.45	1.67	1.89
United Kingdom	0.21	0.63	1.66	0.33
Italy	1.59	1.56	1.97	2.81
Netherlands	0.06	0.04	0.02	0.05
Belgium	0.38	0.34	0.42	0.39
Denmark	0.04	0.05	0.05	0.10
Ireland	0.00	0.01	0.04	0.03
Luxembourg	—	0.00	—	0.02
Total Community	4.82	5.37	7.01	6.70

ning. In spite of the deteriorating outlook in the second half of the year, particularly after the onset of the oil crisis, there was little difference in the value of shares issued as between half years. Foreign direct investment in German enterprises which increased during the fourth quarter when capital was mostly flowing out of Germany, probably helped to sustain the share market in the latter part of the year. Portfolio investment by non-residents in German shares and bonds continued to be subject to prior authorisation by the authorities.

The market in fixed interest securities in the *Netherlands* deteriorated extensively after the first quarter of 1973, as did similar markets in most other countries. In being attached to the fixed exchange rate "snake" arrangement, the *Netherlands* was forced to adopt an interest rate structure similar to that prevailing in other countries adhering to this currency alignment. Nevertheless, the sensitivity of capital flows to interest-rate differentials was reflected in the outflow of foreign portfolio capital in the second and third quarters as foreign investors sought higher yields in other markets. Expectations that interest rates would rise during the course of 1973 and probably into 1974, tended to emphasize the attractions of the short-term market where funds earned a higher yield. These developments exerted an upward pressure on the long-term market which suffered both from rising interest rates and reduced activity.

Bond issues both by public authorities and by enterprises fell somewhat in 1973 in comparison with the previous year, and alternative means of external financing became more prominent. In the enterprise sector, the reduced market activity was reflected mainly in lower non-financial enterprise issues while banks and other financial institutions managed to raise considerably more in 1973. Share issues account for relatively little of the capital raised by enterprises in the *Netherlands* and 1973 was no exception to the general rule, although more capital was raised in the form of share issues than in the previous year. The strong rise in share prices during 1972 continued until April, but was then reversed so that over 1973 as a whole the share price index declined by 23%.

After contracting in 1972 new issues of bonds on the *Belgian* market by enterprises rose again in 1973 but still fell short of the amount recorded two years earlier. Unlike most other markets during 1973, there was a relatively modest increase in yields in *Belgium* and presumably enterprises were able to meet their borrowing requirements at reasonable cost. The public authorities borrowed less against bonds in 1973 than a year earlier, reflecting a reduction in the central government's deficit. Share issues by enterprises were also lower than in 1972 despite fairly buoyant market conditions. Share prices rose until April and did not decline much until the last two months of the year, under the influence of the oil crisis, ending the year 2.5% higher than at the beginning.

The domestic bond market in *Denmark* was active during 1973 with the net supply of bonds being Kr. 16.5 milliard, a growth of over 26% compared with the previous year. There was a full supply of funds from private and business investors to the market since this sector (as opposed to institutional investors) increased its holdings by an estimated 43% in 1973. Share issues are relatively underdeveloped in *Denmark* and, while new issues more than doubled in 1973 to Kr. 645 million, their role in the overall pattern of capital investment funding must still be regarded as small. The combination of tight credit and increasing price inflation inevitably pushed interest rates onto a higher plane, rates on most instruments ending the year 2-3 percentage points higher in December than at the beginning of 1973.

As a result of the heavy commitments to capital investment in the *United Kingdom* undertaken

during the course of last year, and also increased long-term investment abroad (particularly in Europe), the financing requirement of quoted public companies in 1973 was substantially greater than in the previous year. At the same time, rising interest rates and the heavy Government borrowing requirement had eroded the ability of companies to tap the issue market for funds. Net capital issues of loan and equity capital by U.K. quoted companies declined to a trickle in the second half of 1973, the flow of issues at £ 49 million being only one-eighth of the issues made in the comparable 1972 period. For

1973 as a whole, net domestic issues of loan capital by these companies totalled £ 56 million, down substantially from the £ 333 million issued in the previous year. Domestic issues of equity capital similarly declined to £ 159 million last year from £ 712 million in 1972.

While the *Irish* government borrowing requirement increased by 37% in the past fiscal year, little of this was financed through capital markets. New capital raised through issues of securities on the Irish capital market totalled only £ 40 million in 1973 for all categories of borrowers, a decline from the £ 69 million in the previous year.

Table 7 — Net domestic public issues of bonds in the Community

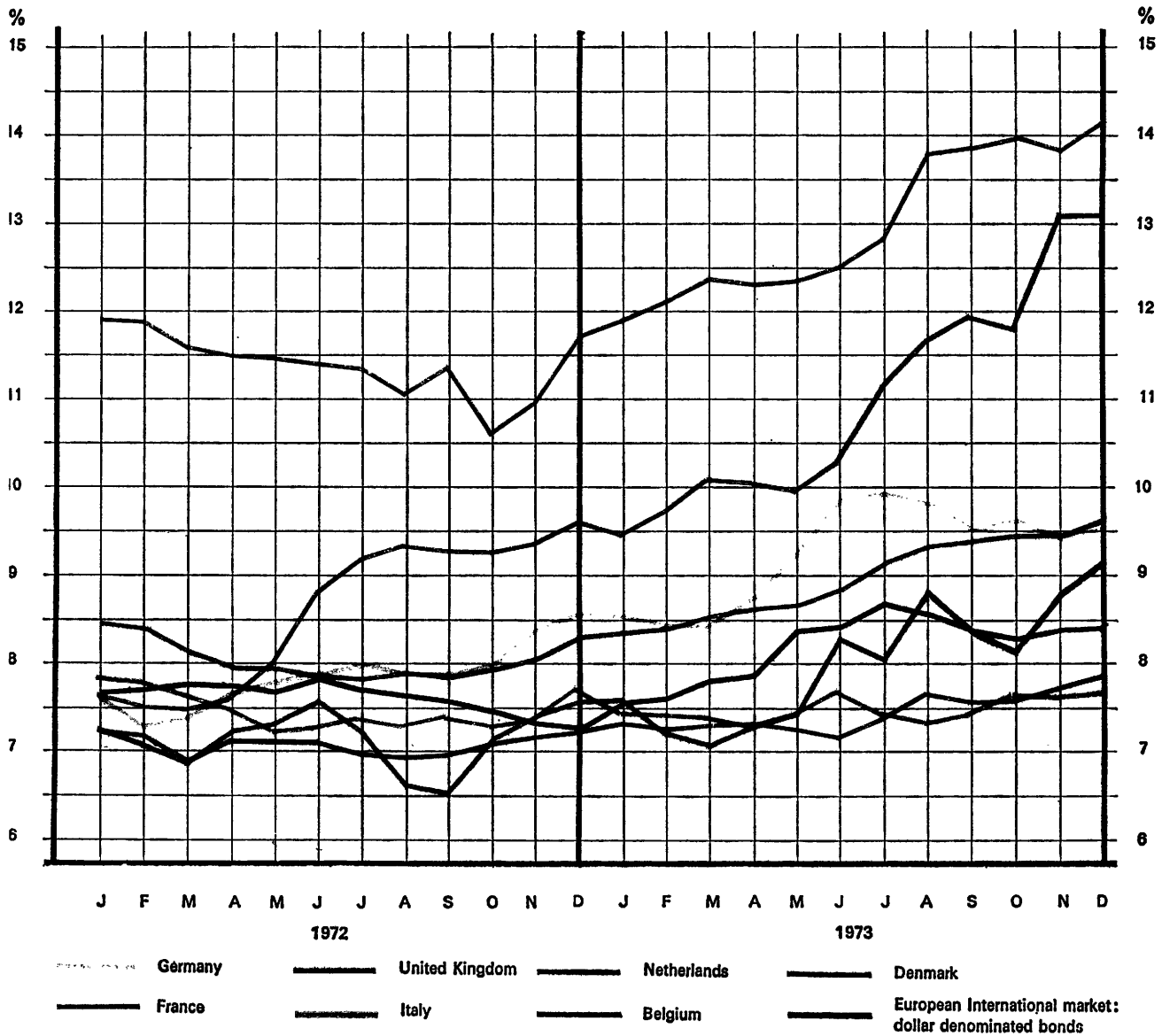
(milliard units of account)

Country ⁽¹⁾	1970	1971	1972	1973
Germany	4.03	5.55	9.26	8.35
Public authorities	0.14	0.33	0.62	1.11
Enterprises	3.89	5.22	8.64	7.24
France	1.88	2.94	3.31	4.97
Public authorities	—0.05	—0.04	0.47	1.25
Enterprises	1.93	2.98	2.84	3.72
United Kingdom	0.04	9.32	—0.33	3.27
Public authorities	—0.41	8.66	—1.09	3.15
Enterprises	0.45	0.66	0.76	0.12
Italy	4.18	8.00	9.28	14.49
Public authorities	1.74	3.62	4.21	4.47
Enterprises	2.44	4.38	5.07	10.02
Netherlands	0.69	0.79	0.80	0.62
Public authorities	0.36	0.37	0.28	0.12
Enterprises	0.33	0.42	0.52	0.50
Belgium	1.46	2.64	2.76	2.86
Public authorities	0.80	1.79	2.07	2.04
Enterprises	0.66	0.85	0.69	0.82
Denmark	0.88	1.34	1.71	2.18
Public authorities	0.04	0.01	—0.01	0.05
Enterprises	0.84	1.33	1.72	2.13
Ireland	0.10	0.13	0.12	0.05
Public authorities	0.06	0.13	0.09	0.05
Enterprises	0.04	—	0.03	—
Luxembourg	0.01	0.01	0.01	0.01
Public authorities	0.01	0.01	0.00	—0.01
Enterprises	0.00	0.00	0.01	0.02
Total Community	13.27	30.72	26.92	36.80
Public authorities	2.69	14.88	6.64	12.23
Enterprises	10.58	15.84	20.28	24.57

(¹) The issues entered under « Public authorities » include all issues by the Government and public institutions, although the proceeds of these issues may sometimes make it possible to grant loans to enterprises. The issues entered under « Enterprises » include all issues by non-financial enterprises, whether national or private, and all issues by credit institutions whose main activity is granting credit to enterprises.

Chart III — Gross bond yields

based on quotations on securities similar to those issued by the European Investment Bank



Note : Ireland and Luxembourg are not included owing to the lack of appropriate statistical data.

2.4 BANK AND OTHER CREDITS TO THE ECONOMY

The influence of Government monetary policies can often be seen most clearly in the availability, or otherwise, of funds from the banking system for investment and corporate working capital. Last year was one in which the differing policy priorities of Governments were brought into sharp relief by the "peaking" of the economic cycle and the upsurge of price inflation. Some Governments adopted an anti-inflationary, restrictive monetary policy posture for much of the latter part of 1973, while others continued to lay primary emphasis on high employment, economic growth and consequently a stimulative monetary policy.

A leading exponent of restrictive policies was *Germany* where new medium and long-term borrowing from banks and other financial institutions by enterprises (excluding the housing sector) was down by 43% in 1973 from the year earlier. This was a reflection both of the low profile of investment last year and of the tight monetary situation. The increasing severity of the credit squeeze from March/April 1973 onwards resulted in sharp rise in the cost of bank finance which would have deterred a number of potential borrowers. The fact that medium and long-term credit rose at all owes something to the practice of German banks in periods of abundant liquidity of guaranteeing the availability of credit to their customers, in some instances at fixed interest rates. Thus there is usually a time interval after the introduction of credit restrictions before the growth of credit is brought under control. This was especially the case with the large commercial banks whose lending business continued to expand rapidly until July of last year—well beyond the commencement of the credit squeeze. Meanwhile in February, measures were taken to tighten controls on external capital flows; these included the requirement that prior approval be obtained from the Bundesbank on loans of more than DM 50 000 borrowed from abroad. Furthermore, while the margin of statutory reserves on such loans (the "Bardepot") remained at 50% throughout 1973, the Bundesbank was given authority to raise the proportion, if necessary to 100%.

The effects of the credit squeeze in Germany were equally evident, as might be expected, in new short-term borrowing by enterprises, which fell by 42.4% between 1972 and 1973. The

successive increases in interest rates charged by banks for advances on current account which took the average rate from 9.08% in November 1972 to 14.02% a year later were an important factor. Stock accumulation, which was partly in-

Table 8 — Credits made available to the economy of short, medium and long duration
(Variations in amounts outstanding at year's end)

(milliard units of account)

Country	1970	1971	1972	1973
Germany	15.69	20.76	28.53	26.19
France	12.05	14.20	19.49	19.24
United Kingdom	6.57	9.07	20.49	20.59
Italy	8.82	12.11	15.33	18.61
Netherlands	2.98	3.39	4.84	6.54
Belgium	1.38	1.69	2.45	2.80
Denmark	0.50	0.42	0.84	1.20
Ireland	—*	—*	0.64	0.55
Total Community	47.99*	61.64*	92.61	95.72

(*) Following an industrial dispute in 1970 involving the banking system in Ireland, statistical material on credits are not available for the years shown. This has affected the total for the Community to a certain extent.

Table 9 — Credits made available to the economy, after eliminating double-counting of resources originating from the capital markets

(Variation in amounts outstanding at year's end)

(milliard units of account)

Country	1970	1971	1972	1973
Germany	12.04	16.31	20.46	19.02
France	10.58	12.49	17.58	16.47
United Kingdom	6.37	8.65	19.38	20.46
Italy	6.30	8.49	11.33	9.54
Netherlands	2.72	3.15	4.59	6.06
Belgium	0.74	0.91	1.98	2.11
Denmark	0.50	0.41	0.83	1.16
Ireland	—*	—*	0.64	0.55
Total Community	39.25*	50.41*	76.79	75.37

(*) See footnote to Table 8.

voluntary as demand for certain products fell away, was however higher in 1973 than in the previous year and created a demand for short-term finance. To the extent that finance from other sources was either unavailable or involved commitment to high interest charges over a long-term, enterprises would have felt compelled to pay the cost of short-term borrowing.

The efforts of the monetary authorities in *France* during 1973 to limit the expansion of credit were successful in that new short-term credits to enterprises were reduced, and the growth in net new credit extended at medium and long-term was less than in the two previous years. New credit advanced at short-term in 1973 fell by 30% to below the level which had prevailed since 1969. It is evident that monetary policy had a sharper impact on short-term credit than that of longer-term, especially as in the earlier part of the year enterprises had a fair margin of their own liquid resources at their disposal. In the closing stages of the year, however, the demand for credit increased in spite of a rise of 3.30% in the bank's base lending rates. As a result of this pressure, a number of large banks found themselves, for structural reasons, exceeding the ceilings placed upon the total of their lending. Interest rate increases tend to be discounted by borrowers if, as in 1973, inflation rates are high; nevertheless, it is possible that they caused some borrowers to seek alternative forms of finance under less onerous conditions, particularly where long-term servicing commitments of variable interest rates were involved. These considerations probably helped in restraining the increase in net new credit at medium and long-term to 10.2% in 1973, following increases of 60.4% in 1972 and of 39.1% in 1971.

The rate of growth of net medium and long-term bank credits, and privately placed debt certificates, to enterprises in the *Netherlands* slowed to 7% in 1973 from 41% in the previous year, following the unusually high demand for long-term funds in 1972. The yield at issue of privately placed debt certificates (*onderhandse leningen*), which form the greater part of the total of bank credit, fell from 7.93% in December 1972 (for public utility loans of this type) to 7.55% at the end of March 1973 but then climbed again to 9.62% by January 1974.

The reduction of borrowing in the form of bond issues and the limitation of the rate of expansion of medium and long-term credits, was evidently

made good by a heavier resort to short-term borrowing from banks and other financial institutions. This was despite a sharp increase in 1973 in rates of interest on bank borrowing, closing the year at rates not quite double those prevailing in January. Meanwhile the *Nederlandsche Bank's* discount rate was raised in three successive stages around mid-year from 4% to 6%, subsequently rising to 8% at end-year. Nevertheless, the total of new short-term credit to the private sector rose by nearly 165% in 1973 after increasing by 52% in 1972.

Medium and long-term credits to the *Belgian* economy during 1973 were rather higher than desired by the authorities. A considerable part of this increase in credit went into the housing sector but a larger amount went into financing purchases of equipment. In *Luxembourg*, it appears that funds from the large increase in savings deposits were readily available for the financing of the moderate expansion in investment activity last year.

Under the constraints of a tight monetary policy in *Denmark*, the flow of funds available for capital investment in 1973 had to be augmented from foreign sources in order to achieve the degree of investment expansion that did occur. Nevertheless the flow of new bank loans increased by more than 35% in the twelve months to December of last year. The ratio of loans actually utilised to loans approved by the commercial banks rose from 66.8% to 73.2% over the year, its highest level for some years, perhaps indicative of the more pressing need for available finance than in the past. The acquisition of foreign loans and credits by businesses increased rapidly during the year, the inflow of new capital at Kr. 2 972 million being more than four times the inflow in 1972.

The existence in *Italy* throughout 1973 of a high degree of corporate liquidity and of conditions on the bond market favourable to borrowers, were no doubt among the reasons why there was very much less resort to medium and long-term bank credit than in either of the two preceding years. A further disincentive was an increase in banks' lending charges in September, which took them to a higher figure than the yields prevailing on the secondary bond market. A technical reduction of Lit. 976 milliards in new medium and long-term credit during 1973 was substantially less than the increase of Lit. 4 002 milliards of new bond issues by enterprises, to which should be added

an increase of Lit. 742 milliards in new share issues. In Table 9, double-counting of credits granted by financial intermediaries has been eliminated and bond issues by such intermediaries are deducted from the total of their lending. Thus it so happens that towards the end of 1973 financial intermediaries raised substantial amounts on the bond market without having time to on-lend the funds. New short-term credit taken by Italian enterprises during 1973 was 13.4% more than in 1972 when such credits had already risen sharply. The further extension of this form of credit to enterprises was probably a reflection of a much faster tempo of business activity than in 1972.

In the *United Kingdom* the financing requirement of industrial companies was substantially greater in 1973 than in the previous year, but the decline in the domestic issue market as a source of funds was more than met by the rapid extension of borrowing from banks. The increase in bank borrowing by industrial and commercial companies in 1973, net of the rise in bank deposits by these companies, totalled almost £ 1 900 million, compared with £ 700 million in the previous year. The sole exception to the generally good availability of finance for capital investment in 1973 was the building society sector and thus the housing market. The rise in interest rates for competing deposit instruments resulted in a decline in new building society deposits and thus limited the availability of new mortgages. In view of this, measures were introduced in September to restrict the interest rates paid by the banks on small deposits in order to re-route funds back to the building societies.

The flow of new credit extended to non-government borrowers by the *Irish* banking system was slightly reduced in 1973 compared with the flow in the previous year. However, total non-government credit outstanding increased by 23% in the 12 months to December of last year, and confirms the impression of the ready availability of finance for companies and individuals. The financing of the housing sector seems to have held up much better in Ireland under the impact of rising interest rates than similar operations in the *United Kingdom*. Mortgages outstanding with the building societies increased by 31% in 1973. Special measures were taken by the Government to help in the provision of mortgage finance, including the granting of an interest subsidy for borrowers from the building societies and the negotiation of special credit facilities for the societies from the commercial banks.

Table 10 — **Gross issues of foreign bonds on the markets of member countries by international institutions and non-residents** ⁽¹⁾

(million units of account)

Country	1971	1972	1973
Germany	205	400	330
France	45	18	36
United Kingdom	91	43	10
Italy	24	95	—
Netherlands	33	11	—
Belgium	65	56	51
Luxembourg	16	25	37
Total	479	648	464
of which:			
European Investment Bank	114	125	116
Commission of the European Communities (European Coal and Steel Community)	76	111	106
Others	289	412	242

(¹) This table includes only foreign public bond issues placed in a given country by a syndicate composed exclusively of national institutions, even if the greater part of the issue proceeds is subscribed by non-residents. Foreign bond issues placed in several countries by international syndicates are registered as issues on the « European international market », Table 12, even if a part of their proceeds is subscribed by the investors of the country in whose currency they are issued.

2.5. FOREIGN CAPITAL ISSUES ON COMMUNITY BOND MARKETS; DEBT ISSUES BY COMMUNITY BORROWERS ON THE SWISS MARKET

A distinction has traditionally been made between foreign issues on national markets and international issues. The criterion adopted in compiling Table 10 is that the issues were placed entirely through banks of the country of the currency of subscription. A further characteristic of foreign issues on national markets is that they are only quoted on the market in question, although for example, in Germany the indications are that a substantial part, if not all, of the issues is usually taken up by non-residents. To the extent that these foreign issues are placed with non-residents, they would not appear in the statistics of net capital flows in Table 11.

There was a slight decline in the gross value of foreign bond issues floated on the German domestic market by foreign borrowers, which totalled 330 million units of account in 1973 as

compared with 400 million units of account in the previous year. Owing to the "Kuponsteuer" provisions, the yield on these issues was more closely geared to the international bond market than to the domestic market and as such were much below the latter at the beginning of 1973. Yields on existing securities in January of last year were at about 7% and remained at this level until June before rising steeply to around 10% in December. By the end of the year yields of foreign issues on the German domestic market were more closely comparable with the yields prevailing on domestic bonds. However, the existence of the yield differential for most of the year assured that foreign issues were taken up mostly by non-residents.

Owing to balance of payments problems in Italy it was not considered opportune to make public issues of foreign bonds on the domestic market. As a result the Italian market did not contribute to the total of funds raised in this manner. Total foreign issues of fixed interest securities raised on the domestic markets of the Community decreased to 464 million units of account in 1973 compared with 648 million units of account in the previous year. Issues by the European Investment Bank and the Commission of the European

Communities also declined slightly in 1973, but their share of total issues rose to 48% compared with 36% in the previous year.

Public issues of debt securities on the Swiss market by Community countries rose from 203 million to 264 million units of account in 1972 and 1973 respectively. This represents an increase in issue activity of 30% last year which can be contrasted with the sometimes difficult placement conditions prevailing in some other bond markets, domestic and international. By far the largest proportion of bond issues by Community borrowers on the Swiss domestic market last year was by United Kingdom companies who accounted for 52% of the total.

It is clear from Table 11 on the contribution of external flows to domestic financing that in 1973 there was a massive net inflow of capital into Germany from the rest of the world for portfolio investment in the private sector, amounting to 4 035 million units of account. Only Denmark among other member countries received a comparable inflow into portfolio investment in the private sector. It needs to be emphasised that these inflows in capital account in the balance of payments came from all, and not just Community, sources.

Table 11 — The contribution of external capital flows to domestic financing ⁽¹⁾, 1973
(+ inflow; — outflow)
Provisional estimates (million of units of account)

	Germany	France	United Kingdom	Italy	Netherlands	Belgium/Luxembourg	Denmark ⁽²⁾	Ireland
Private Long-term Capital:								
Net Direct Investment	+ 176	+ 275	} + 851	+ 523	+ 49	+ 390	+ 30	n.a.
Net Portfolio Investment, incl. Loans	+ 4 035	— 1,810		— 5	— 1,049	— 651	+ 453	n.a.
Total Private Long-term Capital Flow	+ 4,211	— 1,535	+ 851	+ 518	— 1,000	— 261	+ 483	n.a.
Public Sector Long-term Capital Flow, incl. Loans, Total	— 665	— 210	+ 1,739	+3,670 ⁽³⁾	— 37	— 156	+ 72	+ 157
Short-term Capital Flows Total ⁽⁴⁾	— 33	— 847	— 565	+ 199	— 102	+ 207	+ 26	+ 27 ⁽⁵⁾
Total Capital Account of Balance of International Payments ⁽⁶⁾	+ 3,513	— 2,592	+ 2,025	+ 4,387	— 1,139	— 210	+ 581	+ 184

⁽¹⁾ This table is based on national balance of payments data and national definitions, while similar, may differ slightly as between countries. In most cases public enterprises have been included in the public sector.

⁽²⁾ Recorded capital movements.

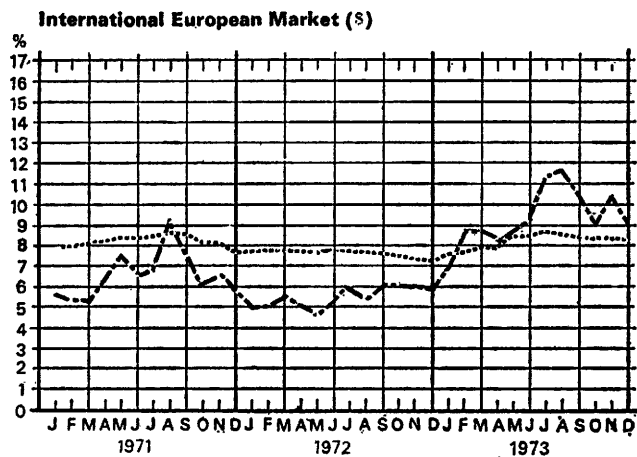
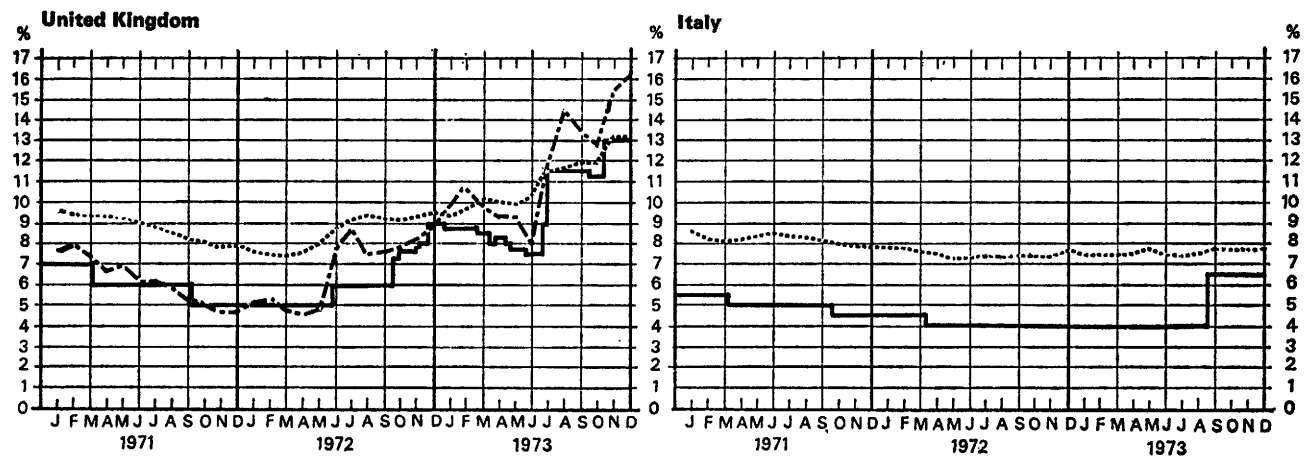
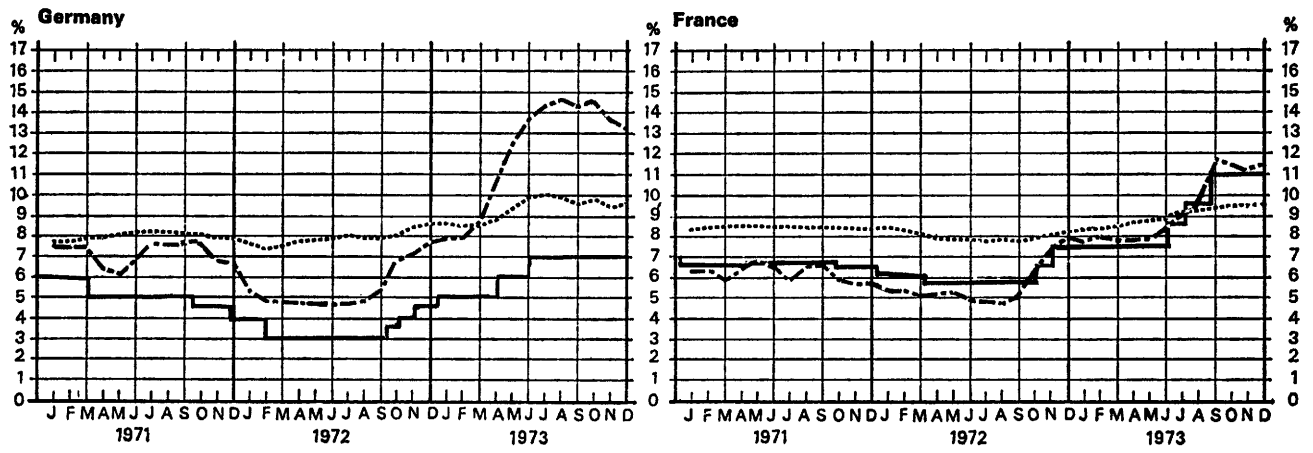
⁽³⁾ Provisional estimate of order of magnitude.

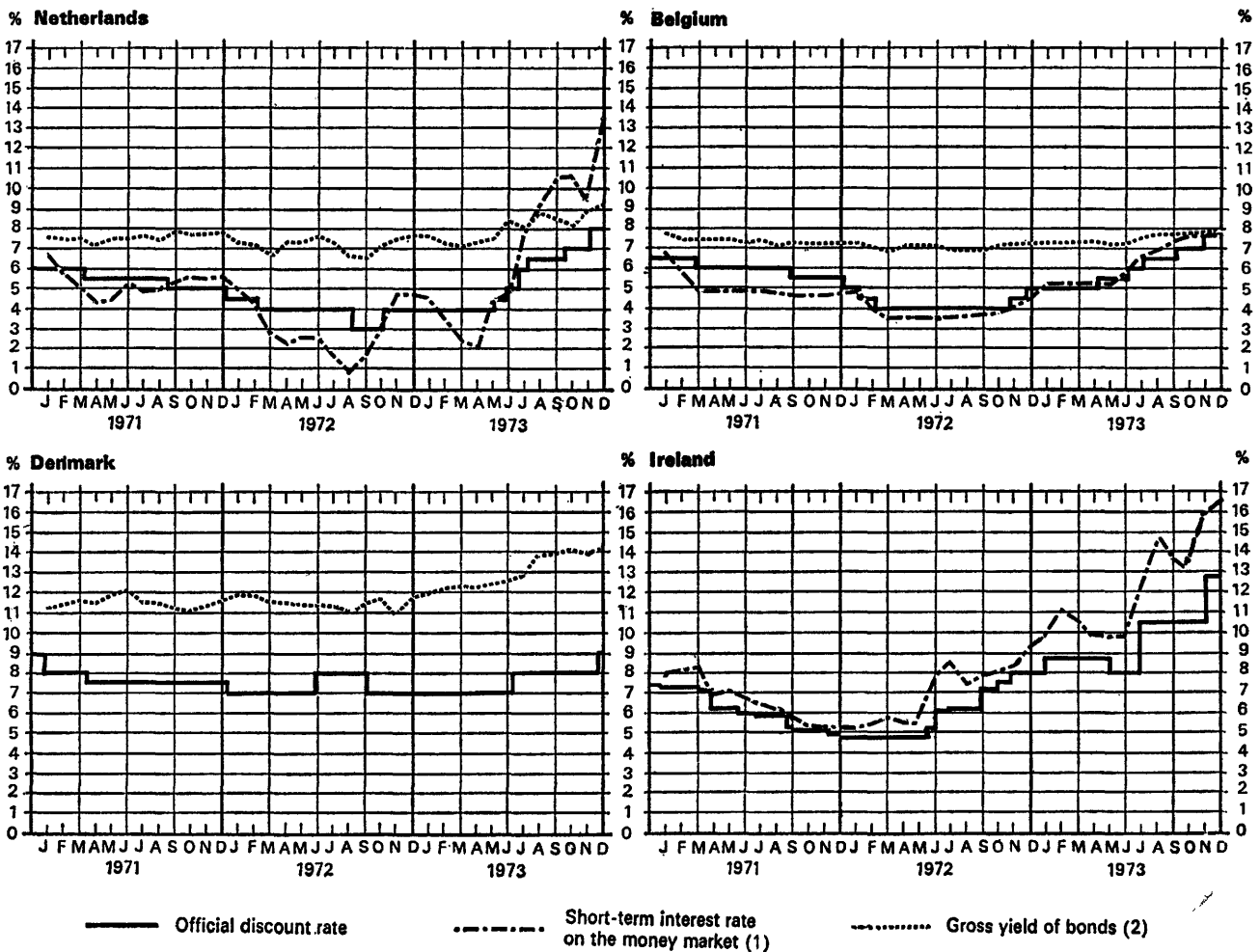
⁽⁴⁾ Includes net external position of private banking sector.

⁽⁵⁾ Private long-term capital has been included with short-term capital.

⁽⁶⁾ Residual error has been excluded except for Ireland.

Chart IV — Short and long-term interest rates





(1) The short-term interest rates are, according to the countries concerned, the following:
 Germany: rate for 3-month inter-bank loans.
 France: rate for 3-month inter-bank loans against private bonds.
 United Kingdom: 3-month sterling lending rate on inter-bank market.
 Italy and Denmark: no representative data available.
 Netherlands: rate for 3-month bank loans to local authorities.

Belgium: rate for transfer to banks of 3-month cash certificates.
 Ireland: rate for 3-month funds on the inter-bank market.
 International European Market: rate for 3-month U.S. dollar deposits with London banks.

(2) The gross yields for bonds are those of bonds quoted on stock exchanges in the different financial markets in the Community, the characteristics of which at issue come closest to those of the European Investment Bank's bonds.

INTERNATIONAL CAPITAL MARKETS

3.1. ISSUES ON THE EUROPEAN INTERNATIONAL MARKET

The international bond market, which was overtaken in 1972 as a source of capital by the market in internationally syndicated credits, contracted sharply, by 39% in 1973, while the volume of new international credit grew even more rapidly. As can be seen in Table 12, the amount raised on the international bond market declined from 4 597 million units of account in 1972 to 2 814 million units of account in 1973.

Before proceeding to analyse the year to year changes in Table 12, it should be explained that the figures of issues on international bond markets denominated in various national currencies or in units of account cover all bonds offered through international syndicates for the placing of issues. Examples of the coverage of the statistics in Table 12 are :

- bonds issued in one or more countries by non-residents, but which are not denominated in the currency of the country of issue ;
- bonds which, although issued by residents of a specific country in their own currency, are expressly reserved for subscription by non-residents ;
- bonds which, although issued in a specific country by non-residents and denominated in that country's currency, are placed in several countries by the issuing syndicates in so far as the syndicates include foreign banks ;
- bonds to which special monetary clauses are attached (units of account, European currency units, Eurco and other multiple currency issues).

The reasons for the contraction of the bond market in 1973, and to a certain extent its replacement as a means of raising finance by bank credit, are complex. The volume of issues was reduced in most sectors of the bond market (the main exceptions being bond issues with warrants and issues denominated in one form or other of units of account) and the structure of the market accounted for by each currency did not alter much between 1972 and 1973. The proportion accounted for by issues denominated in U.S. dollars was in fact almost unchanged, despite the second devaluation of the dollar in February 1973. There was a rather larger proportion of Deutsche mark issues and a slightly smaller proportion of

French franc issues but otherwise the changes were minor.

Nevertheless, the healthy state of the bond market in January and February 1973, when it continued on the rising trend of activity established the previous year, and its subsequent downturn suggest that the events of February-March 1973 formed a turning point in the market's history. The confidence of investors was doubtless affected by the changes in exchange rates in that period, including a second devaluation of the U.S. dollar, a revaluation of the Deutsche mark (which in the event was the precursor of a second and larger revaluation later in the year), the independent floating of the Italian lira and the Japanese yen, and the announcement of a joint float of other Community currencies, except the pound Sterling and the Irish pound which were already floating. Exchange rate uncertainties, particularly with respect to the U.S. dollar, prevailed for most of the first half of the year which not only affected the number of dollar-denominated issues but also diverted funds into short-term rather than long-term markets.

These developments encouraged a modest resort to issues denominated in units of account which had been dormant in 1972. They also encouraged the launching of a new currency unit, the Eurco, made up of amounts of the currencies of the nine member countries of the European Community which remain unchanged throughout the life of a loan. The Eurco was designed to offer investors a more stable medium for their investments by enabling them in effect to spread on a suitably weighted basis the risk of such investments among the nine Community currencies. In the event, however, the amount raised during 1973 by Eurco issues was also relatively modest.

The malaise in foreign exchange markets was a real enough influence in the contraction of the international bond market, but perhaps an even stronger influence was the beginnings of a phased withdrawal by borrowers domiciled in the United States from the international market in Europe. The lower section of Table 12 indicates that U.S. borrowers came to the international market for the equivalent of only 566 million units of account in 1973, after having raised 1 540 million units of account the previous year, a reduction of 63%. The reasons for U.S. corporations borrowing on the European market were diminished by the announcement in February 1973 by the U.S. Secretary of the Treasury to the effect that

exchange controls over capital outflows would be dismantled during the course of 1974. Thus U.S. corporations, encouraged by the thought that they would no longer need to borrow abroad in order to finance their external investments, probably devoted their efforts increasingly towards raising capital on the U.S. domestic capital market which was cheaper for them.

It is also possible that some borrowers resident in the United States found that the international market in medium-term credits suited their need for raising capital better than the bond market. This transfer of attention to syndicated bank credits as a source of capital seems to have been an element in the sharp decline in the total for 1973 of bond issues made by borrowers from the American continent other than in the U.S.A. and by miscellaneous borrowers. Many of these other borrowers would be resident in developing countries and would therefore take longer to acquire a standing on the international bond market than to satisfy the requirements of international banking consortia.

Borrowers in the European Community stood out as raising more in the international bond market in 1973 than in the previous year. If the three countries which joined the Community on 1st January 1973 are included in both years, borrowers in the European Community raised the equivalent of 1 459 million units of account in 1973 compared with 1 190 million units of account in 1972.

Currency uncertainties were not the sole problem facing the market, and rising short-term Eurocurrency deposit rates were perhaps more important in the second half of the year in drawing funds away from the long-term investment market. In pursuit of anti-inflationary policies, there was a steep rise in domestic interest rates in Germany towards mid-year, and a similar increase in short-term rates took place in the United States for much the same reason. In response, Euro-dollar deposit rates were realigned upwards and by early August were about six percentage points higher than at the beginning of the year. Such rates in the Eurocurrency market exceeded the yields offered on dollar Euro-bonds in February, for the first time since 1970, and by mid-summer were about 2½ percentage points above the latter. Short-term Euro-dollar rates declined somewhat in later months although they remained above international bond yields until year-end. With short-term

Eurocurrency rates at such attractive levels, investors were drawn towards that market. Indicative of this trend was the continued expansion of this short-term market in 1973 in contrast to the reduced activity in the international bond market. With inflation approaching or exceeding double figures in many countries, the apparent fairly high nominal yields on bonds gave little or nothing in the way of real return. Concern about inflation persuaded many investors to look more closely at real rates of return and to avoid long-term commitments by turning towards short-term markets.

On the other hand from the point of view of borrowers in the Community, one of the main reasons for the continuing attractiveness of the international bond market was that the prevailing yields rose less than on national capital markets which were suffering to a greater extent from the impact of the reinforcement of anti-inflationary policies.

Yields on international bonds denominated in U.S. dollars admittedly rose until about August while the exchange rate for the dollar against other major currencies was weakening, but they then fell until the end of the year as the dollar strengthened again. Secondary market yields on typical ten to twenty year dollar bonds rose from around 7.3% at end 1972 to about 8.7% in July 1973 only to fall back to around 8.4% by the end of that year. The performance of international bonds denominated in Deutschmarks was, in a sense, complementary to that of dollar bonds. During the first six months of the year, while the market judged that the German currency had a revaluation potential, secondary market yields on bonds denominated in Deutschmarks fluctuated narrowly around 7%. After the second revaluation of the Deutschmark at the end of June, yields on the secondary market climbed three percentage points to end the year at 10%. The two main sectors of the international bond market thus offered useful alternatives to European borrowers. Issuing activity was heaviest in the dollar sector in the first and final quarters of the year; the figures for the first quarter were inflated by, as explained earlier, a carry-over of the 1972 trend into January and February which distorted the pattern in 1973. In the Deutschmark sector the first two quarters of 1973 were clearly the most active.

In spite of the changing composition of borrowers and the reduced scale of operations the pattern of the final employment of resources raised on

Table 12 — **Gross issues of securities on the « European » international market**
(million units of account)

	1972	1973
Convertible bonds	964	398
Dollars	889	398
French francs ⁽¹⁾	32	—
Sterling/DM option	43	—
Bonds with warrants	55	119
Dollars	55	103
DM ⁽¹⁾	—	16
Straight bonds	3,578	2,297
Dollars	1,813	1,112
DM ⁽¹⁾	1,085	792
French francs ⁽¹⁾	396	126
Luxembourg francs ⁽¹⁾	125	76
Sterling / Dollar option	24	—
Sterling / DM option	41	27
Australian dollar / DM option	34	—
Danish kroner / DM option	30	—
Lebanese pounds	—	32
Units of account	—	82
European monetary units	30	—
European composite units (Eurco)	—	50
Total Issues of Securities	4,597	2,814
Borrowers in Europe ⁽²⁾	1,940	1,762
Within the Community	1,190	1,459
(of which the three new Member States)	(803)	(853)
— European Investment Bank	193	253
— Commission of the European Communities (on behalf E.C.S.C.)	27	69
— Other Community borrowers	970	1,137
Outside the Community	750	303
Borrowers on the American Continent	2,060	813
U.S.A.	1,540	566
Others	520	247
Japanese borrowers	29	21
Miscellaneous	568	218

⁽¹⁾ See footnote to Table 10.

⁽²⁾ The geographical classification of borrowers has been based upon the nationality — and hence the location of the registered office — of the issuers except for holding companies which are affiliates of foreign companies; these holding companies have been classified according to the nationality of their parent companies.

Table 13 — **Total resources raised by Community borrowers through public issues on the financial markets**
(milliard units of account)

	1972	1973
— Net issues on the national markets of member countries	33.93	43.50
— Issues on the European international market ⁽¹⁾	1.19	1.46
— Issues on other national markets	0.20	0.26
Total Community	35.32	45.22

⁽¹⁾ As the volume of redemptions effected on Eurobonds in circulation cannot be assessed accurately, the figures given here relate to gross amounts raised.

the international bond market in 1973 was remarkably similar to that established during the previous year. The main borrowers were in manufacturing industry, taking a little over a quarter of the total in both years. Industries in the energy sector, including mining, came next with about 18% of the total. Governments and public authorities were only fractionally behind the energy sector. The financial sector was fourth with about 14%. The chief difference between the two years was that international institutions, by increasing the absolute amount of capital raised in 1973, doubled their share of the market to 11%. A further noteworthy feature in 1973 was the raising of capital by property companies in the United Kingdom to finance new construction in other member countries of the European Community.

3.2. INTERNATIONAL MEDIUM-TERM CREDITS

The available statistics of internationally syndicated medium-term credits still remain incomplete, as many of them remain the subject of a private contract between the borrower and his bankers. Within the limitations of the material, the International Bank for Reconstruction and Development has been able to compile statistics that illustrate the remarkable growth of this market from a total of just over \$ 4 milliard in 1971 to \$ 8 milliard in 1972 and then almost to \$ 23 milliard in 1973.

There seems little doubt that the growth of this form of financing has eased the problems of many developing countries. Borrowers in the third world have included not merely governments but also subsidiary authorities and state institutions. In tropical Africa borrowers in Gabon and Zaire raised several credits during the course of 1973, while in North Africa the same held true of Algerian borrowers. In South East Asia the main borrowers were located in the Philippines and in Indonesia.

In Latin America borrowers in Brazil, Mexico and Peru attracted much publicity. In the last quarter of 1973, after the oil producing countries had begun to raise their prices for petroleum, Iran and the Sultan of Oman were reported as borrowing in the form of international credits. In total, developing countries were thought by the I.B.R.D. to have borrowed \$ 8.2 milliard in 1973 as against \$ 3.4 milliard in 1972.

Large though the increase was in borrowing by developing countries, it was outstripped by the

increase in credits raised by countries with centrally-planned economies, up from \$ 0.4 milliard to \$ 1.4 milliard, and by the growth from \$ 4.0 milliard to \$ 13.4 milliard in credits granted to borrowers in developed countries. Within the Community, state enterprises in the United Kingdom and Italy borrowed heavily. The United Kingdom Electricity Council raised \$ 1.0 milliard for ten years and the Gas Council \$ 0.25 milliard for seven years. In Italy, where the practice of using state enterprises to obtain foreign exchange credits to strengthen the balance of payments is of longer standing, the Istituto di Credito per le Imprese di Pubblica Utilità (ICIPU), the Istituto Mobiliare Italiano (IMI), Ente Nazionale per l'Energia Elettrica (ENEL), Ferrovie dello Stato, Mediobanca and the Consorzio di Credito per le Opere Pubbliche were among the entities which raised a total of about \$ 3 milliard for periods of generally ten or eleven years. The Kingdom of Denmark on the other hand borrowed \$ 150 million in its own name for twelve years. Smaller credits were obtained by numerous other borrowers in the Community, both in the public and private sectors for a wide range of purposes.

The large amounts available on a single credit and a term to maturity extending up to fifteen years have made this form of financing attractive to many borrowers. The interest rates on most credits are normally fixed every three, six or twelve months at a specified margin above a rate at which, theoretically, the lending banks are able to borrow from other banks. Usually the reference interest rate is the six-months London Inter-Bank Offered Rate or LIBOR. The margin or scale of margins charged by the lending banks reflects the availability of funds and the standing of the borrower. During the first three quarters of 1973, the market in medium-term credits was clearly a borrower's market, with most banks very eager to lend. The oil crisis, however, together with mounting rates of inflation and the rapid growth of the market caused the lending banks to adopt a more cautious attitude as the end of the year approached. Whereas credits might have been made available at the beginning of 1973 to first class borrowers in industrialised countries at 0.375% above the reference interest rate and the term to final maturity might have been in the ten to fifteen year range, by the end of the year the margin would, characteristically have been raised to about 0.5% on average and the term reduced to less than ten years. Margins charged to borrowers in developing countries would normally have

been double those indicated for more developed countries.

With short-term interest rates rising in most markets, borrowing in the form of international medium-term credits was not cheap. The reference interest rates used by lending banks are not published but the rate for six-months euro-dollar deposits in London perhaps is indicative of their level as around 97% of international credits are granted in dollars, mostly with a provision for a six-monthly review of the interest charge. The London rate for six-months euro-dollars climbed from a little over 6% in December 1972 to somewhat over 11.5% in August 1973 ; it then fell back to just below 9% in October but rose above 10% again by December. Except at the very beginning of 1973 therefore, internationally syndicated credits were more expensive than bond issues on the international market.

The attitude of borrowers was, as explained earlier, strongly influenced by this ready availability of credit on a large scale. They may also have considered that they would benefit when short-term interest rates eventually fell. As it happened, however, the reverse yield gap which had opened up did not diminish when investors were attracted out of the long-term market into short-term deposits with the international banks. Instead, this movement of resources into the hands of the banks served to encourage them to expand their lending activities even more rapidly.

The extraordinary growth of internationally syndicated credits in the recent past has not been without its dangers. First, the rapid expansion of lending must generally have reduced the ratios of the banks' operations to their own resources. Secondly, the competitive margins which the banks have been charging their customers are likely to look increasingly slim if inflation continues to add to their costs. Thirdly, the normal banking practice of deposit transformation must generally have been stretched during 1973, when new international credits included 62.5% for a term of between six and ten years, and 18.2% for a term of more than ten years. The agreements covering international credits usually contain clauses protecting the lending banks against non-availability of funds and against changes in banking or exchange control regulations, but their application would, at the very least, be most inconvenient for borrowers.

With these provisos the very size of the international market in medium-term credits suggests that it filled a need for such a form of financing which more conventional markets were unable to provide at the relevant time. The resort both by borrowers and investors alike to the market for international medium-term credits, undoubtedly contributed to the relative decline in 1973 in business conducted through the international bond market.

CONCLUSION

In 1973 the financial intermediaries of the Community experienced a major degree of change on many fronts—floating exchange rates, rapidly rising inflation and the oil crisis. These evolving situations have demanded adjustments to policies, methods and outlook which are still continuing. Capital requirements last year remained relatively high in some Community countries at a time when financial markets experienced some difficulties owing to expectations of continuing inflation.

During the first half of 1974 inflation has remained the chief problem throughout the industrialised world. In spite of the danger of an impending recession, counter-inflationary measures have been applied in full force. Progress in this struggle, if any, has been small and in some instances increased prices for energy and rises in other costs have accentuated the problems of the authorities. The erosion to vanishing point of real returns on long-term investment has diverted savings into higher yielding short-term instruments and into any form of asset likely to offset the otherwise depreciating purchasing

power of money. The general lack of incentive to commit financial resources at long-term has placed a greater burden on the banking system as an intermediary in the financing of fixed investment. These strains were most evident in the international capital market where they have given rise to an unprecedented growth in bank credit which, however, is not without its dangers.

Meanwhile the capital needs of enterprises have increased as a result of inflation. Not only has the cost of new fixed investment risen but higher prices for investment goods may in many instances have exceeded normal provisions for the replacement of obsolete equipment. In the same process the relationships between enterprises' own resources to borrowed funds could well have been impaired. Injections of fresh capital have been rendered difficult by a widespread weakness in equity markets under the influence of fears of recession. These considerations underline the urgency of achieving the not necessarily contradictory aims of overcoming inflation and restoring confidence in capital markets.

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 Central Statistical Office: National accounts, monthly Economic Trends.

Italy:

Banca d'Italia: Annual report, bi-monthly bulletin and supplement.
 Ministero del Bilancio: Annual report.

Netherlands:

Nederlandsche Bank: Annual report, quarterly statistics.
 Centraal Bureau voor de Statistiek: Statistical bulletin.

Belgium:

Banque Nationale de Belgique: Annual report, monthly bulletin.
 Commission Bancaire de la Belgique: Annual report.

Denmark:

Danmarks Nationalbank: Monetary review.
 Danmarks Statistik: Annual review, quarterly and monthly reports.
 Det Økonomiske Sekretariat: Economic review.

Ireland:

Central Bank of Ireland: Annual report, bi-monthly bulletin.
 Department of Finance: The Budget.

Luxembourg:

Service Central de la Statistique et des Études Économiques: monthly bulletin, statistical series.
 Conseil Économique et Social du Luxembourg: Annual review.

Organisation for Economic Co-operation and Development: Economic studies, financial statistics.
 Bank for International Settlements: Annual report.

