U.S. Balance of Payments

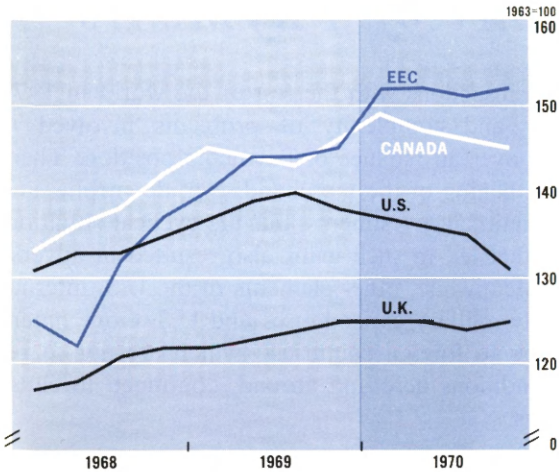
Developments in U.S. transactions with the rest of the world in 1970 illustrated the tenacity and complexity of problems involved in achieving a satisfactory over-all balance of payments position. There was indeed some strengthening of the merchandise trade surplus and of net receipts on international investments, but the cyclical situation, both here and abroad, that led to such gains also resulted in adverse shifts in capital flows. Meanwhile, other elements in the U.S. international accounts—notably military expenditures and U.S. Government aid and private transfers to foreign countries—which are not so responsive to business conditions here and abroad, continued to cause a large outflow of dollars.

MERCHANDISE TRADE

Events in 1970 underline the extent to which the traditional U.S. trade surplus had weakened during the period of excess domestic demand in the latter half of the 1960's and also show the sensitivity of trade flows to economic conditions in other industrial countries. Studies of the effects on U.S. trade of the demand inflation of the late 1960's, which followed an extended period of relative price stability, suggest that a large part—perhaps most—of the deterioration in the trade balance from its 1964 peak was associated with strong and sustained upward pressures on prices and wages in U.S. markets. The adverse effects of such developments in the international competitive position of U.S. industry can be overcome only with the passage of time.

In 1970 the U.S. trade balance with other countries responded well through midyear to the slowing of domestic demand and to the strong growth of demand in most other industrial countries. For most of the year policy in most countries was directed toward reducing inflationary pressures, and only as the year ended—with production in many industrialized countries flattening out—was attention abroad shifting to the problem of averting a general slowdown in economic growth. This course of events was reflected in the U.S. trade performance—leading to some erosion of the gains made in the first half of the year as foreign demands weakened.

16. INDUSTRIAL PRODUCTION



Seasonally adjusted OECD quarterly data.

U.S. exports in 1970 benefited from record shipments of agricultural products and a spurt in exports of large jet aircraft. The major support for foreign sales, however, was the demand in industrial countries for machinery and industrial materials. Even so, as the year progressed, and some slack developed in supply capabilities abroad, demand for these products decreased. New orders for machinery tended to level off, and easier supply conditions for steel abroad not only reduced U.S. exports but also supported a renewed surge of shipments from Europe and Japan to the United States.

The level of U.S. imports tended upward during the year, but it appears that perhaps three-quarters of the rise was accounted for by higher prices of imports. In the last quarter of the year, even though there was a decline in real economic activity, imports rose somewhat, reflecting especially strong demand for foreign steel, automobiles, and petroleum.

These trends indicate the difficulty of restoring a reasonable trade balance after a long period of domestic inflation, especially when growth rates and domestic demands in countries abroad are slowing. There were, however, some favorable indications in 1970 for the future of the trade balance. Import prices rose more rapidly than U.S. export prices, and while this factor may reduce the trade surplus in

current-dollar terms over the short run, over the longer run it may benefit the trade position as the relative advantage of foreign goods is diminished. With improved economic performance in the United States and resumption of stronger economic growth rates abroad, the U.S. trade balance should make further gains over time.

CAPITAL FLOWS

Flows of capital between the United States and foreign countries also respond to the cyclical situation. Indeed, the response may be so large and rapid as to overmatch changes in the current account. This is increasingly true of the immense stock of mobile funds that respond quickly to changes in interest rate levels in the important monetary centers, utilizing the convenient mechanism of the Euro-dollar market. Such flows of funds complicate the management of monetary policy and result in sudden, large shifts of international reserves (largely dollar holdings) among central banks.

In 1970 the need for the United States to pursue a relatively expansionary monetary policy, while other countries did not move in that direction until the closing months of the year, led to a return flow to foreign commercial banks of some $6 billion of funds borrowed earlier by U.S. banks. This flow helped to restore needed reserves to some countries—notably the United Kingdom and France—and added to the reserve gains of other countries with continued strong basic positions—notably Germany.

These flows of liquid funds were not inspired—as were those of other recent years—by financial crises and currency speculation, but rather by market considerations. Under present-day conditions, when investors and borrowers are free to seek the most advantageous market, such flows respond readily to changing interest differentials among countries. These flows tend to be reversible as interest rate relationships change, and they do not have the same significance for the balance of payments as more deep-seated shifts in other transactions affecting reserves. A large part of the Euro-dollar reflows in 1970 represented a readjustment of the U.S. domestic banking system to its renewed regulatory and economic ability to compete for funds in domestic money markets. As noted earlier, the Federal Reserve took steps to moderate the rate at which U.S. banks were repaying their borrowings, in order to help offset the unsettling effect that might occur if large reflows continued over a short period.

Longer-term capital flows are also highly responsive to variations in economic activity here and abroad, and also to corresponding variations in the cost of funds. The outflow of U.S. funds in response to such variations remains inhibited by Government restraints, which have been retained in 1971 because of the persistence of large deficits in the U.S. balance of payments. U.S. industrial firms have indicated that they plan to carry out major programs to expand their foreign productive facilities in 1971. With domestic demand for loans relatively weak, it is to be expected that U.S. banks would wish to enlarge their foreign credits if there were no guidelines concerning foreign credit restraint. Though there was some increase in the outflow of capital for these purposes in 1970, it was probably much less than would have occurred without the restraint programs. In the case of U.S. purchases of foreign securities, the outflows were smaller than in other recent years, in part because of the restraints but also because Canadian borrowers made more use of their own capital markets.

The principal change in flows of foreign capital in response to changes in the economic situation—apart from flows of liquid funds—was in transactions in U.S. equity securities. Foreign investors shifted from net sales of $0.2 billion in the first half to net purchases of $0.8 billion in the second half, once the U.S. equity market began to show basic strength again.

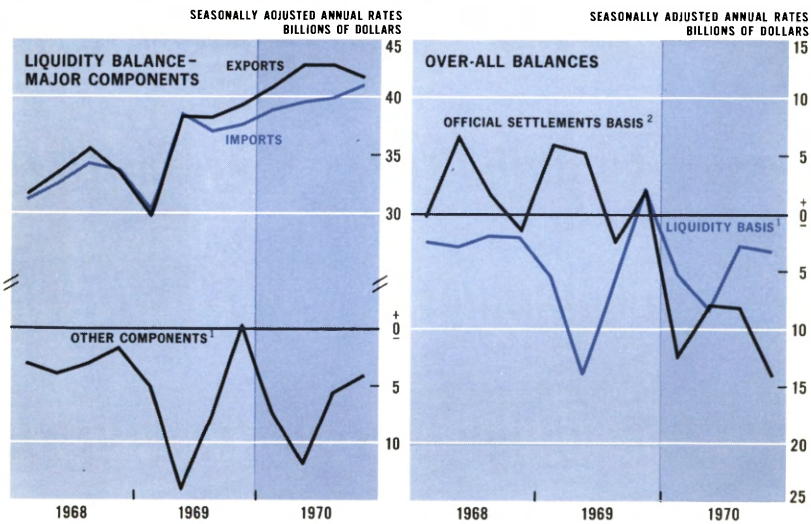
Taking U.S. and foreign private long-term investments together, there appears to have been a net increase in outflows of some $1.5 billion from 1969 to 1970. Of course, the adverse shift in flows of short-term funds was much greater. Looking ahead, it seems likely that the outflow of U.S. private capital will continue to be large in 1971, though the amount will be limited by the restraint programs. However, with recovery in the U.S. economy, some increase in the inflow of funds for investment in corporate securities would be expected. Also, there is much less scope for return flows of borrowed private foreign short-term funds, after the attrition of 1970.

OVER-ALL BALANCE

The net result of divergent changes in the U.S. trade and capital accounts in 1970 was a moderate improvement in the liquidity balance

—apart from special transactions and the initial allocation of SDR's. Over the years there has been a tendency for the current and capital accounts of the U.S. balance of payments to move in opposite directions, as the cyclical conditions favoring improvement in the current account have, at the same time, tended to encourage net capital outflows. Given the large dollar outflows that are not related to economic conditions, large liquidity deficits tend to persist. From another point of view, the desire of foreign governments and private holders of assets to add to their liquid reserves, with the dollar a principal vehicle for doing so, is a factor in the continuation of U.S. balance of payments deficits.

17. U.S. BALANCE OF PAYMENTS



1 Excludes special transactions with foreign governments and the SDR allocation.
2 Excludes SDR allocation.

The U.S. balance of payments reflects a great diversity of economic and political decisions here and abroad—a diversity that is unique because of the pivotal role of the dollar in the world's monetary system. The large flow of dollars into foreign official accounts in 1970 was accommodated with relative smoothness, though not without concern that the continuation of such flows would disrupt the

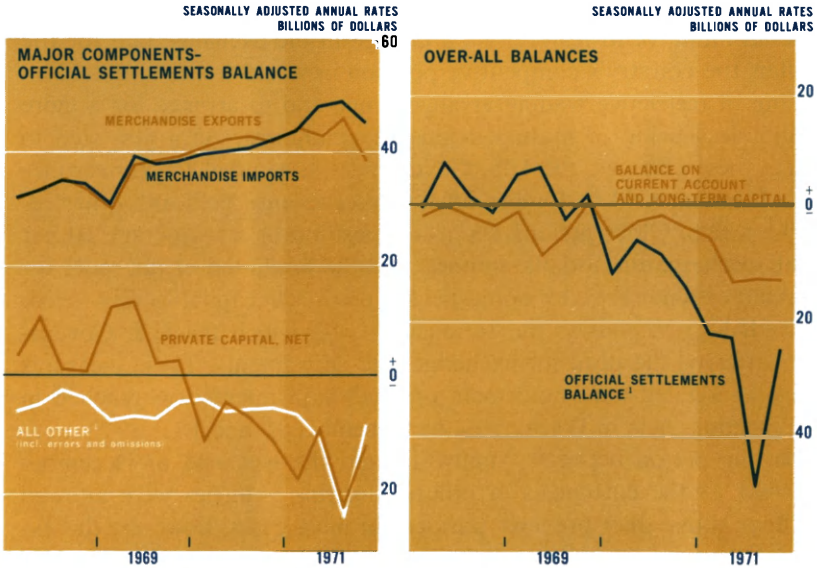
progress being made toward an improved monetary system. Contributing to generally calm foreign exchange markets in 1970 were the exchange rate adjustments accomplished in 1969, increased consultation and cooperation among national authorities, and the introduction of SDR's. □

U.S. Balance of Payments

During 1971 it became evident that the balances of both current and capital transactions between the United States and the rest of the world had worsened to such an extent that conventional changes in monetary or fiscal policies here or abroad could not be expected to reverse the trend. In fact, the cyclical situation was adverse for the balance of payments because demand in the United States was strengthening whereas in most major foreign countries—where resource utilization was still relatively high—the pace of economic advance was slowing.

The international monetary scene in the first half of the year was dominated by huge flows of funds to Germany, as that country continued to pursue a relatively tight monetary policy, while the revaluation of the mark in 1969 did not appear to have diminished Germany's strong trade surplus. By April these flows reflected market expectations that the mark would be revalued, and on May 10 the German authorities allowed the mark to float; at the same time the

14. U.S. BALANCE OF PAYMENTS



[1] Excludes SDR allocations.

Netherlands guilder was allowed to float and Switzerland and Austria revalued their currencies.

For a brief period thereafter there was a partial reversal of speculative flows and some relaxation of tensions in international markets, but as evidence of the deepening troubles of the U.S. balance of payments mounted, another and much more massive flow of funds got under way. Demands for the currencies of most other industrial countries built up, and foreign official reserve accruals accelerated. By the end of July U.S. liabilities to foreign official accounts stood at $37 billion, compared with $24 billion at the end of 1970; meanwhile, U.S. reserve assets had fallen from $14.5 billion to $13.3 billion. In the first 2 weeks of August reserve liabilities grew by about $4.5 billion, while reserve assets were reduced by $1.2 billion. Reductions in reserves occurred mainly in connection with repayments by other countries to the International Monetary Fund. Moreover, the United States made large drawings on swap lines with some countries that were accumulating large holdings of liquid dollar assets.

MEASURES OF AUGUST 15

The external measures announced on August 15 as part of the new economic program represented an effort by the United States to exercise an initiative to restore, via a change in the exchange rate for the dollar, the country's competitive position in world trade, to obtain an easing of restrictive trading arrangements, and to arrange for a more equitable sharing of mutual defense expenditures. As a first step to effect these changes, the U.S. Government suspended the convertibility of dollars held in foreign official reserves into gold and other reserve assets. Other actions taken—imposition of a temporary 10 per cent surcharge on dutiable imports and the limitation of tax relief for capital expenditures to domestically produced capital goods—were intended to emphasize the seriousness with which the U.S. Government viewed the need for exchange rate adjustments. These measures were eliminated once agreement on such adjustments was reached in the meetings held in Washington on December 17 and 18.

In the period between August 15 and the weekend of December 17 and 18 the currencies of other industrial countries were allowed to float above their previous parities. In most cases, however, the extent of the appreciations of these currencies was limited by official

intervention in the market or by various measures intended to limit inflows of speculative and interest-sensitive funds. In that period the outflow of funds from the United States (reflecting not only flows of liquid funds but also leads and lags in payments of all kinds) was again very great, and liabilities to foreign official accounts rose by almost $12 billion. Japan was the principal recipient, as that country was reluctant to accept at an early stage the major revaluation that was generally expected.

As negotiations toward a realignment of exchange rates proceeded, the extent of the change in the U.S. balance of payments that was required came to be better understood, though it was actively debated. In particular, the U.S. trade balance had clearly tended to deteriorate more rapidly in recent years than could be accounted for by changes in general demand conditions here and abroad. By 1972 the trade balance could be expected to register a deficit substantially larger than that already in prospect for 1971. It also seemed clear that, in the absence of major adjustments of exchange rates, the balance on current and long-term capital transactions would be headed for a deficit even larger than in 1971, whereas a surplus of some size for these transactions would be necessary to produce a satisfactory balance on official settlements.

MERCHANDISE TRADE

The U.S. trade balance in 1971 dropped to a deficit of nearly $3 billion compared with a surplus of $2 billion in 1970 (Table 12). The trade deficit stemmed from a very weak showing in exports, which were only slightly higher in value than in 1970, while imports advanced sharply—by about 15 per cent. Part of the difference reflected a somewhat larger increase in import prices than in export prices.

On the export side, increases in sales of agricultural commodities, in sales of automotive vehicles and parts to Canada, and in deliveries of commercial aircraft were just about offset by declines in shipments of machinery and industrial materials. The declines in these exports were attributable mainly to the easing of demand in foreign industrial countries. In volume terms, exports as a whole were slightly lower in 1971 than in the previous year.

The gains in imports in 1971 were broadly based, with all major

Table 12: U.S. INTERNATIONAL TRANSACTIONS

In billions of dollars, seasonally adjusted

Item	1970	1971 p	1971			
			I	II	III	IV p
Merchandise trade balance	2.1	−2.9	.3	−1.1	−.6	−1.5
Exports	42.0	42.8	11.0	10.7	11.5	9.6
Imports	39.9	45.7	10.8	11.8	12.0	11.1
Services, remittances, pensions, net	.1	1.4	.6	.7	.2	−.1
U.S. Govt. grants and credits, net	−3.8	−4.2	−1.1	−1.1	−1.1	−1.0
Long-term private capital, net	−1.5	−5.1	−1.0	−1.8	−1.7	−.5
Balance on current account and long-term capital	**−3.0**	**−10.9**	**−1.3**	**−3.2**	**−3.2**	**−3.2**
Nonliquid short-term private capital	−.5	−2.8	−.4	−.4	−1.2	−.9
Errors and omissions	−1.1	−9.3	−1.0	−2.3	−5.1	−.8
Liquid private capital	−6.0	−7.2	−3.0	.1	−2.8	−1.5
Of which: Liabilities to foreign commercial banks	−6.5	−6.6	−3.1	−.1	−2.1	−1.3
Official settlements balance [1]	**−10.7**	**−30.3**	**−5.7**	**−5.9**	**−12.3**	**−6.4**

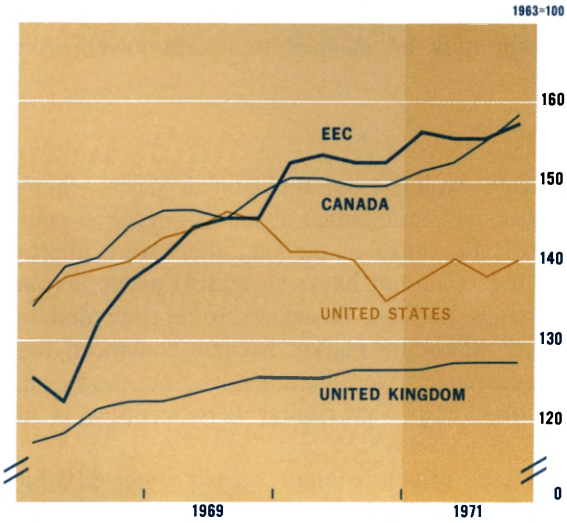
p Fourth-quarter data are partly estimated.
[1] Excludes SDR allocations.
NOTE.—Dept. of Commerce data, with some Federal Reserve estimates. Details may not add to totals because of rounding.

categories of goods—foods, industrial materials, capital equipment, automobiles, and other consumer goods—increasing over 1970 levels. The greatest increase was in imports of autos, especially from Japan. Despite this increase, sales of imported autos other than those from Canada accounted for about the same share of total U.S. sales of autos as they had in 1970—about 15 per cent of the number of vehicles— but this was a much higher share than the 10 per cent average for 1967–69.

A rise in prices of foreign goods accounted for about one-third of the increase in the value of imports in 1971, whereas in 1970 nearly two-thirds of the increase in imports had stemmed from price increases—as measured by unit values.

Trade movements in 1971 were greatly affected at times by such factors as actual or anticipated domestic strikes (mainly in port operations, steel, aluminum, and coal), anticipation that "voluntary" controls would be imposed by foreign governments on their industries' sales to the United States, and the increasing possibility of changes in currency values. Therefore it is difficult to determine how

15. INDUSTRIAL PRODUCTION



NOTE.—Seasonally adjusted quarterly data from the Organization for Economic Cooperation and Development. Data for fourth quarter of 1971 partly estimated.

much of the 1971 deterioration in the U.S. trade position resulted from these factors rather than from more enduring ones. In addition, the deceleration in business activity abroad and the easing of supply conditions in Europe and Japan were major causes for the downturn in U.S. exports of machinery and industrial materials—and probably also for the rise in imports, as foreign producers intensified their selling efforts in the United States. At the same time, however, continued sluggishness in domestic economic activity held imports to levels below what they would have been if output and consumption here had been more buoyant.

The steady deterioration in the trade balance of recent years is expected to be slowed or arrested in 1972 as the recently announced changes in exchange rates begin to shift competitive advantages. However, it may take 2 or 3 years before rearrangements of production and consumption patterns both here and abroad will have gone far enough to produce substantial improvement. In the short run, the U.S. trade balance is likely to be affected mainly by general business conditions, as economic activity in the United States gains momentum while foreign economic activity may remain below opti-

mal levels. Under such conditions, foreign demand for U.S. products will be blunted, even at relatively favorable prices, while foreign suppliers to the U.S. market may be inclined to accept lower profit margins.

CAPITAL FLOWS

The net outflow of private capital from the United States—taking into account both recorded and unrecorded elements—reached enormous proportions in 1971. For most of the year there were interest rate incentives for U.S. investors and banks to add to assets abroad or repay foreign borrowings and for foreigners to borrow dollars. Outflows spurted at times when the market became convinced that appreciations of foreign currencies were imminent. Larger-than-usual outflows, or smaller inflows, of private capital were recorded in all major categories.

Recorded outflows of U.S. private capital reached about $10 billion—some $3 billion larger than in 1970 and more than double the average of the 1960's. Outflows for direct investment rose, reflecting both a further increase in outlays for foreign production facilities and an extension until the end of February 1972 of the requirement to meet the ceilings for 1971 under the direct investment controls. Net additions to foreign assets reported by U.S. banks rose sharply to about $3 billion, as relatively higher interest rates abroad focused demands for funds on the U.S. market. The exemption of export credits from the voluntary ceilings toward the end of the year may also have led to increased foreign lending. Foreign claims reported by U.S. nonbank institutions also rose, but it is believed that many of the transactions affecting the foreign assets of U.S. corporations and of other investors other than banks were of types that are not captured by the statistical reporting system, and are therefore reflected in the residual "errors and omissions" in the balance of payments accounts.

The recorded inflow of foreign private capital (apart from liquid assets in U.S. banks) dropped sharply from $5 billion in 1970 to only about $2 billion in 1971. Foreign investors had placed substantial amounts in U.S. direct investments and corporate stocks in 1970, but under the pressures of exchange rate uncertainties and a weak U.S. economic performance in 1971, such inflows ceased, and at

times there were sizable net outflows. Borrowing abroad by U.S. corporations to finance overseas direct investment or for other purposes also diminished in 1971.

U.S. banks further reduced their borrowings from the Euro-dollar market in 1971, as the increase in the cost of funds in that market relative to costs in the United States outweighed the advantages of retaining the reserve-free Euro-dollar borrowing bases established by the Federal Reserve with a view to moderating the liquidation of such borrowing. By the end of the year borrowings of U.S. banks from their foreign branches as registered in the U.S. balance of payments accounts had dropped to $1.3 billion, a reduction of $5.0 billion for the year and $14.1 billion from the peak in October 1969. U.S. Government securities that had been offered to the branches at attractive rates earlier in the year in order to slow the pace of the withdrawal of funds borrowed abroad were allowed to run off after mid-August.

In addition to the net recorded outflow of U.S. and foreign private capital in 1971—which aggregated about $15 billion—the unrecorded payments element in the U.S. international accounts rose to more than $9 billion. The combined total of $24 billion was about $15 billion greater than the comparable figure for 1970. Such unrecorded net outflows reached their peak in the period of hectic speculation preceding the August 15 measures taken by the United States.

YEAR-END PERSPECTIVE

As 1972 began, the events of 1971 clearly had set in motion strong forces tending to restore equilibrium in the U.S. balance of payments. The exchange rate realignments achieved in December were substantial, and they could be expected over time to move the trade balance into a surplus position more in accord with the normal role of the United States as a supplier of real resources to less wealthy countries. Moreover, such a realignment of rates should also have favorable effects on capital transactions—reducing the incentives for outflows of U.S. capital and restoring the basis for resumption of sizable inflows of foreign investment capital to the United States. In addition, impetus has been given to work on remodeling the structure of the international monetary system—especially regarding the management of international reserves and the process for adjusting ex-

change rates—so that the system will be less crisis-prone and more capable of making the timely adjustments required to avoid persistent deficit or surplus positions among countries.

There can be little doubt that the process of strengthening the U.S. trade and payments balances will take considerable time. It will probably be a year or more before there are clear signs that the necessary adjustments in basic transactions are taking place. Such adjustments are slow to develop even under the best of conditions, and in 1972 they will probably be further delayed by a faster growth of demand for goods and services in the United States than elsewhere. Consequently, there should be no cause for undue concern if the U.S. deficits are not quickly reversed. On the other hand, restoration of a secure equilibrium will require the pursuit of active policies both here and abroad to foster noninflationary economic growth and to accommodate the necessary redistribution of trading surpluses and deficits. □

This material will appear as Part 1 of the Board's
ANNUAL REPORT for 1971.

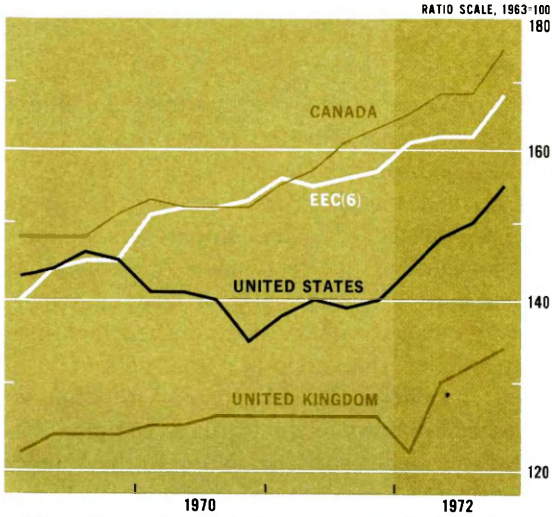
U.S. Balance of Payments

Attention was focused in 1972 on the lack of progress toward equilibrium in the U.S. balance of payments after the realignments of exchange rates agreed to at the Smithsonian meeting in December 1971. The year was relatively free of hectic speculative activity, but pressure on the pound sterling at midyear led to the temporary abandonment of a fixed rate for that currency and a renewal of speculative flows into some other European currencies. Also, a large and persistent flow of funds to Japan, coupled with an undiminished Japanese trade surplus, enormously swelled that country's international reserves. Though there were large inflows of foreign capital to purchase U.S. securities, and some sizable inflows of liquid funds at times, for the year as a whole there was no significant repatriation to the United States of the capital that had moved to other currencies in 1971.

The failure of such a return flow to materialize reflected in part the relatively higher levels of interest rates abroad, especially in the early months of the year, and in part the continuing uncertainty about the eventual effects upon U.S. exports and imports of the exchange-rate changes of 1971. After early 1972, exchange rates against the dollar of the currencies of most industrial countries remained above their central rates or parities, and many countries adopted controls or various types of special reserve requirements or other barriers to protect them from large inflows of foreign capital.

Soon after the end of 1972 exchange markets became increasingly unsettled, as the extent and persistence of the large U.S. deficit and the counterpart surpluses of some other countries were more clearly perceived. Speculation against the dollar in favor of other currencies, primarily the German mark and the Japanese yen, rose dramatically in late January and early February of 1973. In the light of these conditions, and because of the need to achieve a speedier adjustment of the underlying imbalance in U.S. international transactions, the President announced on February 12 that he would request Congress to authorize a devaluation of the dollar by 10 per cent. This step was taken in consultation with other countries and in the expectation that its effects on the exchange rates for the dollar in terms of the cur-

20. INDUSTRIAL PRODUCTION



NOTE.—Seasonally adjusted quarterly data from the Organization for Economic Cooperation and Development. Data for fourth quarter of 1972 partly estimated.

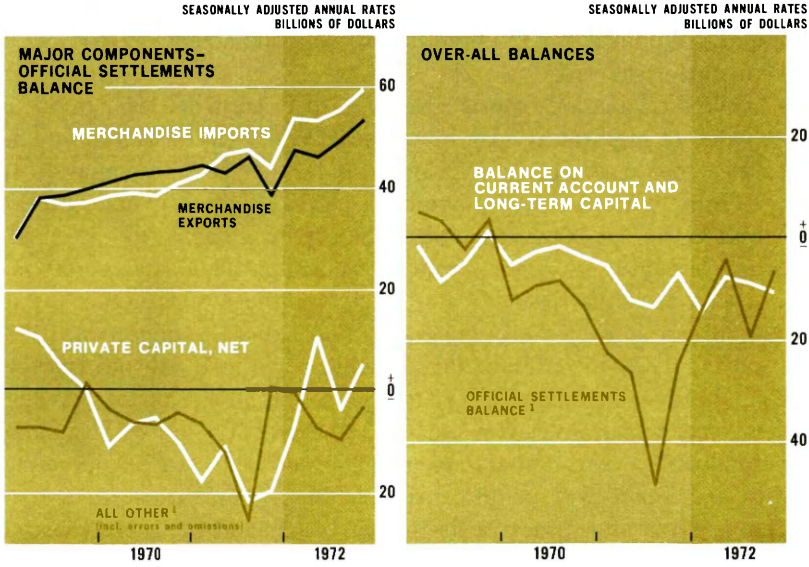
rencies of other industrial countries would in general not be neutralized by other par-value changes. The Japanese yen was allowed to float, and it quickly appreciated by about 16 per cent relative to the U.S. dollar.

In the course of 1972 economic activity rose in most industrial countries but lagged somewhat behind the upswing in the U.S. economy. In a number of European countries price inflation was accelerating early in the cyclical advance. Monetary restraint was commonly adopted as a countermeasure, and several countries moved to offset interest-induced inflows of funds through special controls or reserve requirements. In the United States also, short-term interest rates were rising, as demand in most sectors of the private economy strengthened rapidly.

A large over-all deficit was registered in the U.S. balance of payments in 1972, but it was not swollen by an enormous net outflow of capital as had happened the year before. In terms of official settlements, the deficit for the year was $10.8 billion (apart from SDR allocations) compared with more than $30 billion in 1971. The bal-

ance on current account and long-term capital (the so-called basic balance) probably registered a deficit somewhat greater than the $9.3 billion deficit of 1971. There were divergent swings in the current-account and capital-account components of the basic balance: The balance on goods and services worsened by about $5 billion in 1972, to a deficit of about $4.5 billion, while net long-term capital flows probably improved by a somewhat smaller amount.

21. U.S. BALANCE OF PAYMENTS



[1] Excludes SDR allocations.

GOODS AND SERVICES

A number of factors combined to push the U.S. trade balance to a deficit of $6.8 billion in 1972—about $4 billion larger than the one in 1971. The major influence was the rapid rise of economic activity here in advance of similar developments abroad. In addition, prices of U.S. imports rose sharply, responding to both the devaluation and the general increase in world prices, while export prices in terms of dollars increased much less. These changes in relative prices were

only just beginning in 1972 to yield the reallocations of production and consumption patterns necessary to halt the worsening trend in the U.S. trade balance that had been developing since 1965.

The strongest feature of U.S. export performance in 1972 was the rise in shipments of agricultural products—from $7.8 billion in 1971 to a total of $9.5 billion. By the last quarter of 1972 such shipments were at an annual rate of $11 billion, reflecting the shortage of these commodities in Russia and other countries and a very rapid rise in their prices. Sales of agricultural products in 1973 are expected to continue at a very high rate. Exports of machinery and industrial supplies, supported by the build-up in economic activity abroad, were rising during the year.

While the value of exports rose by 14 per cent from 1971 to 1972, the value of imports rose by 22 per cent. Prices (as measured by unit values) rose 3 per cent for exports and 7 per cent for imports. In real terms, imports rose by about 14 per cent, about double the rise in real GNP, a typical reaction of imports to a sharp step-up in demand. Increases in imports were registered in all major commodity groups; a particularly significant feature was the acceleration of petroleum imports from $3¾ billion in 1971 to $4¾ billion in 1972.

During 1973 the trade balance should begin to benefit measurably from the devaluation of 1971; the net effects of the further realignment of exchange rates early in 1973 will probably not be large until the following year. Other strong influences will also be operating. Most important will be the evolution of demand pressures and of relative costs and prices in the United States and in other industrial countries. This factor will be helpful if this country can continue to moderate inflationary pressures, and if other countries move steadily toward reasonably full utilization of their productive capacity. The United States will also need to compete more effectively for the trade of nonindustrial countries, many of which will be able to increase their imports in 1973 on the strength of their reserve gains in recent years and of a continuing rise in demand for their exports.

There was some reduction in the surplus in the nontrade elements of the U.S. current account in 1972. Part of this resulted from smaller net receipts of investment income, as interest payments to foreigners —mainly interest paid to foreign official holders of claims against the United States—rose faster than receipts from U.S. direct investments

abroad. There was also an increase in net U.S. military expenditures as military sales fell off.

CAPITAL FLOWS

In 1972 the net outflow of long-term private capital from the United States was probably less than $1 billion—a striking shift from the recorded net outflow of more than $4 billion in 1971. One change between the two years was in direct-investment outflows, which apparently declined from their record high in 1971. A striking feature of developments in 1972 was the upsurge in foreign purchases of U.S. corporate securities. For the year as a whole such purchases totaled some $4.5 billion, including $2.4 billion of corporate stocks purchased in U.S. markets, of which $1 billion came in the fourth quarter, and $2 billion of debt issues offered by U.S. corporations in foreign markets, mainly to finance direct investments abroad.

Net outflows of U.S. Government grants and credits were somewhat less in 1972 than in 1971, but they were rising at the year-end and they will probably be considerably larger in 1973.

Table 11: U.S. BALANCE OF PAYMENTS

In billions of dollars, seasonally adjusted

Item	1971	1972 e	1972			
			I	II	III	IV e
Merchandise trade balance	**−2.7**	**−6.8**	**−1.7**	**−1.9**	**−1.6**	**−1.6**
Exports	42.8	48.8	11.8	11.4	12.3	13.3
Imports	45.5	55.7	13.5	13.4	13.9	14.9
Services, remittances, pensions, net	1.9	.8	.1	−.0	.3	.3
U.S. Govt. grants and credit, net	−4.4	−3.6	−.9	−.6	−.8	−1.2
Long-term private capital, net	−4.0	−.6	−1.0	.8	−.1	−.1
Balance on current account and long-term capital	**−9.3**	**−10.2**	**−3.6**	**−1.8**	**−2.2**	**−2.6**
Nonliquid short-term private capital, net	−2.4	−1.5	−.5	.6	−.5	−1.0
Errors and omissions	−11.0	−2.8	.8	−1.1	−1.9	−.6
Liquid private capital, net	−7.8	3.7	−.1	1.4	−.2	2.6
Of which: Liabilities to foreign commercial banks	−6.9	3.9	.5	1.0	.3	2.1
Official settlement balance (excluding SDR allocations)	**−30.5**	**−10.8**	**−3.4**	**−1.0**	**−4.8**	**−1.6**

e Fourth-quarter data partly estimated.

NOTE.—Dept. of Commerce data with some F.R. estimates. Details may not add to totals because of rounding.

Recorded flows of private short-term capital in 1972 were inward, on balance, in contrast to a net outflow of more than $10 billion in 1971. Whereas in 1971 there had been an outflow of nearly $7 billion to commerical banks abroad when U.S. banks repaid all but a relatively small part of their borrowings in the Euro-dollar market, in 1972 there was a sizable inflow as the U.S. agencies and branches of foreign banks brought in short-term funds from abroad. (The agencies and branches of foreign banks are not subject to the same reserve requirements on their liabilities to foreigners as are banks that are members of the Federal Reserve System).

Large swings in the "errors and omissions" item in the accounts provide a crude indicator of flows of funds in response to speculative pressures. Apart from such flows this balancing item is usually negative, and its normal level in recent years has been around $1 billion. According to early estimates, the balancing item in 1972 was larger than normal, but far smaller than the $11 billion figure for 1971, most of which had represented capital outflows through unrecorded hedging and through leads and lags in commercial payments.