FEDERAL RESERVE BULLETIN

VOLUME 37 | March 1951 | NUMBER 3

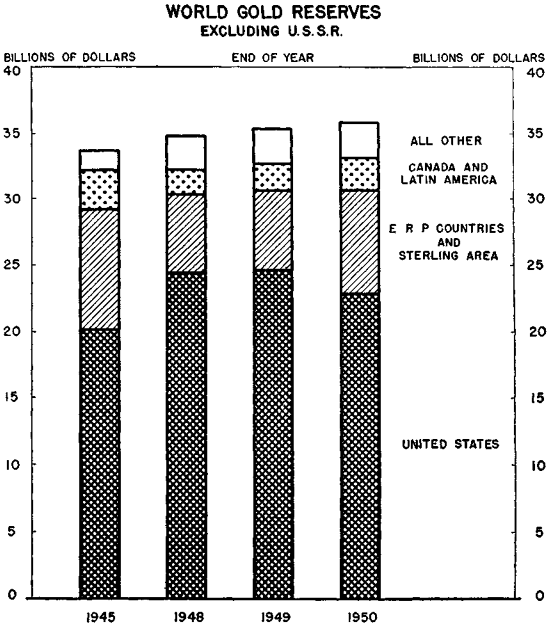
THE INTERNATIONAL MOVEMENT OF GOLD AND DOLLARS IN 1950

In contrast to the earlier postwar years, there was a sustained recovery in the gold and dollar holdings of foreign countries throughout 1950. This development, which was already under way as the year opened, was the result of three factors: a sharp decline in the United States export surplus which had begun in mid-1949; foreign financial assistance by the United States that considerably exceeded its export surplus; and a flow of private capital from the United States which was temporarily enlarged in the third quarter of the year.

The shift in the international financial position of the United States permitted foreign countries generally to increase their monetary reserves, which had been seriously depleted in the period from the end of the war to the widespread currency realignment of the autumn of 1949. By the end of 1950, total foreign holdings of gold and dollars (exclusive of the U.S.S.R. gold reserves) amounted to approximately 19 billion dollars, 4.4 billion more than in September 1949 but still less than the amount at the end of 1945. While most countries shared in this increase in reserves, the rise was particularly notable in the case of the United Kingdom, and served to strengthen confidence in sterling.

The increase in foreign gold reserves was accompanied by a decline in the gold stock of the United States. Despite large sales to foreign monetary authorities, our gold stock remained near its highest levels, both in absolute amount and in relation to the rest of the world.

In an important sense, the increase in monetary reserves abroad is a reflection of the extent to which foreign countries have recovered from the war, since it indicates that the most urgent requirements for imported goods have been satisfied. In the early postwar years, these countries not only spent their current gold and dollar receipts on goods and services but also liquidated a large portion of their accumulated



holdings. The sharp reversal of this trend since the middle of 1949 is a clear indication of the great improvement in economic and monetary conditions abroad since the critical period of 1945-47. The increase in monetary reserves has made possible significant progress toward the relaxation of restrictions on trade and payments, including in certain cases restrictions on dollar transactions.

The outflow of gold and the accumulation of dollars by other countries would, under different conditions, have had a decidedly restraining effect on monetary and credit expansion in the United States. Under the conditions prevailing, however, the banking system was in a position to replenish the reserves lost through the transfer of funds to foreign countries by selling Government securities to the Federal Reserve System, thereby avoiding the significant restriction on credit availability that would otherwise have occurred.

Movement of Gold and Dollars

The year 1950 was the first full year since the war in which there was a net gold outflow from the United States. From the end of 1945 up to the late summer of 1949, this country steadily received gold from abroad in exchange for goods and services which in large part were available only in the United States and for which most countries had no other means of payment. During this period the gold stock of the United States increased by almost 5 billion dollars, or from 20.1 billion at the end of 1945 to a peak of 24.8 billion in August 1949. The latter month marked the turning point; a decline of more than 200 million dollars by the end of 1949 was followed by a further reduction of 1.7 billion dollars during 1950 to a level of 22.8 billion. The decline has continued during the early part of 1951. Notwithstanding the outflow, the gold stock of the United States at the end of the year was still above the 1945 level and represented about two-thirds of the gold reserves of the entire world, excluding the U.S.S.R., as is shown in the chart on the preceding page. Sales of gold by the United States to foreign countries during 1950 are shown in the accompanying table.

With few exceptions, foreign countries used only part of their net dollar accruals for the year as a whole to buy gold. However, reported statistics indicate that in the third and fourth quarters gold purchases by the United Kingdom exceeded its current dollar receipts and that in the fourth quarter gold purchases by the Netherlands and Canada were also accompanied by reductions in their dollar balances.

Net Foreign Purchases of Gold From the United States During 1950[1]

[In millions of dollars]

Area and country	Jan.-Mar.	Apr.-June	July-Sept.	Oct.-Dec.	Year
ERP countries (other than United Kingdom):					
Belgium	35	20	......	3	58
France	......	......	29	56	85
Netherlands	......	......	......	80	80
Portugal	......	......	......	15	15
Sweden	......	3	16	4	23
Switzerland	13	......	25	......	38
Other ERP countries	2	......	......	12	14
Bank for International Settlements	13	12	6	34	65
Total	63	35	75	205	378
Other Continental Europe	−3	......	−9	1	−11
United Kingdom	80	......	580	360	1,020
Union of South Africa	−4	−9	......	......	−13
Canada	......	......	......	100	100
Latin America:					
Colombia	10	......	......	......	10
Cuba	......	......	−8	−20	−28
Mexico	16	......	40	62	118
Uruguay	12	2	24	27	65
Other Latin America	......	1	......	6	7
Total	38	3	56	75	172
Asia:					
Indonesia	......	......	10	20	30
Other Asia	1	......	5	4	9
Total	1	......	15	24	39
Egypt	27	3	15	......	45
Total	202	32	732	764	1,730

[1] Minus sign indicates net sale to the United States.

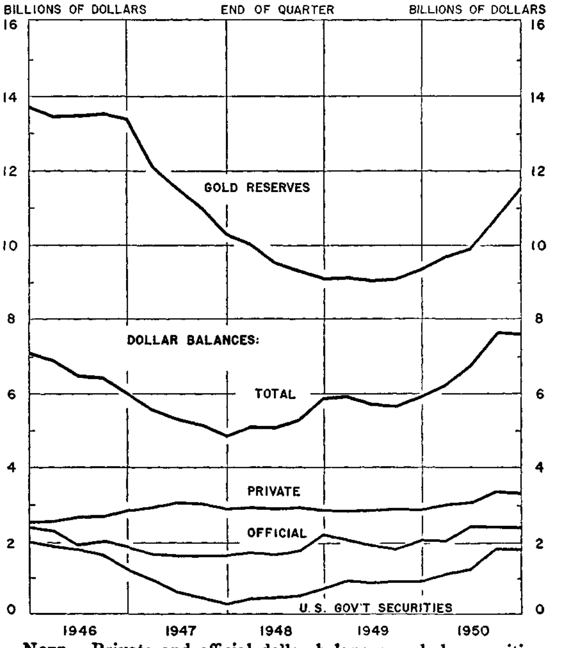
The international and domestic implications of the reversal in the flow of gold cannot be determined without reference to the accompanying changes in foreign holdings of dollars—liabilities due by the United States (banks and Government) to foreigners. In 1950 foreign countries improved their dollar positions to such an extent that in addition to the acquisition of 1.7 billion dollars in gold from the United States, their total dollar holdings (private and official) increased by about 1.6 billion, as shown in the table on the following page. At least 1.2 billion of this increase was recorded in foreign official accounts. Appropriate adjustments of reported private balances (to exclude certain British trust funds reported in August 1950 for the first time and to shift certain Japanese balances technically reported as "private," though in reality of an official character) lead to the conclusion that the increase in foreign dollar holdings over the year was entirely accounted for by increases in official reserves.

Of the total reported increase in official dollar holdings (1.2 billion dollars), about 900 million dollars was invested in United States Government securities with maturities up to 20 months. About 100 million dollars was added by foreign monetary authorities to their deposit accounts with Federal Reserve Banks, and the balance (200 million dollars) remained in foreign accounts with commercial banks.

Changes in Foreign Reserve Positions

In addition to the growth of 1.6 billion in their dollar holdings and gold purchases of 1.7 billion dollars from the United States, foreign countries as a whole added about 400 million dollars of newly mined gold to their reserves in 1950. Thus foreign gold reserves rose during the year by an estimated 2.1 billion dollars and the combined increase in foreign gold and dollar holdings from all sources was 3.8 billion dollars. At the end of the year, however, foreign gold and dollar resources were still 1.7 billion dollars below the level of 20.8 billion at the end of 1945. The proportion of gold to total gold and dollars held by foreign countries at the end of 1950 was almost identical with that at the end of the preceding year (60 per cent as compared with 61 per cent) and was below the proportion at the end of 1945 (66 per cent).

FOREIGN GOLD RESERVES AND DOLLAR BALANCES



NOTE.—Private and official dollar balances exclude securities. United States Government securities with maturities up to 20 months are shown separately.

The increase in the combined gold and dollar resources of foreign countries during 1950 was spread over the year, with a sharp rise in the third quarter. However, the timing of gold purchases from the United States and of changes in dollar holdings differed, as shown in the accompanying chart. Countries accumulated dollars heavily in the first three quarters of the year (almost 1.7 billion dollars), but by the fourth quarter gold purchases exceeded dollar receipts, so that in this period dollar holdings dropped slightly. Foreign gold purchases from the United States did not reach high levels until the second half of the year, in which over 85 per cent of the annual total

ESTIMATED CHANGES IN FOREIGN GOLD RESERVES AND DOLLAR HOLDINGS DURING 1950 [1]

[In millions of dollars]

Area and country	Holdings at end of 1949		Increase or decrease (−)						Holdings at end of 1950 p	
			Jan.-June		July-Sept.		Oct.-Dec. p			
	Gold reserves	Dollar holdings	Gold reserves	Dollar holdings	Gold reserves	Dollar holdings	Gold reserves	Dollar holdings	Gold reserves	Dollar holdings
ERP countries (other than United Kingdom):										
Austria	50	42	....	−7	....	1	....	5	50	40
Belgium-Luxembourg (and Belgian Congo)	754	158	−37	−4	−59	8	−9	24	649	187
Denmark	32	38	−1	−2	....	1	....	9	31	45
France (and dependencies)	[2] 543	196	....	47	....	29	....	12	[2] 543	285
Germany (Federal Republic of)	....	149	....	78	....	59	....	−65	....	222
Italy	252	298	....	−18	....	24	....	4	252	308
Netherlands (and Netherlands West Indies and Surinam)	219	196	36	59	....	29	79	−61	334	224
Norway	51	69	−1	−3	....	13	....	−37	50	43
Portugal (and dependencies)	190	44	−1	−6	....	7	15	7	204	52
Sweden	70	90	1	23	16	−3	3	4	90	114
Switzerland	1,504	517	55	78	−30	5	−59	−50	1,470	550
Turkey	154	10	−5	3	−3	−1	4	3	150	14
Other ERP countries and accounts [3]	256	117	63	29	40	−18	92	126	451	254
Total	4,075	1,925	110	277	−36	154	125	−19	4,274	2,338
Other Continental Europe [4]	489	109	−7	−5	−9	−10	2	−6	475	88
Sterling area:										
United Kingdom	1,350	574	350	339	700	[5] −208	500	−44	2,900	662
U. K. dependencies	....	103	....	24	....	−18	....	−3	....	105
India	247	63	....	−13	....	5	....	....	247	56
Union of South Africa	128	6	49	9	2	19	18	12	197	46
Other sterling area [6]	157	59	1	−14	1	−3	....	3	159	46
Total	1,882	806	400	345	703	[5] −206	518	−31	3,503	914
Canada	496	869	25	114	33	608	36	−192	590	1,399
Latin America:										
Argentina	216	201	....	36	....	31	....	33	216	302
Brazil	317	193	....	−68	....	62	....	39	317	226
Colombia	52	86	16	−32	3	12	3	−13	74	53
Cuba	299	164	....	73	−8	23	−20	−2	271	259
Peru	28	53	....	−3	....	8	3	2	31	60
Uruguay	178	58	11	8	28	8	27	4	244	78
Venezuela	373	143	....	−27	....	−15	....	−20	373	82
Other Latin America	192	503	20	−41	44	40	98	21	354	522
Total	1,655	1,401	47	−53	67	169	111	65	1,880	1,582
Asia:										
Indonesia	178	16	....	26	10	31	20	42	208	115
Japan	162	215	−34	124	....	59	....	61	128	459
Philippine Republic	1	297	1	−6	1	27	....	57	3	375
Other Asia	401	243	−30	−18	−8	21	−10	−5	353	242
Total	742	771	−63	127	3	137	10	155	692	1,190
All other countries	56	84	30	3	14	6	....	8	100	102
Total	9,395	5,965	542	809	775	[5] 859	802	−20	11,514	7,612

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[1] Dollar holdings include private and official balances as well as holdings of U. S. Government securities with original maturities of up to 20 months.

[2] Includes gold reserves of Bank of France and French dependencies only.

[3] Includes holdings of Bank for International Settlements (both for its own and European Payments Union account), gold to be distributed by Tripartite Commission for Restitution of Monetary Gold, and other unreported holdings of ERP countries.

[4] Excludes gold reserves of, but includes dollar balances held by, the U.S.S.R.

[5] If allowance were made for private British balances reported in this period for the first time, the decrease for the United Kingdom would be greater, and the increase for the total would be smaller.

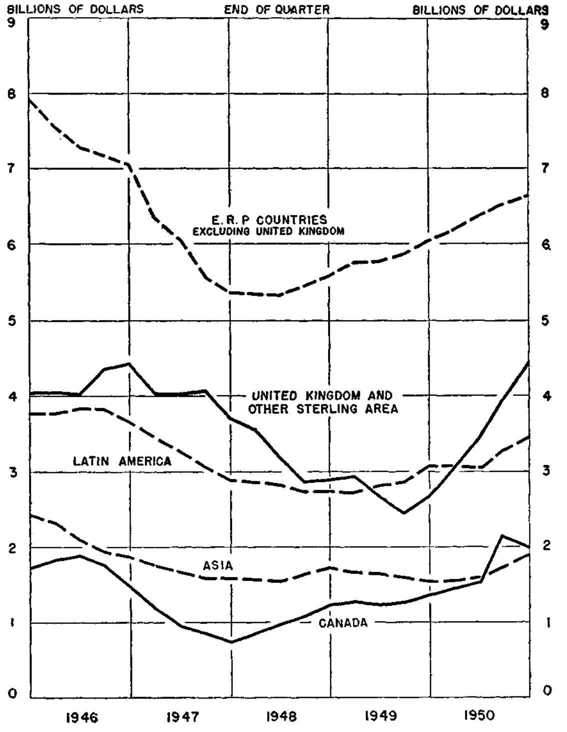
[6] Excludes Eire and Iceland, which are included under "Other ERP countries and accounts."

was concentrated. Whereas only 235 million dollars of gold was bought during the first six months of 1950, the figure rose to 730 million in the third quarter, and to 765 million in the last three months of the year. In effect, foreign monetary authorities in the first part of the year were accumulating dollars which they later converted into gold; in the latter part of the year this conversion into gold exceeded current dollar accruals and began to cut into previously accumulated holdings.

Improvement in the gold and dollar positions abroad was widespread in 1950, as shown in the accompanying table and chart. Only a few countries, including Belgium, Norway, and Venezuela, failed to add to their holdings. Almost two-thirds of the over-all increase was concentrated in the United Kingdom and Canada. These two countries, however, distributed their gains differently. The United Kingdom converted practically all its current dollar receipts (1.0 billion dollars) into gold, in addition to obtaining another estimated half billion dollars in gold from other sources. On the other hand, Canada's gold reserves increased by only 100 million dollars in this period, while its dollar balances rose by over 500 million and were largely invested in United States Government securities.

Continental countries participating in the European Recovery Program purchased about 380 million dollars in gold from the United States during 1950 (of which about 200 million was included in monetary reserves) and added about 400 million to their dollar balances. Latin American countries, chiefly Mexico, purchased about 175 million dollars of gold from the United States and also added to their reserves some gold from new production. Their dollar balances rose by 180 million dollars, accounted for largely by Argentina and Cuba.

FOREIGN GOLD RESERVES AND DOLLAR BALANCES
SELECTED COUNTRIES AND AREAS



Indonesia, Japan, and the Philippines were the Asiatic countries with the most significant gold and dollar increases, totaling about 400 million dollars. Indonesia converted about a quarter of its total gain of 130 million dollars into gold; the other countries maintained theirs in the form of dollar balances.

Causes of the Reversal in Gold and Dollar Movement

The basic cause of the outflow of gold and the rise in foreign dollar balances in 1950 was a further decline in the United States export surplus combined with a continued flow of United States Government aid. The export surplus (including services) dropped from 6.2 billion dollars in 1949 to about 2 billion in 1950, reflecting improvement in the economic and competitive position of foreign countries and also the emergence of sellers' markets for many raw materials produced abroad. Accompanying this reduced export surplus was a net extension of United States Government aid of 4.1 billion dollars, primarily to Western European countries. While this represented a considerable reduction from the 1949 total aid of 5.9 billion, the amount nevertheless exceeded the over-all export surplus by about 2 billion dollars. Without this net outlay of dollars, the bulk of the growth in foreign gold and dollar resources could not have taken place.

It should be noted that the figure of 4.1 billion dollars, representing the net utilization of United States foreign aid, does not reflect fully the reduction in allotments under the European Recovery Program that were made possible during 1950 as conditions abroad improved. Owing to a lag between allotment of funds and actual flow of goods, the effects of these reductions will be felt mainly during the course of the current year. On the other hand, the 1950 aid figures include only a comparatively small portion of the defense assistance that is projected under the Mutual Defense Assistance Program.

Another factor which helped to finance the export surplus, and contributed to the increase of foreign gold and dollar holdings, was an estimated 1.4 billion dollars made available to foreigners in 1950 through private financial transactions. Of this amount about 1 billion represented direct investments and loans, including certain special transactions such as a 225 million dollar loan extended to France by private American banks. The remaining 400 million represented private donations.

During the second half of the year, and especially in the third quarter, the movement of private funds from the United States included some speculative capital, particularly to Canada and the sterling area, and in smaller amounts to Latin America. The extent and significance of this outflow was greatly exaggerated in some press comments. Reports of "capital flight" in the second half of 1950 often confused transfers of American and other dollar funds with movements of nondollar funds from Europe. Also, they often confused current account payments with capital transactions and failed to distinguish between bona fide foreign investment and the speculative movements of funds.

There was a heavy flow of American funds to Canada in the third quarter of 1950. Canadian holdings of United States dollars rose by 600 million dollars in a period of three months, a much larger expansion than can be accounted for by trade and service transactions. The flow was to a considerable extent connected with anticipated changes in the value of the Canadian dollar. A substantial part of the flow appears to have represented advance purchases of Canadian dollars by American companies projecting future investments in Canada. Of the remainder, much of which arose from speculation with the object of obtaining an exchange profit, some part may eventually find its way into long-term investment in Canada. There was only a small return flow of dollars to the United States in the latter part of 1950 after the unpegging of the Canadian currency.

There was also an unusual demand for sterling during the autumn of 1950, part of which appears to have originated in Canada as well as in the United States. Some of this demand accompanied unfounded rumors of sterling appreciation, but the major portion probably resulted from the rapidly expanding purchases of raw materials from the sterling area. Speculation on sterling revaluation subsided toward the end of the year.

The movement of funds to Latin America arose from a variety of motives. American venture capital was attracted by the developing boom in a number of countries, especially Mexico. It appears that the flow of funds also involved substantial amounts of foreign-held (e.g., European) dollar balances; such transfers altered the distribution of dollar assets among foreign holders but did not, in themselves, affect the aggregate amount. In addition, there was probably also a movement of nondollar capital from Europe to the Western Hemisphere.

The nature and extent of the outflow of private capital in 1950 should be evaluated in the light of the over-all balance-of-payments position of the United States, and reactions abroad to economic trends in this country. The bulk of the accumulation of gold and dollars by foreign countries in 1950 was the result of a shift in the trade balance and of continued American aid. The net gain in dollar balances was approximately equal to the net gain in gold, with varying degrees of preference among foreign monetary authorities between the two forms of holdings. At the same time, however, the outflow of private capital, whether from European or American sources, was apparently motivated in part by fears of further deterioration in the international situation as well as by inflationary developments in the United States.

Effect of Improved Reserve Positions On World Trade

The marked recovery in foreign gold and dollar reserves during 1950 from the very low levels of the preceding years may be regarded primarily as a reflection of improved economic conditions abroad and of the success of the American foreign-aid program. The fact that foreign reserves have increased is an indication that foreign countries as a group, though not necessarily individually, have recovered from the war to the point where gold and dollars are valued more highly as reserves than as an immediate claim for additional goods and services.

The rise in monetary reserves has made possible significant progress toward a more liberal system of international trade, based on general convertibility of currencies and freedom from restrictions, particularly discriminatory restrictions, on trade and payments. The freer movement of goods and services which has thus been attained has helped to bring about a more effective use of world resources and higher levels of production.

Partly as a result of increased reserves, countries participating in the European Recovery Program have taken steps to remove by stages most of their restrictions on intra-European trade and payments. Their latest goal, announced in October 1950, is to eliminate quantitative restrictions on 75 per cent of private intra-European trade (as measured by 1948 statistics). In recent months other countries, including Brazil, Canada, India, Indonesia, Mexico, and Peru, have partially relaxed their restrictions on dollar trade and payments.

These measures represent progress toward the objectives which the United States Government, both within and without the International Monetary Fund, has long advocated. In December 1950 the United States position was reiterated at the conference on the General Agreement on Tariffs and Trade held at Torquay, England. At this conference the United States representative supported the view that countries experiencing a marked improvement in monetary reserves should relax restrictions on trade and payments in so far as this is consistent with considerations of mutual defense.

The primary objective of trade liberalization—to achieve a more effective use of world resources—has become even more important in view of the large-scale diversion of resources which the mutual defense effort will require. The relaxation of trade restrictions can make a positive contribution to mutual defense by making it possible for countries participating in the common effort not only to obtain goods from the cheapest source, but at the same time to acquire goods necessary for the productivity and morale of civilian populations. Such goods may rank second in importance only to basic military necessities, and to the extent that they can be obtained from countries which are not in a position to undertake a high degree of mobilization, the result may be a substantial contribution to the defense effort.

Recent trade developments indicate that the more realistic exchange rates established in 1949 have brought about a more balanced pattern of trade between the United States and the rest of the world. Where a country is in a position to obtain goods either from the home market or from third countries at prices and terms competitive with American goods, it can remove its restrictions on dollar imports without increasing its purchases from the United States. In the case of strategic materials, however, the demand is likely to be determined by considerations other than price. Nonetheless, it may be observed that, from the viewpoint of the United States, the mere existence of legal restrictions on import transactions abroad does not protect this country from an increased external demand for scarce items. Since import and exchange restrictions are maintained in the interest of the protected country, such restrictions cannot be regarded as a satisfactory substitute for an orderly allocation of strategic materials among countries cooperating in the mutual defense effort. In the absence of an allocation system, an increase in the demand for scarce materials arises whenever individual governments enter world markets as buyers on their own account or permit their domestic importers to increase their foreign purchases of critical items.

Finally, the removal of restrictions on trade and payments would contribute to easing inflationary pressures in individual countries, although this may be accompanied by greater inflationary impacts elsewhere. Among the countries participating in the mutual defense effort, the inflationary pressure is likely to be particularly serious in those carrying out a high degree of economic and military mobilization in terms of their own resources. Relaxation of trade restrictions by such countries would reduce inflationary pressures in their economies, and this effect should be considered in evaluating the inflationary impact which may arise elsewhere. Under these conditions, trade liberalization can facilitate a flow of goods consistent with the requirements of mutual defense, at the same time contributing to the over-all financial and monetary stability in the group of countries participating in the common effort.

These considerations suggest that in many cases diversion of resources to defense is not impeded and may actually be facilitated by further trade liberalization. At the same time, it may be noted that where foreign countries are prepared to accept and hold dollar assets in exchange for their goods and services, instead of seeking immediately to purchase American goods, they are reducing the pressure on world resources of the current preparedness effort and demonstrating their growing ability to support themselves independently of material assistance from this country.

Effect of Outflow of Funds on Domestic Situation

The outflow of gold and the increase in foreign dollar balances during the past year operated in a restraining direction on the domestic monetary situation at a time when other influences in the American economy were predominantly inflationary.

As has been shown, international transactions during 1950 resulted in a net over-all transfer of gold and dollars from American to foreign ownership amounting to 3.4 billion dollars. Foreign payments had varying effects on the domestic banking situation, depending on the type of financial transaction to which they gave rise.

When dollar payments are made by Americans to foreign individuals and firms, the typical result in the first instance is a transfer of dollar balances from American accounts in commercial banks to dollar accounts maintained in commercial banks by foreign depositors. This transfer of funds from one commercial bank account to another in itself has no effect on total bank deposits or on total bank reserves.

Generally, however, traditional practices and the existing exchange-control regulations of other countries result in the transfer of dollars obtained by foreign nationals to their central bank against payment in local currency. The fact that total foreign private deposits in recent years have shown little over-all change indicates that by and large foreign commercial banks and business firms maintain only such balances in their dollar accounts as they need for working purposes and turn over all excess dollars to the central banks of their respective countries. In some cases central banks hold dollar balances acquired from their nationals in accounts with American commercial banks; the transfer of funds to these accounts similarly does not affect total deposits or reserves of American banks. More often, however, foreign central banks transfer the dollar balances to their accounts at the Federal Reserve Banks.

It is at this stage that the transfer of funds to foreign ownership has a restraining effect on the domestic credit situation. The withdrawal of funds from the commerial banks, and their deposit with Reserve Banks, involves a corresponding reduction in commercial bank deposits and, more importantly, in commercial bank reserves. Where the amount of reserves maintained by banks against deposits is not greatly in excess of the required amount, a reduction in reserves would cause a contraction in bank lending in an amount substantially greater than the decline in reserves unless the banks re-establish their previous reserve position by borrowing from the Reserve Banks or by selling United States Government securities.

Restoration of reserves by these operations reduces the over-all liquidity of the banking system. In view of their extraordinary liquidity, however, commercial banks during the past year were able to offset the outflow of funds by selling Government securities to the Federal Reserve, and thus did not need to restrict the availability of credit to domestic borrowers.

So far as further effects on bank reserves are concerned, it is immaterial whether the official balances accumulated by a foreign central bank at Reserve Banks are permitted to remain inactive or are used to purchase gold. Foreign purchases of gold with funds drawn from accounts at Reserve Banks are accompanied by a transfer to the Treasury of gold certificates held by the Federal Reserve System. This particular transaction results in a corresponding reduction in the assets and liabilities of Reserve Banks but in no way affects the level of commercial bank reserves.

In addition to purchases of gold, foreign central banks frequently invest dollar balances held at Reserve Banks in short- or medium-term United States Government securities. Foreign purchases of securities in the market, financed by drawing upon balances with Reserve Banks, are equivalent to open market purchases by the System and have the immediate effect of adding to the reserves of commercial banks. However, the net effect on bank reserves, bank deposits, and bank holdings of Government securities of the entire series of transactions—from the initial building up of foreign balances to their final investment in Government securities—is the same as for net purchases of securities from the banking system by domestic nonbank investors. Bank deposits are extinguished as funds are used to purchase securities from banks, thus contracting total bank credit. The total volume of bank reserves is not, on balance, affected by the transactions. In the course of the process, and independently of other operations affecting their position, commercial banks lose reserves at the time the balances are accumulated at the Reserve Banks, and obtain reserves at the time the balances are used to purchase securities in the market.

The effects of the transfer of funds to foreign ownership were obscured during 1950 by other influences operating to expand bank reserves, in particular the large-scale sale of Government securities to the Federal Reserve System. In the circumstances, banks were able through liquidation of some of their Government security holdings to replenish their reserves whenever the withdrawal of foreign balances tended to contract such reserves. However, the over-all liquidity of the banking system was somewhat reduced in the process. While it is impossible to measure the direct effects of these transactions, it may be said that the reversal of the flow of gold and dollars during 1950 was a restraining element in the domestic money market and thus exerted a salutory influence in a period of strong inflationary pressure.