

OCT 14 1965

H. 13

December 8, 1965.

No. 225

CAPITAL MARKET DEVELOPMENTS ABROAD

- I. India
- II. Nine Charts on Financial Markets Abroad
- III. Latest Figures Plotted in H. 13 Chart Series

I. India: Money and Capital Markets--Third Quarter, 1965

During the quarter, India's chronic foreign exchange crisis has become more acute. This was due in part to the failure of a series of measures to reduce the trade deficit and mounting inflationary pressures and in part to adverse developments caused or aggravated by the war with Pakistan.

Moreover, prospects for improvement do not seem bright. A severe food crisis is developing due to unfavorable weather conditions which could further increase demand for food, fertilizer and other agriculturally oriented imports. Since India's exports are mainly agricultural products, the export outlook is also not promising.

Faced with these conditions, the Prime Minister in a nationwide broadcast on October 10 urged his countrymen to disband foodgrains from last year's crop, to consume currently less foodgrains and to produce and export more this year. Nevertheless, foreign exchange difficulties continue to grow as defense and food import requirements rise; as scheduled foreign exchange debt payments increased; and as new foreign aid commitments continue to be postponed pending a review by the World Bank for the consortium of aid-giving countries.

Foreign exchange reserves of the Reserve Bank by the end of September were \$175 million compared with \$205 million a year earlier. The September level was \$13 million higher than at the end of June, but only because of the postponement of a \$25 million debt payment due at the end of September to the International Monetary Fund. Even after drawing from a \$200 million IMF credit, gold and foreign exchange reserves in excess of the legal minimum to back the currency were still equal to less than one week's imports.

Measures to reduce the trade deficit. To reduce further the immediate demand for foreign exchange new import restrictions were imposed. On August 19, an unexpected supplementary budget introduced changes and increases in import duties to cover an anticipated deficit of \$210 million and to encourage import substitutions. Also certain import quotas were eliminated or sharply reduced. Licensing of non-defense imports especially from free foreign exchange were delayed to permit increases in defense imports. Demand for the latter rose because of the war with Pakistan and the suspension of U. S. military aid in September.

To encourage foreign exchange earnings, the government announced that an expanded list of 22 traditional agricultural export commodities shipped after February 28 would begin receiving export tax credits ranging from 2 to 15 per cent from October 1. This will cover about 62 per cent of total exports. In addition, the

OFFICIAL USE ONLY
(Declassified after 6 months)

export promotion scheme for non-traditional or manufactured items previously suspended was reinstated. Since this program covers about 20 per cent of total exports, at least 82 per cent of total exports will be covered by some form of export subsidy.

Despite these measures, the trade deficit may continue to widen. In the April-July period, exports were 8.9 per cent lower than a year ago. Meanwhile imports increased 8.6 per cent. As a result, the trade deficit increased 38 per cent to \$468 million. The war with Pakistan could widen the deficit further as exports are being delayed while scheduled imports continue to arrive.

Moreover, import restrictions may be ineffective because of increases in government imports. In 1964-65 government imports increased 28 per cent to \$1,645 million surpassing private imports for the first time. Government imports were 56 per cent of total imports. Private sector imports decreased for the fourth consecutive year to \$1,286 million.

Foreign exchange earnings. Although export incentives are improved, foreign exchange earnings may not increase. In 1964-65 foreign exchange earnings decreased \$86 million to \$1,260 million because exports to communist bloc countries which pay in rupees increased only slightly. Since the government export subsidy schemes do not discriminate between exports for foreign exchange and local currency, foreign exchange earnings could decrease further this year.

External debt payments in 1964-65 increased \$23 million to \$231 million. This increased the percentage of foreign exchange debt payment to foreign exchange earnings from 16 to 19 per cent. This year, 1965-66, the percentage may increase further as foreign exchange debt payment increased \$57 million (21 per cent) to \$288 million.

In a further move to bolster foreign exchange reserves, the government announced that foreign exchange remittances to Indian citizens from any source would be granted import licenses up to 60 per cent of the amount remitted. Since import licenses may be sold at large premiums in excess of the face amount depending upon the commodity, the effective exchange rate would provide more rupees than the official rate. While the measure was designed to encourage repatriation of foreign exchange holdings at this time, it also set an official precedent recognizing the degree of rupee depreciation which may be difficult to reverse. In addition, the government offered to redeem a new gold bond issue in 15 years with an equivalent amount of gold. So far both programs have not attracted significant amounts of gold or foreign exchange.

Continued inflationary pressures. Although the government planned to balance the budget this year, the accumulation of inflationary pressures remain strong. Prices increased to a seasonal peak by the end of August but began to decline more than seasonally in September despite the war. The index of wholesale prices increased 11 per cent from the seasonal low in March to August compared with 12.5 per cent last year. At the end of August, the index was 6.5 per cent higher than a year earlier. In September, the index decreased 1.3 per cent due to a 4.3 per cent decline in wheat

prices. In part this may reflect initial dishoarding due to advance publicity given to a compulsory foodgrain procurement program at fixed prices, an expansion of foodgrain rationing to all cities of 100,000 population and more and a national campaign to reduce foodgrain consumption by reducing rations.

Prices are not expected to decrease seasonally in the coming months because adverse weather conditions during the sowing season reduced estimates of foodgrain production sharply below the record harvest of 88.5 million tons last year. An unofficial index of wholesale prices has already increased 3.5 per cent from the end of September to mid-November compared with a decrease of 5.3 per cent last year. In addition, substantial price uncertainty exists because food imports under the U. S. PL 480 program have been limited to monthly agreements pending a review of the PL 480 program objectives in India.

Credit developments. The seasonal contraction of money supply is less than expected despite restrictive credit policies. The contra-seasonal increase in credit demand slowed accumulation of deposit resources. As a result, the inter-bank lending rates showed less than the usual seasonal decline. This hindered large bank participation in the government borrowing program. The Reserve Bank had expected that the continuation and increase of restrictive policies in the summer slack season would sharply decrease bank credit and provide resources for the coming busy season. These expectations were not fulfilled and the Reserve Bank continued a complex system of selective credit controls.

On November 23, the Reserve Bank announced that banks could borrow unlimited funds to finance credit for defense, exports and food procurement at the 6 per cent bank rate. However, these borrowings would reduce a bank's net liquidity ratio for other borrowings. For each percentage point below the net liquidity ratio of 30 per cent, the borrowing rate on all other borrowings would be increased 1 percentage point over the bank rate. Also, loans of Rs. 10 million or more are subject to individual approval by the Reserve Bank. Since the bank lending rate is still limited to 10 per cent, the banks appear to have less flexibility in granting non-essential credits. However, it will be difficult to limit borrowings at the bank rate to an anticipated Rs. 1,000 to Rs. 1,200 million of an estimated total of Rs. 2,000 million not only because of the difference in borrowing rates but because the limits of defense, export and food credits will be difficult to define.

The consequences of increasing restrictive policies are reflected in the continuous decline in stock prices and a lack of investor interest in new capital issues. Also, the rate of increase in industrial production is expected to decrease further this year due to the drastic reduction of maintenance imports and a severe power shortage due to inadequate rain. In 1964-65, the rate decreased sharply to 6.4 per cent from 9.1 per cent. In the June-August period industrial production decreased 3.1 per cent compared with a slight increase last year. To spur industrial production this year, the government is offering various tax credits to certain industries for production in excess of last year's output.

Money market. The average day-to-day inter-bank rate in Bombay decreased 2.39 percentage points to 5.49 per cent from the second to the third quarter. (See Table 1). However, this was still 3.27 percentage points higher than a year earlier. The high rate reflects the impact of restrictive credit policies in the slack season and an increase due to the war with Pakistan in September.

In July and August, the rate increased seasonally from a low of 3.40 per cent to 5.44 per cent. By the third week of September the rate increased to 9 per cent. After the ceasefire in late September the rate decreased sharply to 5.90 per cent by the first week of October. This was still extraordinarily high compared to 1.31 per cent a year earlier.

From July 12, 1965, the Reserve Bank discontinued the weekly auction of Treasury bills and sales of intermediate Treasury bills. Thereafter, the Reserve Bank began to sell Treasury bills at fixed discounts of 3.50 per cent. (See Table 2). This action eliminates money market influences on the Treasury bill rate. However, the rate could be changed because the Reserve Bank also manages the public debt.

The total amount of Treasury bills outstanding increased \$269 million or 8.9 per cent from the end of March to September, the first six months of the current fiscal year. At the end of September, the total outstanding was 6.1 per cent higher than a year earlier. Gross sales of Treasury bills to the public were 43 per cent higher in the same period than a year earlier. Sales to state governments and approved bodies which were previously lumped with Reserve Bank purchases are now shown separately. Net Reserve Bank claims on government at the end of August were Rs. 2.28 billion (8.4 per cent) higher than a year earlier and Rs. 1.08 billion (3.6 per cent) higher than at the end of March 1965 the end of the last fiscal year. Unplanned defense expenditures due to the war with Pakistan in September could actually result in substantial deficit financing of government expenditures this year which would increase Reserve Bank claims on government.

Deposit rates. Industrial firms accepting time deposits from the public recently increased rates about 0.5 percentage points. This could be in anticipation of restrictive bank credit policies in the coming busy season. Table 3 indicates the range of non-bank rates for each time period are higher than the corresponding deposit rates of banks. The prime lending rate of banks for unsecured loans is about 9 per cent. Time deposits of non-bank companies amounted to Rs. 1.859 million or 15 per cent of total time deposits of banks at the end of March 1964.

Table 1. India: Bank and Non-Bank Time Deposit Rates
(in per cent per annum)

<u>Deposit Period</u>	<u>Bank Rates</u>	<u>Non-Bank Rates</u>
3 days notice	0.00	4.00 - 4.50
3 months	5.00	5.50 - 7.25
6 months	5.50	6.00 - 9.00
1 year	6.00	7.00 - 10.00

Table 2. India: Inter-Bank Call Money Rates in Bombay^{a/}

Quarterly Averages	1963	1964	1965	Monthly Averages	1964	1965
I	5.64	5.67	5.92	July	1.60	3.93 ^{b/}
II	4.46	5.01	7.88	August	2.37	4.96 ^{b/}
III	2.01	2.22	5.49 ^{b/}	September	2.68	7.57 ^{b/}
IV	2.93	3.04				

Selected Dates - 1965^{b/}

July 2	4.85	August 6	4.69	September 3	5.44	October 1	5.90 ^{b/}
9	3.79	13	5.00	10	8.07	8	7.23 ^{b/}
16	3.40	20	5.00	17	9.00	15	6.46 ^{b/}
23	3.72	27	5.13	24	7.75		
30	3.91						

^{a/} Weekly averages weighted by deposits.^{b/} Provisional.Table 3. India: Treasury Bills and Reserve Bank Claims on Government
(in billions of rupees)

	Average Rate of Discount for Auction Sales in % Per Annum	Gross Sales ^{a/}				Total Reserve Bank Claims on Govt. (Net) at end of Period ^{b/c/}
		To Public	To State Govts. & Approved Bodies	To Reserve Bank	Total Outstanding at End of Period	
<u>1964</u>						
I	2.38	.315		13.54	13.82	26.97
II	3.00	.581		15.16	15.71	28.63
III	2.45	1.163		13.81	14.81	26.86
IV	2.45	1.018		15.26	14.85	28.13
<u>1965</u>						
I	2.91	.369		14.11	14.44	28.55
II	3.50	.584		15.31	15.90	30.41
III	3.50	1.660	2.486	10.81	15.72	29.28
April	3.50	.167		8.67	15.02	30.30
May	3.50	.167		3.57	15.50	30.33
June	3.50	.250		3.08	15.90	30.41
July	3.50	1.122	.306	7.85	16.34	29.83
August	3.50	.315	1.338	2.87	15.88	29.58
September	3.50	.223	.842	.85	15.72	29.28

^{a/} Includes intermediate Treasury bills. From July 12, 1965, the Reserve Bank listed separately sales to state governments and approved bodies. Includes central and state government claims.^{b/} Claims on government net of deposits.^{c/} Provisional or partial.

Banking developments. Despite a continuation of complex restrictive credit measures into the slack season, the Reserve Bank will be unable to achieve its seasonal goal of reducing bank credit and increasing deposits by Rs. 2,000 million each from May to October. (See Table 4). Although the seasonal reflow to banks slowed because of higher slack season credit demands and higher price levels, the war with Pakistan in September actually increased bank credit and decreased deposits. By the end of September, seasonal bank credit contraction was Rs. 1,204 million compared with Rs. 1,397 million last year and deposit expansion was only Rs. 1,468 million compared with Rs. 2,002 million a year earlier.

From April to July, banks used the reflow to pay back record borrowings from the Reserve Bank. In part, this prevented banks from participating heavily in the central and state government borrowing programs in July and August.

The Reserve Bank tried to maintain and add selective credit controls but was forced to withdraw or relax some of them. The 25 per cent advance import deposit scheme imposed in February was adjusted several times but was withdrawn on August 19. A bank's limit on advances secured by wheat was increased from 80 to 100 per cent of advances in August and September last year. Ceilings on unsecured advances imposed on June 29 were subsequently changed and modified but were withdrawn on September 9. The Reserve Bank instructed banks that unsecured advances should not finance speculation.

Credit demand is expected to increase more than seasonally in the coming busy season because of anticipated price rises resulting from declines in foodgrain production. Since bank resources may not be adequate for seasonal needs, banks requested the Reserve Bank to provide a record Rs. 2,500 million at the bank rate which would eliminate a sliding scale of penalty rates based on net liquidity ratios.

On November 23, the Reserve Bank announced the continuation of restrictive policies during the coming busy season. Banks may borrow unlimited funds from the Reserve Bank at the 6 per cent bank rate if the funds are to finance credit for defense supplies, exports or food procurement. These borrowings would, however, reduce each bank's net liquidity ratio for borrowings for other purposes. For each percentage point below the net liquidity ratio of 30 per cent, the rate on all other borrowings would be increased 1 percentage point over the bank rate. Also, individual loans of Rs. 18 million or more are subject to individual approval by the Reserve Bank. Since the commercial bank lending rate is still limited to 10 per cent, the banks appear to have less flexibility in granting credits other than for the three priority reasons.

Table 4. India: Scheduled Banks--Changes in Deposits, Borrowings from the Reserve Bank and Principal Assets
(in millions of rupees)

	Deposits	Per Cent Change	Credit	Per Cent Change	Holdings of Govt. Securities	Per Cent Change	Borrowings from Reserve Bk.	Cash & Bal- ances with Reserve Bk.
<u>1964</u>								
I	291	1.3	2,342	14.8	- 698	- 9.8	745	62
II	1,000	4.4	- 418	- 2.7	153	2.4	- 814	158
III	1,375	5.8	- 699	- 3.9	1,599	24.4	- 3	25
IV	29	0.1	1,069	6.3	- 500	- 6.1	348	8
<u>1965</u>								
I	554	2.2	2,221	12.3	- 453	- 5.9	1,171	16
II	1,273	4.9	362	1.8	71	1.0	- 869	89
III	831	3.1	- 712	- 3.4	1,154	15.9	- 573	18
April	638	2.5	854	4.2	- 4	- 0.1	- 290	3
May	265	1.0	- 219	- 1.0	22	0.3	- 208	82
June	370	1.4	- 274	- 1.3	53	0.7	- 370	11
July	845	3.1	- 439	- 2.1	1,026	14.1	- 564	46
August	446	1.6	- 150	- 0.7	299	3.6	- 3	13
September	- 460	-1.6	- 123	- 0.6	- 172	- 2.0	- 7	51

Comparison of the Slack Season - 1964 and 1965

May -
September

1964	2,002	8.6	-1,397	- 7.6	1,998	32.5	- 437	189
1965	1,468	5.6	-1,204	- 5.7	1,228	17.1	-1,151	62

Central government bonds. Yields on government securities increased most sharply in long-term maturities (0.69 per cent) in the third quarter. (See Table 5). This reflects the recent increase in bank rate and a policy to increase long-term interest rates. The Reserve Bank, which manages the public debt, began to lengthen the maturity structure by purchasing short-dated securities before redemption by offering to sell long-dated issues at fixed prices. On September 21, 1965, the Reserve Bank offered to sell a 3 per cent 21-year conversion bond at Rs. 54.25 which would yield 5.53 per cent. At the same time, it offered to purchase two issues due for redemption in 1966 to 1968. Also, holders of two issues to be redeemed in 1969 and 1970 were offered three issues maturing in 6, 24 and 25 years. To induce these switches to longer-dated securities, the Reserve Bank offered increases in yields up to 1.42 percentage points.

On October 19, the government announced the opening of two new National Defense Loans on October 27. The three year loan at 4.25 per cent interest and the seven year issue at 4.75 per cent are similar to yields of comparable government securities.

State government bonds. On August 28, fourteen state governments completed a Rs. 1,067.4 million borrowing program. The bonds were for 12 years being 5.5 per cent compared to 4.75 per cent last year. Yields varied up to 5.59 per cent because the bonds were priced below par. Since maturing state bonds amount to Rs. 115 million, net market borrowing amounted to Rs. 952.4 million compared with Rs. 853.9 million last year. Press reports indicate that the public purchased the major portion of the issues. Bank purchases were less than previous years and the Reserve Bank did not participate. However, after subscriptions were closed, state bonds were selling at heavy discounts, which increased yields up to 5.80 per cent. The Reserve Bank, commercial banks and other state-owned financial institutions are expected to purchase these state bonds at the higher discounts.

Table 5. India: Yields on Selected Government Securities
(end of period--in per cent per annum)

	<u>Short^a/</u>	<u>Medium^b/</u>	<u>Long^c/</u>
1962	3.89	3.94	4.76
1963	3.89	4.15	4.57
1964	3.81	4.19	4.84
<u>1965</u>			
I	3.81	4.92	5.15
II	4.23	5.21	5.34
July	4.06	5.23	5.53
August	4.06	5.21	5.53
September	4.07	5.25	5.53

a/ 3-3/4 per cent N.P.B., 1968.

b/ 3-3/4 per cent 1974.

c/ 3 per cent 1986 or later.

Stock market. In the third quarter, the price index of variable dividend industrial securities sharply declined 5 per cent. By the end of September the index was 9 per cent lower than a year earlier and 24 per cent below the May 1962 peak.

The sharp decline in stock prices may be due in part to business reaction to additional import restrictions and taxes imposed by the government's supplemental budget measures announced on August 19, 1965, and in part to a continuation of restrictive credit and import policies. Also, the rate of increase in industrial production slowed to 6.4 per cent in 1964-65 from 9.1 per cent a year earlier. The

target rate is 11 per cent. Press reports indicate that the severity of import restrictions increased idle capacity up to 50 per cent in certain industries. Investors' interest not only slackened but shifted from equities to debentures. This has forced unusually large participations by underwriters particularly government owned financial institutions.

Table 6. India: Price Index of Variable Dividend Industrial Securities

<u>Quarterly Averages</u>	<u>1962</u>	<u>1963</u>	<u>1964</u>	<u>1965</u>
I	190.0	167.4	170.4	162.0
II	192.6	162.9	163.7	156.3
III	185.0	162.5	166.0	151.8
IV	173.6	172.7	163.7	

Selected Dates - 1965

July	3	155.9	September	4	150.4
	10	154.7		11	149.6
	17	153.8		18	149.1
	24	154.1		25	149.2
	31	153.6	October	2	148.1
August	7	153.0			
	14	152.1			
	21	150.6			
	28	150.3			

Money supply. The contraction of money supply so far in the slack season (May-September) of 2 per cent is less than the 3.2 per cent decrease for the comparable period last year. (See Table 7). As a result, the monthly annual rate of increase rose from 9.3 per cent in June to 10.6 per cent in September.

The slower rate of decrease in money supply during the slack season reflects the ineffectiveness of restrictive policies and could create favorable conditions for a larger seasonal monetary increase beginning in October. Since the increase in real national income this year is not expected to equal the record increase of 7.5 per cent last year (1964-65), a further increase in money supply for the coming busy season could create additional price increases.

Table 7. India: Money Supply with the Public
(last Friday of the period--in billions of rupees)

	<u>Quarterly Annual Percentage Rates of Change</u>				
	<u>1960-61</u>	<u>1961-62</u>	<u>1962-63</u>	<u>1963-64</u>	<u>1964-65</u>
I	5.5	6.2	8.7	13.4	10.0
II	3.9	7.6	10.4	13.5	9.3 ^a / _a
III	3.4	9.4	12.0	10.7	10.6 ^a / _a
IV	4.8	9.9	13.7	10.1	

TABLE 7 (Cont.)

Month	1964	1965 ^{a/}	Monthly Annual Percentage Rate of Change
April	38.40	41.96	9.3
May	38.38	41.91	9.2
June	38.16	41.72	9.3
July	37.67	41.20	9.4
August	37.66	41.26	9.6
September	37.19	41.12	10.6

^{a/} Provisional.

Wholesale prices. The index of wholesale prices increased 11 per cent from the seasonal low in late March to a high in August compared with 12.5 per cent a year earlier. (See Table 8). At the end of August, the index was 6.5 per cent higher than a year ago. However, during September, an unofficial index declined 3.6 per cent mainly due to a sharp 7 per cent decrease in food prices. This seasonal decrease is about a month early compared with last year.

Press reports speculated that dishoarding caused the early decline in food-grain prices due to discussions concerning compulsory government procurement. The government announced that rationing would begin November 1 in cities with populations of 100,000 and above. In addition, rations may be reduced by varying quantities depending on local food supplies. An initial reduction of 2 ounces per day per adult to 12 ounces was proposed.

The government estimated that foodgrain production for the coming year would be less than last year's record crop of 88.6 million tons due to a delay in the monsoon season and the disruption of the sowing season in areas affected by the war with Pakistan. Moreover, the government maintained that a sharp decline in market arrivals of foodgrains this year despite a record crop indicated substantial hoarding. The Prime Minister urged farmers and traders not to speculate on the coming crop and appealed to consumers to reduce foodgrain consumption by substituting fruits and vegetables from "kitchen gardens."

Table 8. India: Index Numbers of Wholesale Prices
(1952-53 = 100)

<u>End of Quarter</u>	<u>1963</u>	<u>1964</u>	<u>1965</u>
I	196.3	139.0	151.0
II	134.0	147.7	158.0
III	136.3	158.7	164.9
IV	135.7	157.9	

TABLE 8 (Cont.)

Selected Dates - 1965

June	5	157.6	August	7	166.4
	12	158.2		14	167.5
	19	158.5		21	167.3
	26	158.0		28	167.0
July	3	158.7	September	4	166.8
	10	161.2		11	166.7
	17	163.2		18	164.9
	24	164.8		25	164.9
	31	165.9			

Gold market. After attaining a record high of \$91.35 per ounce in the first week of July, the official gold price in Bombay declined \$9.05 to \$82.30 by the second week of September. (See Table 9). Though the price strengthened contra-seasonally to \$84.58 by the end of September the market did not indicate a strong upward price trend. This may be due in part to easier market conditions created by the cease fire with Pakistan in late September. By the last week of September, the price averaged 8.3 per cent above a year earlier.

On October 19, the government offered 15 year gold bonds which would be redeemable in gold and yield two rupees per 10 grains of 24 carat gold per year. This works out to 1.54 per cent of the official gold price at the end of September and 3.73 per cent at the international price. The gold is exempt from various taxes and inquiry. Subscriptions will be open to January 1966.

Table 9. India: Price of Gold Bullion in Bombay^{a/}
(U. S. dollars per fine ounce)

<u>Quarterly Averages</u>	<u>1962</u>	<u>1963</u>	<u>1964</u>	<u>1965</u>
I	79.38	66.98	72.24	78.31
II	80.60	72.10	75.99	84.46
III	82.06	69.98	98.60	86.63
IV	71.41	66.42	75.38	

Monthly Averages - 1965

April	81.57	July	90.01
May	83.99	August	85.98
June	87.82	September	83.89 ^{b/}

^{a/} Average of Friday spot rupee quotations in 14 carat gold per 10 grams from August 28, 1963, converted to U. S. dollars per fine ounce.

^{b/} Provisional.

Exchange rate. The free market selling rate of Indian rupee notes in Hong Kong sharply appreciated 6.3 per cent in the two months ending August. (See Table 10). In Bangkok, the rupee depreciated in the same period. This brought the rates in the two cities closer together. Compared with the official rate of Rs. 4.7619 to one U. S. dollar, the discount on the rupee was 45 per cent in Hong Kong in August and 42 per cent in Bangkok in September.

On October 20, the day after the government announced the incentive import licensing scheme to attract foreign exchange to India, the unofficial price of the U. S. dollar increased from 8 to 10 rupees in India.

Table 10. India: Hong Kong and Bangkok Free Market Selling Rates
of Indian Rupee Banknotes per U. S. Dollar

Quarterly Average

	<u>Hong Kong^{a/}</u>			<u>Bangkok^{b/}</u>		
	<u>1963</u>	<u>1964</u>	<u>1965</u>	<u>1963</u>	<u>1964</u>	<u>1965</u>
I	5.83	6.99	7.93	5.42	6.43	7.42
II	6.18	7.52	8.94	5.70	7.01	8.05
III	7.05	7.96	8.75	6.57	7.44	8.38
IV	6.94	7.93		6.19	7.06	

Monthly Average - 1965

	<u>Hong Kong</u>	<u>Bangkok</u>
April	8.71	7.72
May	8.87	8.16
June	9.25	8.28
July	9.19	8.45
August	8.67	8.41
September	8.38	8.28

a/ Average of month.

b/ End of month.

International reserves and foreign trade. At the end of September foreign exchange reserves of the Reserve Bank were \$175 million or 15 per cent less than a year earlier. However, compared with the end of June 1965, this is an increase of \$13 million. As a result, gold and foreign exchange reserves rose by that amount to \$456 million. (See Table 11). Since \$420 million is required to back the currency, only \$36 million or less than one week's imports, was freely available. This was made possible by a postponement of a \$25 million IMF debt payment due at the end of September.

The chronic foreign exchange shortage was intensified by a 38 per cent increase in the trade deficit to \$468 million in the first four months of the current fiscal year (April to July) compared with the corresponding period a year ago. This was due to a 8.9 per cent decrease in exports and a 8.6 per cent increase in imports. Moreover, foreign exchange earnings may be even less than indicated because exports to communist bloc countries which pay in rupees have increased sharply. In 1964-65, these exports increased 36.3 per cent to Rs. 1,484 million (\$312 million) increasing its share of total exports to 18 per cent from 14 per cent. In addition, press reports state that foreign exchange earnings decreased \$86 million in 1964-65 to \$1,260 million. This is 75 per cent of total exports of \$1,687 million.

The crisis in foreign exchange has been met by a series of import restrictions and export promotion proposals. On August 19 the Finance Minister announced an unexpected supplementary budget to cover an expected budget deficit of \$210 million. This is about 2 per cent of the February budget amounting to \$8,996 million. Increases in import duties over a wide range of commodities were imposed to increase revenues and restrict imports. The structure of rates range from 40 per cent on machinery to 100 per cent on consumer goods. In addition, import quotas on selected items were reduced or eliminated. An import surcharge of 10 per cent imposed in February was retained. On September 18, press reports stated that maintenance imports for non-defense industries from free foreign exchange were suspended indefinitely from August 30. On July 17, the export promotion scheme was reinstated. The scheme was suspended on May 15 because the government believed that advance import entitlements caused a foreign exchange drain because corresponding export earnings were not actually forthcoming. This program affects about 20 per cent of total exports. On August 25, the government announced export tax credits on 22 traditional items effective from October 1 for shipments after February 28. The tax credit varies by commodity between 2 to 15 per cent. This program will affect about 62 per cent of total exports. Together the two export subsidy schemes will cover over 82 per cent of all exports.

In addition, the Prime Minister requested public sector enterprises to maximize exports. Periodic export reports are to be submitted by each enterprise. Government exports in 1964-65 were only Rs. 17 million compared with total exports of Rs. 8,031 million.

The additional import restrictions also appear to be ineffective in reducing imports because government imports in 1964-65 increased 28 per cent to \$1,645 million. This was 56 per cent of total imports and for the first time exceeded private imports which decreased for the fourth consecutive year. In view of continued increases in imports to July of this year despite restrictive measures, the additional defense needs caused by the war with Pakistan in September and the decrease in exports, the foreign exchange crisis may well continue into the busy season. In part this may be the reason for a number of drastic proposals to solve the balance of payments problem. For example, on October 10, 1965, the deputy chairman of the Planning Commission suggested that maintenance imports should be

eliminated as this would reduce foreign exchange payments by about \$525 million. In addition, he thought that foreign exchange earnings could be increased substantially by sharply restricting domestic consumption of export commodities by compulsory government procurement. Bulk export sales could be accomplished by creating government export monopolies. To reduce food imports, the Prime Minister in a nationwide radio broadcast on October 10 urged farmers to increase food production, producers and traders to dishoard foodgrains, and consumers to voluntarily restrain food consumption and to produce their own fruits and vegetables in "kitchen gardens."

The foreign exchange crisis is heightening by press reports that the World Bank was holding back release of loan funds and commitments after announcing that the consortium for aid giving countries would reassess needs in the light of the war with Pakistan.

The increase in external debt payment creates further strains. On October 4, the IMF agreed to postpone a repayment of \$25 million scheduled for September 30. The external debt due this fiscal year increased 34 per cent to \$321 million of which \$288 million must be paid in foreign exchange. This is equal to 23 per cent of foreign exchange earnings in 1964-65.

On October 19, the government announced an incentive import licensing scheme to attract foreign exchange. Individuals could receive a transferable import license for 60 per cent of their foreign exchange remittances. The approved imports will be mainly for raw materials, spares, components and capital goods. This offer is effective on remittances to January 1, 1966, and on import applications to April 30, 1966. Since import licenses may be sold for 100 to 700 per cent of face value, the government believes that the implied devaluation of the rupee would encourage foreign exchange transfers to India.

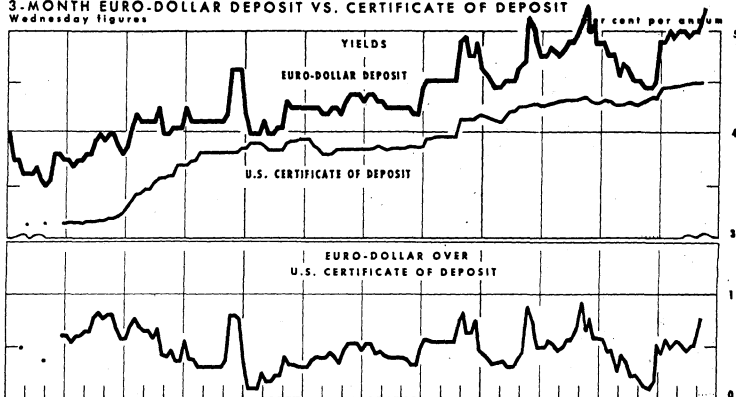
Table 11. India: Gold and Foreign Exchange Holdings of the Reserve Bank and Foreign Exchange Holdings of the Government
(in millions of U. S. dollars at the end of the period)

<u>Quarter</u>	<u>Reserve Bank</u>	<u>Change</u>	<u>Government</u>	<u>Change</u>	<u>Total</u>	<u>Change</u>
<u>1964</u>						
I	513	44	130	- 8	643	36
II	450	-63	135	5	585	-58
III	452	2	74	-61	526	-59
IV	447	- 5	51	-23	498	-28
<u>1965</u>						
I	461	14	63	12	524	26
II	443	-18	76	13	519	- 5
III	456	13				
April	456	- 5	69	6	525	1
May	443	-13	68	- 1	511	-14
June	443	0	76	8	519	+ 8
July	440	- 3	46	-30	486	-33
August	441	1	52	6	493	+ 7
September	456	15				

Chart 1

INTERNATIONAL MONEY MARKET YIELDS FOR U.S. DOLLAR INVESTORS

3-MONTH EURO-DOLLAR DEPOSIT VS. CERTIFICATE OF DEPOSIT Wednesday figures



SELECTED INTERNATIONAL MONEY RATES Friday figures

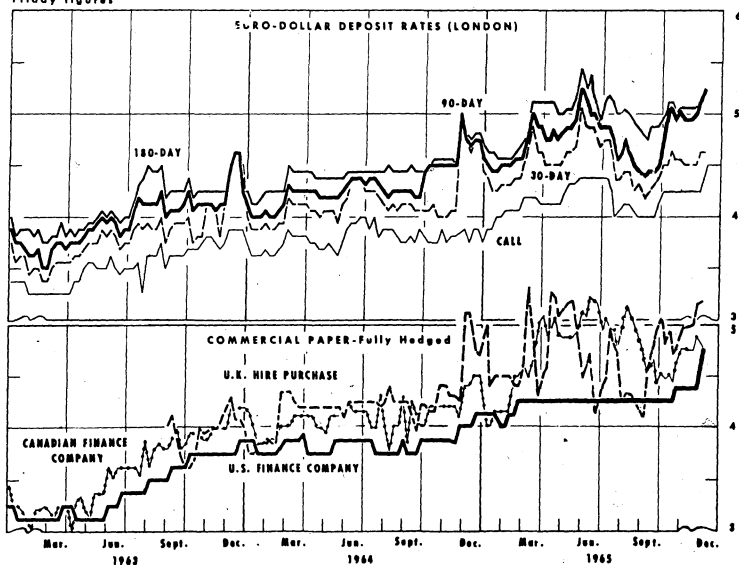
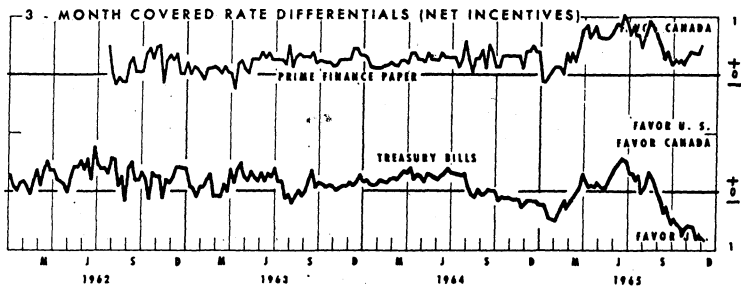
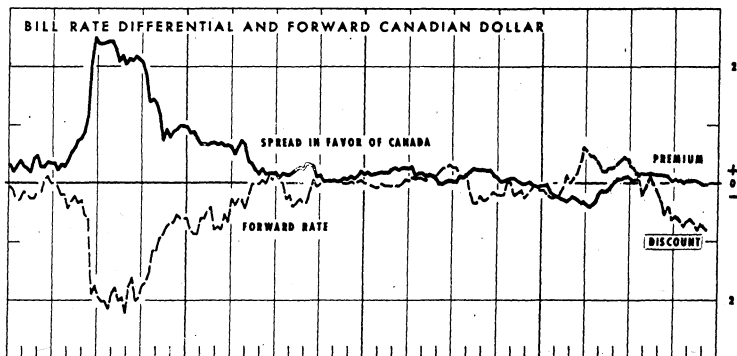
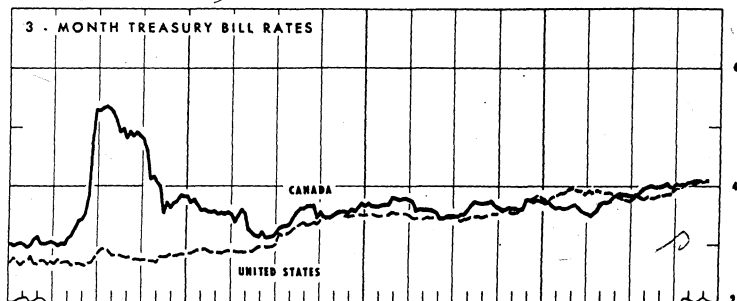


Chart 2

INTEREST ARBITRAGE, UNITED STATES / CANADA

Friday figures*

Per cent per annum



Thursday figures 1962, Friday thereafter.

Chart 3

INTEREST ARBITRAGE, NEW YORK/LONDON

Friday figures

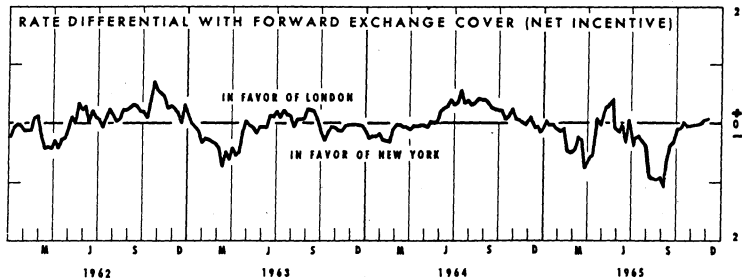
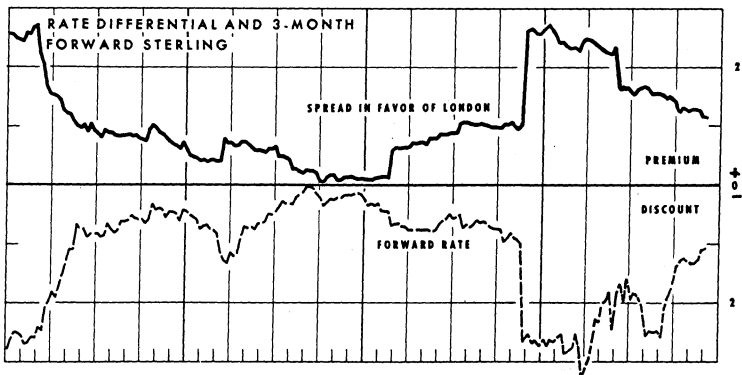
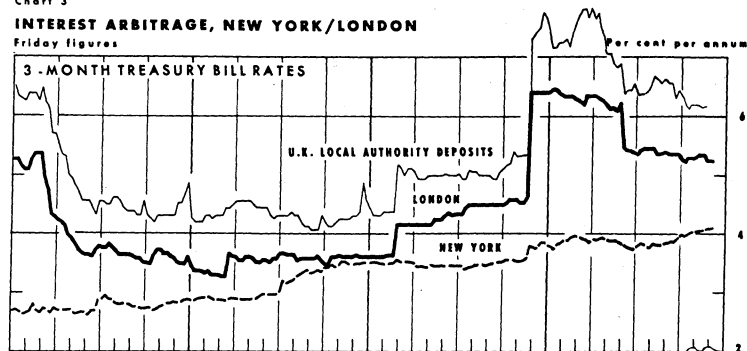
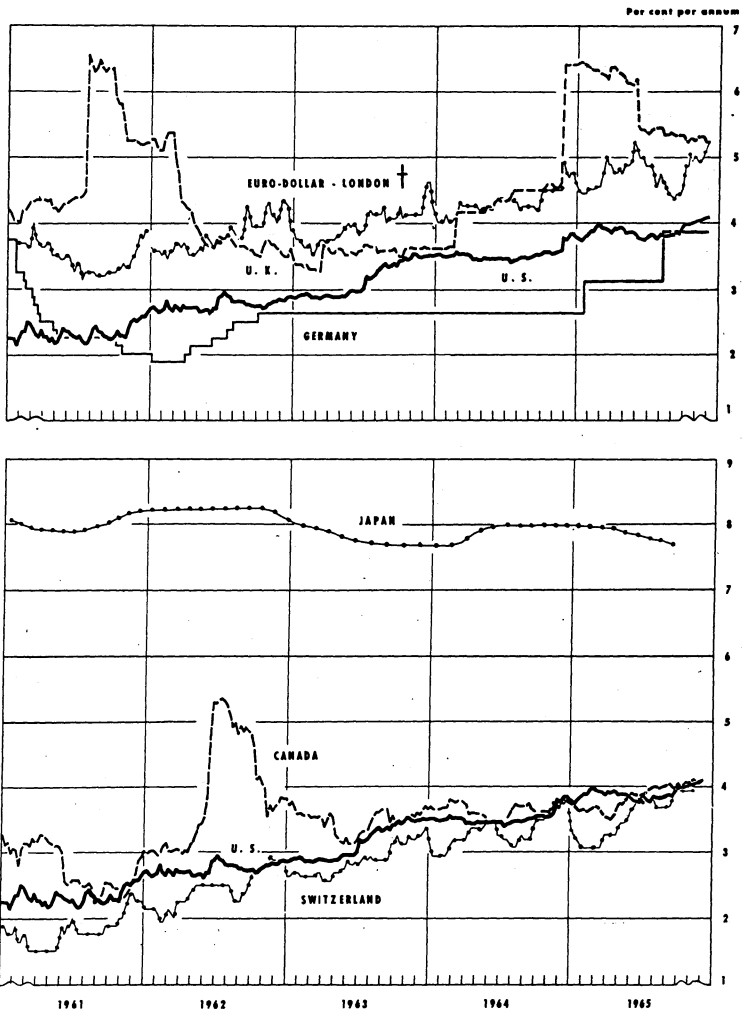


CHART 4 was not published in this issue.

Chart 5
SHORT-TERM INTEREST RATES*



* 3-month treasury bill rates for all countries except Japan. (Average rate on bank loans and discounts)
and Switzerland (3-month deposit rate)

† 3-month rate for U.S. dollar deposits in London.

Chart 6
LONG-TERM BOND YIELDS

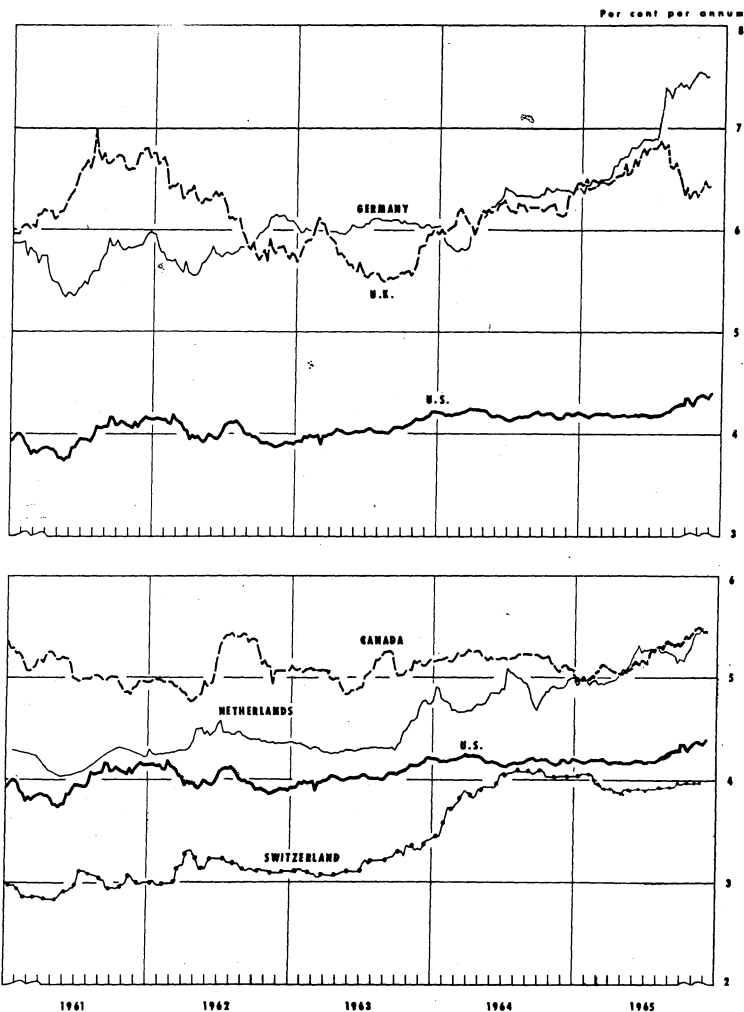
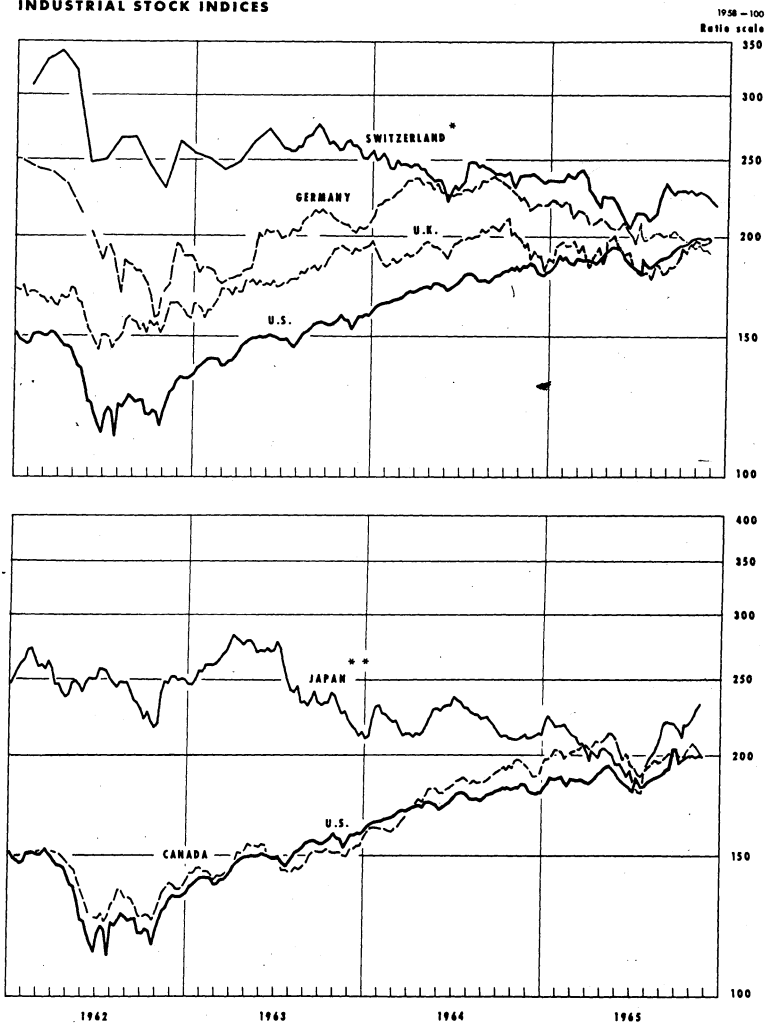


Chart 7

INDUSTRIAL STOCK INDICES



* Swiss Bank Corporation industrial stock.

** Japan: index of 225 industrial and other stocks traded on the Tokyo exchange.

Chart 8

SPOT EXCHANGE RATES - MAJOR CURRENCIES AGAINST U.S. DOLLAR

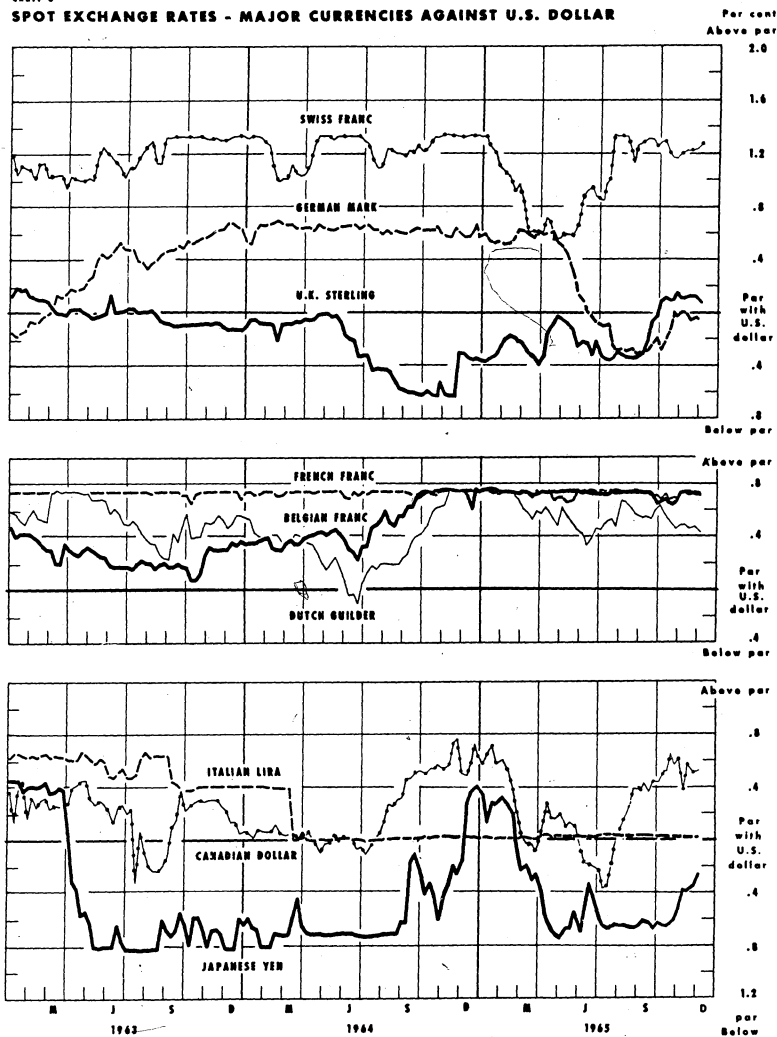
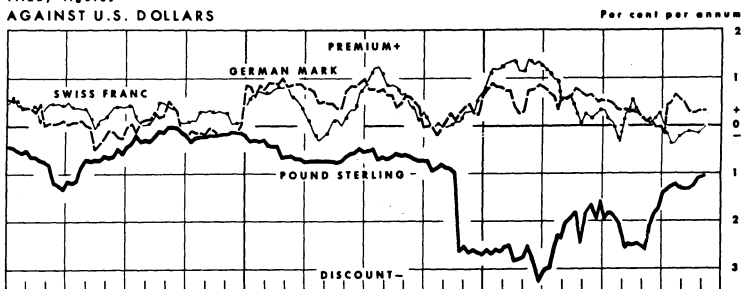
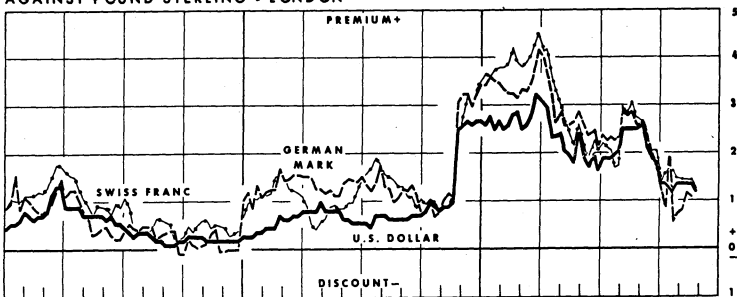


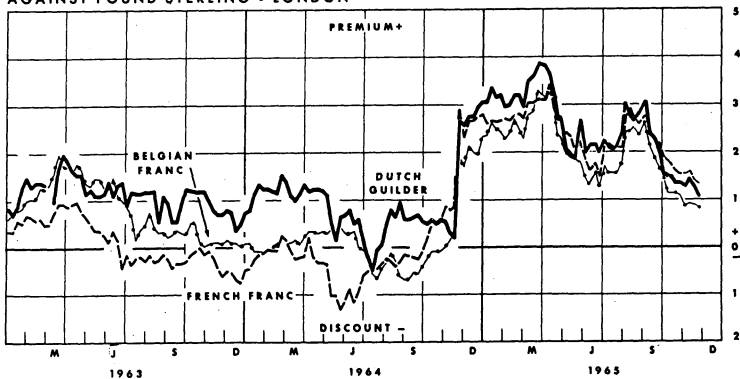
Chart 9
3-MONTH FORWARD EXCHANGE RATES
 Friday figures
 AGAINST U.S. DOLLARS



AGAINST POUND STERLING - LONDON



AGAINST POUND STERLING - LONDON



Latest Figures Plotted In H. 13 Chart Series, 1965

<u>Chart 1</u>	<u>Per cent per annum</u>
<u>Upper panel</u>	
(Wednesday, <u>December 1</u>)	
Euro-\$ deposit	<u>5.25</u>
U.S. certif. of deposit	<u>4.49</u>

<u>Lower panels</u>	
(Friday, <u>December 3</u>)	
Euro dollar deposits. Call	<u>4.50</u>
7-day	<u>4.62</u>
30-day	<u>4.62</u>
90-day	<u>5.25</u>
180-day	<u>5.25</u>
(November 25)	
Finance Co. paper: U.S.	<u>4.38</u>
Canada	<u>4.91</u>

Hire-purchase paper, U.K. 5.71

<u>Chart 2</u>	
(Friday, <u>December 3</u>)	
Treasury bills: Canada	<u>4.08</u>
U.S.	<u>4.10</u>
Spread favor Canada	<u>-0.02</u>
Forward Canadian dollar	<u>0.81</u>
Net incentive (Canada +)	<u>-0.83</u>

<u>Chart 3</u>	
(Friday, <u>December 3</u>)	
Treasury bills: U.K.	<u>5.24</u>
U.S.	<u>4.10</u>
Spread favor U.K.	<u>+1.14</u>
Forward pound	<u>-1.07</u>
Net incentive (U.K. +)	<u>+0.07</u>

<u>Chart 5</u>	<u>Per cent per annum</u>
(Friday, <u>December 3</u> , except as noted)	
Treasury bills:	
U.S.	<u>4.10</u>
U.K.	<u>5.24</u>
Germany	<u>3.88</u>
Canada	<u>4.08</u>
Swiss 3-month deposits (Date: <u>November 15</u>)	<u>3.94</u>
Euro-\$ deposit (London)	<u>5.25</u>
Japan: composite rate (Date: <u>September 24</u>)	<u>7.580</u>

<u>Chart 6</u>	
Bonds:	
U.S. govt. (Wed., <u>December 1</u>)	<u>4.40</u>
U.K. war loan (Thurs., <u>November 25</u>)	<u>6.44</u>
German Fed. Railway (Fri., <u>November 19</u>)	<u>7.50</u>
Swiss Confederation (Fri., <u>November 19</u>)	<u>3.97</u>
Canadian govt. (Wed., <u>December 1</u>)	<u>5.45</u>
Netherlands government perpetual (Fri., <u>November 26</u>)	<u>5.50</u>