

VIII. Adjustment Responses Expected of Trading Partners

During 1968 the international payments pattern has been subject to large and, to some extent, unusual capital movements. During the first quarter these were associated with the large-scale speculation in gold. During the second and third quarters the French franc felt the impact of large-scale capital outflow, following the labor and student disturbances in May. The United States was the recipient of substantial inflows of capital for the purchase of portfolio stocks, and from large-scale borrowing from the Euro-dollar market by the American commercial banking system.

At the same time, the combined current balance of payments surplus of the European Community countries as a group appears to have increased even above the extremely high level of 1967, when it amounted to \$4 $\frac{1}{4}$ billion. Italy's current account surplus rose to nearly \$2 $\frac{1}{2}$ billion, and Germany's to perhaps \$2 $\frac{3}{4}$ billion. The German trade surplus was again particularly striking, at about \$4 billion a year with imports figured to include insurance and freight, or over \$5 billion a year on a basis comparable to that used in United States trade figures.

These figures are cited to give some indication both of the importance of these large trade surpluses in sustaining the domestic economies in these two countries, and at the same time making it much more difficult for the United Kingdom and the United States to achieve an improvement in their trade and current accounts.

These developments in the current and capital accounts have led to questioning as to whether an adjustment pattern can be based over a longer period of time on an extremely high trade and current account surplus in the European Community, offset by a very large outflow of capital in the form of banking funds and portfolio investments. Partly because of the substantial reserve losses of the French, the European Community countries actually recorded a decline in reserves of \$1.1 billion in the first half of 1968, following a number of years in which these countries regularly added to their reserves at the rate of nearly \$1 $\frac{1}{2}$ billion a year. This very substantial swing indicates the very large size of capital movements that can occur in a relatively short time when a currency comes under pressure.

Because of these capital movements, the dollar has been strong in the exchange market, and the United States has had a substantial official transactions surplus in 1968, as against a deficit measured on