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CABINET

BALANCE OF PAYMENTS PROSPECTS

MEMORANDUM BY THE CHANCELLOR OF THE EXCHEQUER

I circulate for the information of my colleagues the text of a personal message which I have recently sent to all Commonwealth Finance Ministers. It sets out the balance of payments prospects as clearly as they can be seen at the present time.

R. A. B.

*Treasury Chambers, S.W. 1,
5th March, 1954.*

TEXT OF PERSONAL MESSAGE FROM THE CHANCELLOR OF THE EXCHEQUER TO COMMONWEALTH FINANCE MINISTERS

When we met at Sydney I undertook to let you have a further view of the balance of payments prospect as seen from London and also to let you know the impressions gained by Rowan and Hall during their visit to Washington.

2. The balance of payments forecasts which we jointly discussed did not go beyond the middle of this year. But even on the favourable assumptions then used (a continuation through 1954 of the prices and the levels of activity, especially United States activity, ruling in the third quarter of 1953), our officials concluded that the Sterling Area was unlikely to have any substantial surplus at all with the rest of the world in the second half of the year. This was mainly because rising non-sterling imports would overtake the corresponding earnings, which would be reduced for the usual seasonal causes.

3. New forecasts have now been prepared for me on the assumption that the general climate during the year 1954 as a whole would not greatly alter from the conditions ruling at the end of 1953. This assumption is less favourable than that used in the previous forecast since the United States industrial production was 6 per cent. less in December than the third quarter average, though a net outflow of dollars continued. These forecasts are, of course, subject to all the usual qualifications about the uncertainties surrounding such work. While they are especially difficult to make at this juncture, they are valuable as signs of the trend in our affairs.

4. These calculations indicate that the surplus of the sterling area as a whole with the rest of the world in the Calendar year 1954 might amount to some £110 millions. This is only a quarter as good as the out-turn for mid-1952-mid-1953 and only half the figure for *mid-1953-mid-1954*, based on previous assumptions which we discussed at Sydney; our new figure for the first half of 1954, however, does not differ materially from that discussed at Sydney. We are thus faced with a markedly downward trend. This surplus of £110 millions is made up of a Rest of Sterling Area (R.S.A.) surplus of about £130 millions (allowing for gold sales and official assistance of £220 millions) and a United Kingdom deficit of about £20 millions, allowing for defence aid which is tentatively put at £80 millions. If we take the overall balance of payments, the R.S.A. is expected to have a deficit of £100 millions with the rest of the world including the United Kingdom, while the United Kingdom expects a surplus of £210 millions with the rest of the world, including the R.S.A. The United Kingdom itself would expect to have a substantial surplus of £230 millions with the R.S.A.

5. It is, of course, still more difficult to apportion forecasts of this kind between the different currency areas. But taking the sterling area as a whole it still looks as if most of the non-sterling surplus would be earned with the dollar area, while with the Organisation for European Economic Co-operation (O.E.E.C.) countries the United Kingdom surplus of perhaps £40 millions would be balanced by an R.S.A. deficit of similar size. With the other non-sterling countries there might, on balance, be a small surplus.

6. The implication of these forecasts for the reserves might be a rise of roughly £100 millions in the first half of 1954, together with a decline of a rather smaller amount in the second half of the year, after the servicing of the North American loans on 31st December. In other words, the reserves might remain roughly stable in the second half-year, or only decline by a small amount, apart from debt-service at the end of December. Over the year as a whole there would, accordingly, be little change in the reserves.

7. A special word is necessary about the position in relation to the O.E.E.C. countries. The balance as shown above does not include the full extent of the position since we must also take account of the transfers of sterling from other non-sterling countries to Europe, which will amount to a considerable sum. We, therefore, expect to have a rising deficit with the European Payments Union (E.P.U.) this year which would probably lead towards the exhaustion of our credit and settlement of deficits 100 per cent. in gold. The gold payments involved are,

of course, included in the calculation in paragraph 6 above. While this development is serious and means that we must all pay special attention to our trade with the O.E.E.C. countries, it is only fair to regard the Sterling Area position *vis-à-vis* the E.P.U. in the context of its total position *vis-à-vis* the rest of the world.

8. Since the end of last year, United States industrial production has declined further, so that these forecasts probably give too favourable a view of the prospect. While the comparative stability of commodity prices, taken as a whole, and the continued sale of gold by the United States Treasury, taken together, suggest that the position of the rest of the world has not significantly worsened, nevertheless, a continuance of United States activity at its present level, and still more a further decline, unless matched by a rise later in the year, is bound to result in a worsening trend.

9. As we recognised at Sydney, much turns on the action of the United States Government. The discussions which Rowan and Hall had in Washington were encouraging from this standpoint since they found United States officials not only keenly alert to the situation, but reasonably confident of the ability of the Administration to take suitable action. Broadly, the views of United States officials confirmed those which we expressed at Sydney about the nature of the recession, though it was fully recognised that there are bound to be divergences in interpretation, and particularly about the speed at which events might unfold in the short run. The Report of the Council of Economic Advisers was especially encouraging since it specifically mentioned internal measures which could be used in various ways to mitigate a downturn. Hall and Rowan were both impressed by the grasp of the situation shown by the Council of Economic Advisers and by their success in re-establishing its standing. United States officials were generally of the view that consumption had so far held up remarkably well and that this would tend to be the crucial sector in the economy in the coming months. There seemed nothing, as yet, to suggest that the process of orderly readjustment was likely to break down. An encouraging factor in the situation is the complete change in United States credit policy which has taken place since 1953 owing to the intervention of the Federal Reserve System in the market and the general easing of credit.

10. The political factors lying behind the analysis cannot be ignored since a great deal depends upon the speed with which the United States Congress is likely to act if circumstances should require it. On this, the evidence in Washington did not suggest any reason for altering the view that the Republican Party could not afford any kind of deep depression and that when the point came action would probably be taken in time. It is true that the United States Treasury has asked for certain tax reductions, due to come into operation in April, to be deferred, but it is already doubtful whether Congress will agree to this course. Summing up, it may be said that the impression gained in Washington was one of cautious confidence in the Administration's ability to deal with the situation as it arose. The alarm which has been recently expressed in some quarters in Washington does not necessarily contradict this view. Indeed, it bears out the readiness of the Administration to act if necessary.

11. We have considered all this very carefully here, for the prospect is one which is bound to cause anxiety, and the following are the main conclusions which we have reached. In the first place, the sterling area has now weathered over six months of a gradual down-turn in United States activity with confidence fully maintained and with the reserves steadily increasing despite the heavy debt repayments at the end of last year. This is an immeasurably better performance than we have put up on any previous similar occasion since the war. There are many factors which account for it, but among the most important are the control of inflation and the maintenance of confidence among foreign countries in our policies and in sterling. It is vital that both should continue, for any return of inflation or any loss of confidence could add greatly to the size of the task which we face. Nevertheless, the prospect represents a definite check to our vital aim of building up the central gold and dollar reserves.

12. In the second place, we have decided that our own policy should be based on the following:—

- (a) to avoid making any new major relaxations which are likely to put an additional strain on the reserves; I feel bound to warn you however that we are under considerable pressure from certain European

countries to make changes in the E.P.U. which would involve additional gold payments;

(b) to intensify our export effort on the lines we discussed at Sydney. I am personally devoting a great deal of attention to this, and in particular setting the need for increased competitiveness and increased exports before the public on every occasion. It is vital that we should not allow the public or ourselves to be lulled into any sense of false security by the fact that we shall probably do fairly well in the first half of the current year.

13. In the third place, while we do not think the time for specific action has yet come, we are keeping in very close touch with the United States authorities, through our representatives in Washington. I shall keep you informed of developments as we go along. We shall continue to prepare the ground for any action in the national or international field should it prove to be necessary later on. In the meantime, our attitude will be based on vigilance, confidence and the maximum export effort.

14. I shall greatly value your views on these important matters, especially as to how you think you may have to adjust your sails to these freshening but rather stormy winds. I shall also be very interested in any indications of the effect of developments in the United States on your own external position.

15. I look back with especial personal pleasure to our talks at Sydney. Do please send me an answer to my last paragraph.

3rd March, 1954.