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14th October, 1957

CABINET

THE ECONOMIC SITUATION

Note by the Chancellor of the Exchequer

I circulate this note on our external position for the information of my colleagues.

2. We have been near to the edge of economic disaster. We are still near the edge. Over the past two months we have lost £185 millions from our gold and dollar reserves. The reserves at the end of September were down to £660 millions, only two-thirds of what they were at the end of 1954, despite the £200 millions which we drew from the International Monetary Fund (I.M.F.) last year and the £37 millions which we gained by not paying last year's interest on the American loan.

3. A continued run on the reserves at the rate which we have recently experienced would exhaust them in six months. In practice, of course, the crack would come much sooner. Within weeks it would become clear that the rate could not be held. Increased leads and lags and the run which would be started by the central core of holders of sterling in the sterling area and elsewhere could and would start the reserves pouring out many times faster. In the collapse which would follow the cost of our imports of essential food and raw materials would rise sharply, adding very much to the dangers of an inflationary spiral at home.

4. Two factors are holding the situation:-

- (a) the money we have borrowed to fortify the reserves;
- (b) the policies we have declared at home for dealing with inflation.

We have got to repay the former and carry through the latter.

5. But now we have got not only to hold the position but re-establish it. Reasonably sound as our current trading position may be in itself, this is going to be very difficult indeed.

(i) If we draw in full the £180 millions from the Export/Import Bank between now and next January, we shall bear debt obligations in dollars alone repayable over the following seven years of £870 millions, i. e. £200 millions to the I. M. F., £180 to the Export/Import Bank and £70 millions a year for the Canadian and United States loans. By

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claiming a "bisque" under the United States and Canadian agreements we can only save £70 millions a year from our existing commitments and we should do this only twice or three times in the period.

(ii) We have got to face the run down of sterling balances by the rest of the sterling area. India may impose a great strain in the coming year. Last year her I. M. F. drawing helped us out. We shall almost certainly not have the relief Australia gave us in the last twelve months and the Colonies may start being a strain too.

(iii) We have to meet these increased burdens from a weaker initial position and in a world in which the earning of gold and dollars may be even harder than it has been in recent years.

6. We will remain in danger of another crisis until our policies have finally and demonstrably shown themselves successful. Their first announcement has been greeted with respect. Inside and outside this country we are being watched to see that we carry them through.

P.T.

Treasury Chambers, S. W. 1.

14th October, 1957.