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Currency and Finance

THE monetary experience of the last financial year is extremely difficult to interpret even in retrospect though many months have passed since it closed and the information contained in the. *Report on Currency and Finance* for the year is exhaustive, The price recession with which the year opened did not develop into a general depression. Industrial production was not onlv maintained but improved appreciably, despite the difficult transition during the year to a buyers' market. The explanation is twofold—continuation of industrial peace and improvement in the supply of industrial raw materials. The combined effect of the two was enough to offset whatever might have been lurking in the price-cost relationship. Broadly speaking, after the initial impact of recession was over, prices steadied and over the year, the general index of wholesale prices showed little net change.

The volume of exports fell, despite the removal of export duties and other measures to help exports. So did the volume of imports, but that is largely a matter of licensing policy. More significant was the sharp decline in the terms of trade, the average for the year deteriorating by some 24 per cent. Though the volume of exports declined by 10 per cent and that of imports by 12 per cent, and as a result of worsening, of the terms of trade, the trade deficit widened, the overall deficit in the glance of payments was actually smaller than in the previous year, as , result of a favourable swing in invisibles and donations. The trade deficit seems to have been fairly distributed, the surplus with the sterling area countries other than Pakistan being reduced by half, while dollar deficits nearly doubled. It is only in the current account with Pakistan that the deficit of the previous year was turned into a handsome surplus.

More obscure was the operation of the monetary policy and the impact on the monetary situation of the budget deficit. There was no change in the foreign assets of the Reserve Bank to account for the decline in money supply, smaller though it was than in the previous year, The impact over the year of the higher bank rate would of course by itself account for a substantial contraction. That this did not happen- was because the budgetary deficit offset the contraction that could be expected in its absence. How the budget deficit did it and by what circuitous process this final effect was reached is not so easy to trace in detail. Surely, in these circumstances the Reserve Hank cannot claim credit, as it seems to do, for the' relatively comfortable conditions in the money market and the comparatively easier position of the banks which enabled them to increase their investments in securities.

The only explanation one can find for this comparative improvement in the giltedged situation is that the fact of the higher money rates established strengthened expectations that their was to be no substantial change, and that the higher rates had come to stay. Those who had been holding out for return of gilt-edged values to the normal could therefore be persuaded to change their ideas about what was normal in the post-Korean years. The stability of the gilt-edged market was purchased at a price. In the absence of any substantial improvement of net Government borrowing, it was not a small price to pay. This limited stability was hardly an adequate compensation for the continued downward trend in industrial securities during the year. The resulting widening of prices and yields between the two was at best a reflection of the depressing prospects in the private sector, if not a danger signal of a further deterioration in the value of industrials.

The contra indications to a genuine improvement in the gilt-edged market are too many to recount. To pick up a few in random from the report, the sanction given for new issues during the year was the smallest on record for any year. The volume of debentures floated was even smaller than in the previous year. There was no sign of returning life in the investment market. In the circumstances, would it be wrong to conclude that it was deficit financing, however obscure its relation to money supply, which softened the impact of a deflationary policy initiated with the raising of the bank rate and subsequently countermanded by various other measures operating in the opposite direction?

The impact of the recession stands out in the reduction of volume of trade advances. Can industries continue to prosper while trade declined? In the end, all must conform to the dominant trend whatever it may be. In the long run industrial production can not re-*main immune and cannot be insulated from influences operating in the rest of the economy. From the advantageous position of watching the monetary scene from a certain distance, one can see more clearly what that trend is likely to be. Lately, wholesale prices have shown a rising tendency and this has caused some uneasiness since the other indicators have all moved uniformly downwards.

In its world review in the earlier chapters, the report brings together the main lines of developments in the western countries with which we arc more intimately concerned. They can be summed up as a return to sanity or to orthodoxy, according to one's predilections. This has been accompanied in the West, it is mentioned, with a stretching out of the rearmament programmes of these countries over a longer period, which means in effect the slowing down of the activities of the public sector. This was the price paid, by, these countries, not very cheerfully though, for reviving the private sector. Here we are following the same monetary policy in returning to orthodoxy without being very clear about its purpose. It has note benefited appreciably the implementation of the targets for the public sector in the Plan. These targets have not been scaled down. This is commendable, if not heroic. The private sector, however, has been woefully trailing behind. The monetary and fiscal policy takes lite tle note of it and keeps on forgetting that the private sector needs more powerful accelerators to step up its activities than any that has been tried or is being devised.