

CHAPTER III

THE BALANCE OF PAYMENTS—GENERAL SURVEY

No signs appeared in 1975 of a significant turnabout in the country's balance of payments position. The current deficit continued to widen owing to a bigger defense import bill; excluding this item, the deficit edged down fractionally, following a slight drop in imports and a minuscule export gain. This reflected the stagnation of the economy in the year reviewed, which arrested the uptrend in imports, as well as the slump in Israel's overseas markets and the inability of its goods to compete more effectively, which held down the export advance even though the economy was saddled with plenty of spare capacity.

As regards the financing of the deficit, the gap between it and the long-term sources of finance was narrowed. This was accompanied by a much greater dependence on American aid, whereas all other sources of long-term funds continued to shrink. At the same time there was a further increase in short-term funds, and while it was not as fast as in 1974, the mounting reliance on such sources for covering the current deficit underscores the vulnerable point in the economic situation, which is fraught with great peril.

1. FINANCING THE DEFICIT

The dimensions and gravity of the balance of payments problem underwent a drastic change in the last two years. In the past the problem was predominantly of a long-range nature--a large import surplus, whose convenient sources of financing were expected to dry up, thereby making it imperative to greatly expand exports. Developments in the past three years have transformed the problem into an essentially short-term one, notably a marked reliance on much less convenient sources of funds, a large portion of which is for short periods. The economy's dependence upon such sources for covering the deficit is a very risky matter, and its ability to do so is anyway limited.

Table III-1
FINANCING OF THE CURRENT DEFICIT, 1968-75

(\$ million)

	1968-72	1971	1972	1973	1974	1975
Current deficit		-1,228	-1,101	-1,794	-3,387	-4,036
Current deficit, less transfers		-463	-49	-765	-1,650	-2,281
Deficit (-) or surplus after deducting long-term capital imports		216	675	—	-1,017	-775
Deficit (-) or surplus after deducting capital imports, excl. U.S. govt. aid		-26	413	-331	-1,838	-2,630
Sources of financing as a percent of deficit						
Transfers	66.1	62.3	95.5	57.2	51.3	43.5
Long-term capital, excl. U.S. govt. aid	92.5	97.9	137.5	81.3	45.7	34.8
Total long-term capital imports	108.4	118.3	161.2	100.0	69.7	81.2
Deficit not covered by transfers/exports	24.4	25.5	2.3	28.0	47.8	63.4
Deficit not covered by long-term capital (excl. U.S. govt. aid)/exports	7.4	1.4	-19.4	12.1	53.2	73.1

The altered nature of the problem is reflected in several developments: the swelling of the deficit relative to the growth of the economy and to the usual convenient sources of finance; a much heavier dependence on American aid and on short-term sources; and the bulging of the external debt and burden of interest payments, which in itself accelerates the growth of the deficit.

The eroding balance of payments situation is the cumulative effect of several structural changes: the persistence of inflation since the early 1970s, which has greatly impaired the ability of the country's goods to compete abroad and caused the diversion of a much larger share of output to the home market; a grave deterioration in the country's terms of a trade since 1973; and a much larger defense bill.

In 1975 the gross national product stood less than 30 percent above its average level in 1969-72, while the current deficit grew during this period at a 55 percent real rate. In 1972-75 Israel's terms of trade took a marked turn for the worse, commodity import prices rising 20 percent relative to those of commodity exports. Defense imports in the year reviewed were more than double their real volume in the prewar period.

The much larger deficit has created, as stated, acute problems with respect to its financing. The proportion of unilateral transfers and other convenient sources of funds has sagged perceptively: whereas unilateral transfers covered 66 percent of the deficit in 1968-72, by 1975 the figure stood at 44 percent (discounting U.S. government transfers, the decline was from 65 to 28 percent). Concurrently, the weight of long-term sources other than U.S. aid plummeted from 92 percent in 1968-72 to 35 percent in the year

surveyed. Taking all the long-term sources together, including American aid, their weight declined from a level exceeding the deficit in 1968-72 to 80 percent in 1975.

The other side of the coin is, of course, a rise in the share of American aid, which shot up from 15 percent of total long-term capital imports in 1968-72 to 57 percent in 1975. Because of the altered dimensions of the problem, the mounting dependence on the U.S. government has far-reaching significance: whereas in 1968-72 this source was equal to 2 percent of Israel's GNP, by 1975 it came to almost 20 percent.

Admittedly the conventional sources are also not under Israel's control, but in general there are special, close links between them and the economy; they are quite stable and, above all, are not subject to the control of a single factor which can suddenly and drastically change their scope.

Another reflection of these balance of payments developments is the bulging of the economy's external debt and a disturbing change in its makeup, with the share of short-term funds rising. In 1975 the debt grew from \$6.2 billion to \$7.6 billion, with short-term liabilities soaring from \$560 million to \$930 million. However, it is important to note that the recording of outstanding foreign currency liabilities is neither complete nor up-to-date.¹ According to balance of payments data, the country's indebtedness, including the commercial banks' net obligations,² approached the \$2.3 billion mark.

In contrast to 1974, foreign exchange reserves at the Bank of Israel did not contract this year. However, the commercial banks' total net claims on foreigners shrank during the year and the economy continued to resort to short-term sources; although the increase was not as fast as in 1974, the level continued to climb.

2. THE CURRENT ACCOUNT

The current deficit rose from \$3.4 billion in 1974 to \$4 billion, with all the increment being due to the much larger defense procurements abroad. Excluding this item and adjusting for the advance of prices, the deficit declined somewhat, imports drifting down 1 percent and exports moving up to the same extent.

The reduction of the civilian deficit can be attributed to two factors: the flattening of economic activity, which resulted in a smaller import, and the failure of exports to make any significant progress. The latter is explained by the faltering of demand in the overseas markets because of the world economic slump on the one hand and the inability of

1. Only part of the short-term liabilities are recorded.

2. I.e. the change in liquid obligations to the rest of the world, less the change in the banks' liquid claims on the foreign sector.

Table
CURRENT
(\$)

	Imports				
	Goods	Services	Total, excl. defense	Defense imports	Total, incl. defense
A. \$ million					
At current prices					
1971	1,759	768	2,527	555	3,082
1972	1,900	871	2,771	490	3,261
1973					
Jan.-Sept. ^a	2,930	1,153	4,083	471	4,554
Entire year	2,896	1,176	4,072	1,253	5,325
1974	4,073	1,605	5,678	1,224	6,902
1975	4,019	1,867	5,886	1,846	7,732
At 1972 prices					
1971	1,863	798	2,661	583	3,244
1972	1,900	871	2,771	490	3,261
1973					
Jan.-Sept. ^a	2,405	1,068	3,473	437	3,910
Entire year	2,261	1,053	3,314	1,127	4,441
1974	2,320	1,195	3,515	977	4,492
1975	2,190	1,292	3,482	1,341	4,823
B. Index of quantitative growth (1972=100)					
1971	98	92	96	119	99
1972	100	100	100	100	100
1973					
Jan.-Sept. ^a	127	123	125	89	120
Entire year	119	121	120	230	136
1974	122	137	127	199	138
1975	115	148	126	274	148
I ^b	117	139	124	304	151
II	113	154	126	224	141
III	109	156	124	297	150
IV	124	141	129	271	151
C. Prices indexes (1972=100)					
1971	94	96	95	95	95
1972	100	100	100	100	100
1973	128	112	123	111	120
1974	175	135	162	125	154
1975	183	145	169	137	160
I ^b	187	143	172	137	161
II	189	146	172	137	164
III	180	147	167	136	158
IV	175	146	165	139	158

^a At annual rates.

^b Quarterly data are at annual rates.

SOURCE: Central Bureau of Statistics.

III-2
ACCOUNT, 1971-75
(million)

Exports			Deficit			Total, incl. defense imports	Current account with administered areas	Total current deficit
Goods	Services	Total	Goods	Services	Total			
900	914	1,814	-859	146	-713	-1,268	40	-1,228
1,082	1,047	2,129	-818	176	-642	-1,132	31	-1,101
1,422	1,310	2,732	-1,508	157	-1,351	-1,822	28	-1,794
1,366	1,288	2,654	-1,530	112	-1,418	-2,671	29	-2,642
1,706	1,748	3,454	-2,367	143	-2,224	-3,448	61	-3,387
1,810	1,789	3,599	-2,209	-78	-2,287	-4,133	97	-4,036
966	935	1,901	-897	137	-760	-1,343		
1,082	1,047	2,129	-818	176	-642	-1,132		
1,174	1,211	2,385	-1,231	143	-1,088	-1,525		
1,114	1,141	2,255	-1,147	88	-1,059	-2,186		
1,175	1,233	2,408	-1,145	38	-1,107	-2,084		
1,191	1,229	2,420	-999	-63	-1,062	-2,403		
89	89	89	110	78	118	119		
100	100	100	100	100	100	100		
109	116	112	150	81	169	135		
103	109	106	140	50	165	193		
109	118	113	140	22	172	184		
110	117	114	122		165	212		
117	120	119						
108	121	115						
95	109	102						
123	119	121						
93	98	95						
100	100	100						
123	113	118						
145	142	143						
152	146	149						
156	143	149						
154	149	151						
146	147	147						
148	143	146						

Israeli-made goods to compete more aggressively on the other. A breakthrough on the export front which would allow a rapid thrust ahead is the key factor at this stage of Israel's economic development. It is a precondition for extricating the economy from the stagnation into which the balance of payments constraints have mired it.

Merchandise imports were down 5 percent quantitywise. Excluding the highly erratic ships and aircraft item and rough diamonds, which are also only tenuously connected with current economic developments, the decline was 3 percent.

Import trends were mixed in 1975, reflecting the impact of several factors which worked in opposite directions and with varying intensity. The principal one blunting the growth of overseas purchases was of course the economic slowdown. The government's policy of retrenchment, which dampened real incomes, and the rise in the relative price of imports over the last two years depressed demand for imports. This was felt most in consumer goods, notably durables, led by motor vehicles; sales of vehicles defined as capital goods also tumbled sharply.

The principal influence stimulating imports was apparently the expectation of a rise in their relative price. Because of the grave balance of payments situation it seemed highly probable that import prices would far outrace local prices, so that it paid to stock up on imported commodities. When there is a strong likelihood that imports will become dearer, and even that rationing may have to be instituted with all its attendant difficulties, there is a tendency to expand imports, thereby adding to the already worrisome balance of payments strain.

This is evidently the backdrop to the high level of imported inputs in 1975. True, such imports fell off 5 percent, but estimates based on input-output coefficients show that, as in 1974, such imports far exceeded current production requirements. This is indicative of the economy's tendency to continue building up stocks of imported goods; nevertheless, it is noteworthy that the gap narrowed in 1975.

There was also a much larger overseas purchase of capital goods other than land transport equipment. This coincided with an increased investment in domestic plant and equipment, but it lagged behind the incremental spending on imported items, even though the latter became relatively costlier. Here too the worthwhileness of acquiring imported equipment in anticipation of a possible rise in its relative price probably played a part; another likely reason was the concessions granted under the Law for the Encouragement of Capital Investments, which greatly reduced the cost of capital to the investor.

As regards exports, it is too early to speak of any significant turn for the better. Overseas commodity sales drifted up 1.5 percent in 1975, with manufactures failing to

forge ahead at all. To be sure, in the final quarter there was a strong upswing in the latter after a prolonged bout of virtual stagnation. This trend carried over through the first quarter of 1976, although a little less vigorously than in the previous one. However, the advance was led by military goods, while all other industrial products lost considerable ground. The nature of this growth--its confinement to a special, narrow segment of the manufacturing sector--raises the question whether it signifies a real change of trend or whether it is of a fortuitous character.

Agricultural exports moved ahead 23 percent in tonnage terms in 1975 and commanded much higher prices. Citrus made an impressive gain, thanks to reduced supplies from competing sources. Noncitrus farm sales were up 34 percent quantitywise, thus resuming their healthy advance of the past decade, which had been interrupted in the two preceding years because of the war.

Polished diamonds and minerals slipped appreciably because of sagging international demand. The 1975 standstill in industrial exports exclusive of diamonds and minerals followed three years of sluggish growth--a 6 percent average for 1972-74, which fell far short of the 20 percent average figure posted before then.

The development of industrial exports is a function of several influences: demand in the world markets, the pressure of domestic demand, and changes in the competitive standing of the Israeli economy. The combined effect of these influences varies from period to period and from branch to branch.

The world economic setback and the softening of foreign demand had a severe dampening effect on overseas sales in 1975. The country's export markets did not expand this year, whereas in 1969-73 they had grown at a 10 percent average annual rate. The slump bottomed out in the first half of 1975, and there were signs of an upturn in the second half; this probably goes some way to explain the rebounding of the country's exports toward the end of the year.

Israel's competitive standing apparently did not undergo any noticeable change, even though the boosting of export profitability is a top economic policy objective. Various indicators point to a slight improvement in 1975, but the profitability level was still low compared with 1973. What is more, in the second half of the year there was a downswing according to these indicators.

The failure to make any real progress was accompanied by a marked aggravation of price inflation and the tracing of a more jagged path by the profitability curve during the year. This greatly heightened the element of uncertainty and diminished the ability of a given improvement in profitability to stimulate foreign sales. A 5 percent rise in the

price received by the exporter relative to that paid for inputs has an entirely different weight in a period of general price stability than in one of high inflation, when it may be totally erased within a very short time. The solution of the country's balance of payments problem, which entails a restructuring of the economy, is inherently a long-run process, one that can only be achieved if it is based on a credible export profitability performance, i.e. one devoid of sharp short-run swings.

Table III-3
CURRENT DEFICIT AND CAPITAL ACCOUNT, 1968-75

(\$ million)

	1968	1969	1970	1971	1972	1973	1974	1975	1971-72	1974-75
Current deficit	-648	-869	-1,234	-1,228	-1,101	-2,642	-3,387	-4,036	-2,329	-7,423
Long-term capital										
Total, excl. U.S. govt. aid	564	591	888	1,202	1,514	2,117	1,548	1,406	2,716	2,954
Thereof: Transfers		459	649	765	995	1,377	1,062	1,113	1,760	2,175
U.S. govt. aid	35	54	343	262	262	1,057	822	1,855	524	2,677
Surplus or deficit (-), net of long-term capital		-224	-3	236	675	532	-1,017	-775	910	-1,785
Long-term loans ^a		168	559	624	580	815	539	1,425	1,204	1,964
IMF credit		22	—	10	-33	—	39	215	23	254
Short-term capital		258	23	-187	-663	-297	1,323	663	-850	1,988
Foreign credit to non-financial sectors		-25	23	9	-36	17	82	160	-37	242
Liquid foreign obligations of Israeli banks		-38	19	49	-93	212	464	531	-44	995
Change in foreign exchange reserves of monetary authorities		321	-19	-245	-534	-526	778	-68	-779	710
Other items		-22	1	-125	-23	-266	-69	-75	-148	-144
Errors and omissions		-64	-49	47	47	28	-272	-17	89	-255

^a Included in both U.S. government aid and other long-term capital.

Domestic demand pressure evidently did not constrain the expansion of exports as a whole. This was because numerous industries were saddled with plenty of spare capacity, in many of them overseas marketing fell off, together with a dent in domestic sales or a further buildup of unused capacity. But there were no signs of any marked improvement in labor mobility, and very likely hidden unemployment continued to exist in some industries side by side with a shortage of labor in others.

In manufacturing two broad groups can be distinguished, which in the last few years have diverged widely. One consists of electronics, chemicals, machinery, and metalworking, which in general may be termed technologically advanced industries; the second group consists of "traditional" industries which are not in the front rank technologically speaking: food, textiles and clothing, leather, wood, and rubber and plastics.

The first group has enjoyed a fine export performance together with a faster-than-average growth of domestic sales. In the last four years it boosted its foreign sales by 86 percent in real terms and accounted for 112 percent of the industrial export increment. In the last two years 60 percent of its additional output was marketed abroad. In the other group overseas sales have been sliding since 1972, and the uptrend in domestic sales has slackened.

These developments apparently reflect a long-term structural change in world commerce and in the relative advantages enjoyed by Israel. A comparison of wages per unit of output suggests an improvement in the ability of Israel's goods to compete abroad relative to the developed economies, at least until 1972. But a comparison of this sort is valid only for the high-technology industries, as in the other group Israel's main rivals are not the advanced industrial states. The situation is different as regards the traditional industries: here the relative advantage of the developed countries has taken a turn for the worse in comparison with those on a lower rung of industrial development. In measuring the international competitiveness of the traditional industries in Israel the comparison ought therefore to be made with the latter countries and not the developed states; here the picture is apparently one of a disturbing erosion of Israel's position.

These developments in the industrial export mix and the resulting changes in the country's competitive standing have significance for the structural changes required for grappling with the balance of payments problem. This means that the diversion of resources to export production will have to be done primarily not by directly altering the market destinations of the existing industries' output, but through a roundabout, painstaking restructuring of the economy.

The nature of the requisite structural change--the transformation of the industry makeup of the economy and the new investment this entails, the time required for doing this, and the need to increase labor mobility--all these make it imperative that the relative price structure be such as to properly steer entrepreneurs in their decision-making, and as soon as possible. To do this it must reflect, already at this stage, the requisite improvement in export profitability and be credible enough to permit the taking, on the strength of this factor, of decisions which will bear fruit only after several years. Such credibility is hard to come by when prices are climbing at the rate of tens of percent a year.

To counteract the harmful effect of these factors by a system of sweeping concessions to investors, operated by a bureaucratic apparatus, will not ensure correct decision-making, and in most cases it will have negative repercussions. It cannot be regarded as

a good substitute for an appropriate exchange rate policy, the blunting of inflation, and a realistic relative price structure (including the price of capital).

3. THE CAPITAL ACCOUNT

Long-term capital imports were much larger in 1975. This greatly improved the sources of financing the current deficit compared with the grave situation the year before, and permitted a less heavy resort to short-term funds for this purpose. But compared with the period before 1974 there has been a serious deterioration, and the economy continues to be crucially dependent on short-term capital, with all its attendant perils.

The upsurge in the long-term capital inflow in 1975 was due entirely to U.S. aid. All other sources continued to shrink: whereas in 1968-72 they covered fully 92 percent of the deficit, in 1975 the figure plunged to 35 percent. In 1975 they yielded a total of \$1.4 billion, as against \$1.2 billion in 1971 and \$1.5 billion in 1972. This period was one of high inflation, as reflected by the swelling of prices and nominal incomes: between 1972 and 1975 imports became more than 80 percent dearer and the real capital inflow from these sources was halved. On the other hand, during this period U.S. aid surged from an average of some \$300 million in 1970-72 and a much smaller sum before then to \$1,850 million in 1975. It has become the foremost source for financing the payments deficit, its weight in long-term capital imports soaring from 14 percent in 1971-72 to 57 percent in 1975. This was connected with the much heavier import from the U.S.

These changes in the capital import mix took place when both the deficit and the capital inflow were growing; this means that there were even more drastic changes in other sections of the balance of payments. Thus, for example, that part of the deficit not covered by unilateral transfers rose from a 34 percent average in 1968-72 to 56 percent in the year reviewed. Relative to exports, the change was even sharper--from 24 to 63 percent.

The principal results of these developments were a ballooning external debt, a disquieting change in its makeup, with a steep rise in the proportion of short-term funds, and a much heavier debt servicing burden.

The capital inflow to the nonbank private sector fell in nominal terms, for the second consecutive year; given the rise of prices, there was an even more pronounced drop in real terms. The total capital inflow of the private sector, excluding nonprofit institutions, came to \$735 million in 1975, as opposed to \$835 million the year before and \$1 billion in

Table III-4
LONG-TERM CAPITAL IMPORTS, 1967-75

Source	1967	1968	1969	1970	1971	1972	1973		1974	1975
							Jan.- Sept. ^a	Entire year		
	\$ million									
U.S. govt.	36	35	54	343	262	262	331	1,057	822	1,855
United Jewish Appeal and Israel Bonds	496	242	238	426	414	494	418	1,101	544	598
Private transfers and investment	215	286	317	405	595	827	850	815	745	709
Other loans	88	65	51	80	200	194	190	196	226	94
Total long-term capital	835	629	659	1,255	1,471	1,777	1,789	3,169	2,337	3,256
	Percent									
U.S. govt.	4.3	5.6	8.2	27.3	17.8	14.7	18.5	33.4	35.1	57.0
United Jewish Appeal and Israel Bonds	59.4	38.5	36.1	34.1	28.1	27.8	23.4	34.7	23.3	18.4
Private transfers and investment	25.7	45.5	48.1	32.3	40.4	46.5	47.5	25.7	31.9	21.8
Other loans	10.5	10.3	7.7	6.4	13.6	10.9	10.6	6.5	9.7	2.9
Total long-term capital	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

^a At annual rates.

1973. Only one item continued to advance--personal restitution from West Germany; this can be partly credited to the adjustment of the payments for the price inflation in that country. All other private sector capital items slipped noticeably; the ones losing most ground were investment from abroad, down from \$185 million in 1972 to \$80 million, and immigrant transfers, which were on the decline throughout the entire year and in the second half sank to a \$10 million quarterly level--roughly one-fourth their volume in 1972. These changes can be ascribed to a combination of factors: the economic slowdown in Israel and the belief that it would persist, the diminished profitability of investment, the downswing in immigration and its effect on transfers by newcomers, and the more precarious political and security situation compared with the prewar period. To these should be added a short-term speculative influence: the eroding balance of payments position and the failure to make any significant breakthrough here, which engendered expectations of further measures calculated to make foreign currency dearer in IL terms. These jitters affected the decisions of those transferring funds, increasing the tendency to send money out of the country and to delay receipts from abroad in various ways, legal and otherwise. It is hard to quantify the effect of this factor, but it cannot be ignored. The lack of any real progress in resolving the balance of payments problem and the strong probability of a rise in the relative price of foreign currency are apparently exacting no small price from the economy as far as capital imports go. The use of short-term funds to finance the current deficit was reduced in 1975, but the country's overall dependence on such sources continued to mount. In 1974 the figure came to \$1.3 billion, rising by an

additional \$660 million this year. In 1974 the bulk of the short-term funds came from running down foreign exchange reserves by \$780 million. In 1975 the reserves moved up a notch;³ the incremental short-term finance was obtained by borrowing abroad, with the banks playing the leading role. Their net⁴ liquid obligations to foreigners grew by more than \$500 million this year, after increasing \$460 million in 1974.

4. EXCHANGE RATE POLICY

In 1975 a more flexible exchange rate system was introduced, with a view to making it an instrument of current balance of payments policy and to diminish the need for large

Table III-5

FOREIGN EXCHANGE RESERVES AND NET FOREIGN LIABILITIES OF ISRAELI BANKS, 1970-75

(\$ million)

End of period	Foreign exchange reserves			Liquid bank obligations to foreigners		
	At Bank of Israel	Deposits of other central monetary institutions	Total official reserve assets	Deposits in foreign banks	Liquid obligations to foreigners	Net liquid obligations to foreigners (5-4)
	(1)	(2)	(3)	(4)	(5)	(6)
1970	459	24	483	369	631	262
1971	732	36	758	677	986	309
1972	1,230	57	1,287	1,134	1,343	209
1973	1,810	169	1,979	1,328	1,742	414
1974	1,200	58	1,258	1,246	2,166	920
1975	1,184	165	1,289	1,225	2,690	1,465
1972 I	1,021	40	1,061	719	1,039	320
II	1,085	41	1,126	637	912	275
III	1,108	36	1,144	818	1,045	227
IV	1,230	57	1,287	1,134	1,343	209
1973 I	1,445	77	1,522	1,162	1,359	197
II	1,519	145	1,664	1,223	1,536	313
III	1,607	144	1,751	1,347	1,855	508
IV	1,810	169	1,979	1,328	1,742	414
1974 I	1,648	131	1,779	1,408	1,696	288
II	1,416	124	1,540	1,298	1,708	410
III	1,145	77	1,222	1,155	1,608	453
IV	1,200	58	1,258	1,246	2,166	920
1975 I	1,489	48	1,537	825	2,077	1,252
II	1,481	60	1,541	839	2,031	1,192
III	1,237	49	1,286	947	2,089	1,152
IV	1,184	105	1,289	1,225	2,690	1,465

NOTE: The changes in the various items listed here differ from the asset and liability changes in Table III-3, since in the latter table they stem from current transactions only, whereas here they include foreign currency valuation adjustments and other changes of a noncurrent nature (such as the closure of the Israel-British Bank).

3. The data here refer to changes in the current flows only and not to foreign currency valuation adjustments.

4. I.e. the change in liquid obligations to foreigners less the change in liquid claims on foreigners.

devaluations with all their unsettling effects. The creeping devaluation was initiated at a time when the gravity of the balance of payments problem became even more pronounced, and it intensified the speculative exchange rate expectations.

While this expectational change was connected, from the aspect of its timing, with the introduction of the creeping devaluation, it can be understood only against the backdrop of the basic balance of payments problem and the growing awareness of its seriousness. Admittedly the mini-devaluations make the modification of the exchange rate a regular, less unexpected feature, thereby reducing the element of uncertainty and enhancing the attraction of holding foreign currency assets. By the same token, since there is no big lag in adjusting the rate, the expectations with regard to the overall rate of devaluation are diminished. The relative importance of these contrasting influences cannot be easily assessed, but it would seem that the new system cannot be blamed for the devaluation expectations, which reflect the country's balance of payments position and not the modification of exchange rate policy.