BANK OF ENGLAND

REPORT FOR THE YEAR ENDED

28th FEBRUARY

1966

Issued by Order of the Court of Directors, 7th July 1966

Court of Directors

28th February 1966

The Rt. Hon. the Earl of Cromer, M.B.E., Governor
Leslie Kenneth O'Brien, Esq., Deputy Governor
William Maurice Allen, Esq.
James Vincent Bailey, Esq.
The Rt. Hon. Lord Bicester
Sir George Lewis French Bolton, K.C.M.G.
Sir William John Carron
Sir Geoffrey Cecil Ryves Eley, C.B.E.
William Johnston Keswick, Esq.
The Rt. Hon. Lord Kindersley, C.B.E., M.C.
Cecil Harmsworth King, Esq.
Sir John Maurice Laing
Christopher Jeremy Morse, Esq.
The Rt. Hon. Lord Nelson of Stafford
Sir Maurice Henry Parsons
Sir William Henry Pilkington
Michael James Babington Smith, Esq., C.B.E.
Sir Henry Wilson Smith, K.C.B., K.B.E.

The term of office of Lord Bicester and Sir Geoffrey Eley expired on 28th February 1966; the Rt. Hon. Lord Robens of Woldingham, P.C., and Sir Ronald Thornton were appointed in their place for a period of four years.

The term of office of Mr. W. M. Allen and Sir Henry Wilson Smith also expired on 28th February 1966 and they were reappointed for a period of four years.

The term of office of the Earl of Cromer expired on 30th June 1966. It was announced in April that Mr. L. K. O'Brien had been appointed Governor in his place for a period of five years from 1st July 1966 and that Sir Maurice Parsons had been appointed Deputy Governor for the same period. Mr. J. Q. Hollom was appointed to the Court for the remainder of Sir Maurice Parsons' term of office as a Director, namely until 28th February 1969.

Bank of England

Report for the year ended 28th February 1966

The first part of this Report *discusses the main monetary developments during the year, most of which have already been reported more fully in the Bank's* Quarterly Bulletins. *The second part, which begins on page* 15 *with the Bank of England Return for* 28*th February* 1966, *deals with some particular aspects of the Bank's work.*

The year was an eventful one, particularly in the foreign exchange market. During the spring and summer of 1965 the pound came under very heavy pressure at times, caused largely by fears of devaluation. Then, from September onwards, confidence improved and sterling made a marked recovery. Primacy in economic policy had to be given to measures which would reduce the growth in the pressure of domestic demand and would restore a proper external balance: among these measures was the tightening of credit restrictions. By the end of 1965 the balance of payments had improved considerably; nevertheless, much further progress was necessary if the underlying external deficit was to be eliminated. Early in 1966, when home demand still remained high, more steps were taken to contain it, and in particular to secure continued restraint of credit.

The external situation

Foreign exchange market

After the exceptionally heavy drain on the reserves in November and December 1964, the pressure on sterling had gradually eased. In February 1965 there was even a moderate inflow of exchange, which arose mainly because relative interest rates made it advantageous for the accepting houses and overseas banks to switch a substantial amount of foreign currency deposits into sterling, for on-lending to local authorities and other domestic borrowers. The improvement, however, was short-lived. During February the U.S. authorities had taken steps to reduce their balance of payments deficit: these included restraints on bank lending abroad and an appeal to corporations to repatriate liquid funds and to reduce outward direct investment. The U.S. measures soon led to a general shortage of dollars, and the modest inflow of exchange into the United Kingdom ceased. Moreover, from the middle of March the approach of the Budget caused uncertainty in the market, and rumours of sterling devaluation became rife. There were very heavy sales of sterling during the last week of March and early in April; but they ceased after the Prime Minister's assurance in Paris, on 3rd April, that there would be no devaluation. The Budget three days later was well received in the market; and sentiment improved further after another speech by the Prime Minister, in New York on 14th April, in which he made it clear that on first taking office the Government had rejected devaluation as a solution to the country's balance of payments problems. Thereafter the authorities were again able to acquire foreign exchange for the reserves, while allowing the spot rate to rise gradually—from around \$2·79 at the beginning of April to almost \$2·80 at the end.

The better tone in the foreign exchange market was maintained for most of May, but towards the end of the month sentiment again faltered and the spot rate fell back to \$2·79¼. Confidence remained weak in June and July. The monthly trade figures continued to be disappointing and misgivings persisted abroad about the prospects for the economy: there were renewed rumours of sterling devaluation. The pressure ceased only briefly after the Chancellor's measures of 27th July (described later), and early in August there was again persistent talk of devaluation, accompanied by further large-scale selling of sterling. During these months the withdrawal of overseas funds from London was aggravated by the seasonal weakness of the balance of payments and by the conversion back into foreign currency of some of the funds which the banks had earlier switched into sterling.

Towards the end of August the pressure to sell sterling appeared to be petering out, and in the first few days of September the authorities were able to recover modest amounts of exchange. On 10th September, the announcement that further international resources had been mobilised behind sterling gave a marked impetus to the change in sentiment. From then until after the turn of the year a considerable amount of foreign exchange was acquired for the reserves, and the authorities were able to repay much of the short-term assistance taken in the summer. The spot rate moved up to over \$2·80, touching \$2·80½ in November and in January.

In February 1966, however, the rate fell back and demand for sterling slackened: the market was unsettled first by the threat of a rail strike and by poor trade figures for January, and later by uncertainty arising from the possibility of an early general election. On 28th February, when the date of the election was announced, the spot rate fell below \$2·80 for the first time since the previous September. Early in March it fell further, touching \$2·79¾ at one time; during the rest of the month it remained fairly steady at a little above this level.

By no means all the exchange that the authorities acquired from September onwards was used to repay short-term assistance, or to augment the reserves. Some of it was the counterpart of the reduction in the authorities' outstanding forward commitments. Up to September 1965 most of the very large number of forward contracts, originally entered into around the end of 1964, were extended as they matured, and from time to time, notably in March and August 1965, there was a fresh demand for forward exchange. The authorities' forward commitments with the market reached a peak at the end of August but thereafter were substantially reduced; by the end of February 1966 they had fallen to well below their level at the end of December 1964, the month in which the authorities had first supported the forward market on a large scale. They were little changed during March 1966.

Reserves and special assistance At the end of February 1965 the United Kingdom had already drawn the equivalent of \$1,000 million from the International Monetary Fund; and Switzerland, which is not a member of the Fund but is associated with the General Arrangements to Borrow, had provided a three-year credit in Swiss francs equivalent to \$80 million. In addition, \$705 million was outstanding under the swap facility with the Federal Reserve Bank of New York and short-term facilities with other central banks. By the end of April a further \$392 million (net) had been drawn under these facilities, raising the total of short-term assistance outstanding to \$1,097 million.

On 25th May the United Kingdom made a further drawing from the I.M.F., repayable within five years and equivalent to \$1,400 million. The drawing was made in eleven currencies: the Fund provided the equivalent of \$475 million from its existing currency holdings, \$400 million from the sale of gold, and \$525 million through the General Arrangements to Borrow. As in December 1964, Switzerland provided a parallel credit—for five years and equivalent to \$40 million. Of the total new borrowing of \$1,440 million, \$1,097 million was used to repay all outstanding short-term debt and the balance of \$343 million (£122 million) was added to the reserves.

After sterling came under renewed pressure, from June onwards, further recourse was made to the \$750 million swap facility with the F.R.B., and total assistance outstanding rose to a peak at the end of August. By then the whole of the \$750 million had been drawn and the U.S. authorities had provided an additional \$140 million, also on a swap basis. Despite these drawings, equivalent to £318 million, and the receipt of £41 million in July from Western Germany—as provision for future purchases under the agreement to offset part of the foreign exchange cost of U.K. military expenditure in that country—the reserves fell by £98 million between the end of May and the end of August.

As sentiment improved, a start was made in repaying short-term assistance. The special

$140 million swap was repaid early in September, and by the end of January $460 million more had been repaid. These repayments totalled the equivalent of £215 million; yet over the same five months the reserves rose by £155 million. In February 1966 the remaining $290 million (£103 million) outstanding under the credit facilities with the U.S. authorities was repaid; and that part of the official portfolio of dollar securities which had been put into liquid form, amounting to £316 million, was brought into the reserves, which rose by £225 million.

In March 1966, the United Kingdom paid £44 million in gold to the I.M.F., as part of its increased subscription. This payment, as noted on page 4, was offset by a special drawing of the same amount, and did not affect the reserves. These nevertheless fell by £27 million. During the month there were a number of inter-central bank operations, which together balanced out. Such operations can take various forms and are sometimes on a multilateral basis and not initiated by the United Kingdom. The largest of these operations during March was a special swap with the U.S. authorities for the equivalent of £54 million; this offset the reversal of other inter-central bank transactions entered into in earlier months.

Gold Private demand for gold had been exceptionally heavy in February 1965, partly because of rising political tension over Viet-nam but mainly because of criticism of the gold exchange standard which had been expressed in France. By early in March the dollar equivalent of the daily fixing price had risen to almost $35·18 per fine ounce. Demand then eased somewhat until late in July, when it strengthened appreciably, largely because of buying on Chinese account and the disturbed conditions in the exchange market. The price fell to under $35·09 at one point in June, but by early in August it was above $35·19; it then fell back to below $35·11 on expectations that the U.S.S.R. would sell gold in order to finance purchases of grain. The fall was only temporary, however, and demand was quite heavy for most of September after fighting had broken out between India and Pakistan. But following large sales on Russian account early in October the price eased again. During December and the first three months of 1966, demand was heavy at times and the price ranged up to over $35·17.

At the beginning of 1965 private demand for gold was sufficiently strong to exceed sales by producing countries, and the central banks' sales consortium began to operate for the first time since 1962. It continued in operation until the autumn, when demand subsided a little, and before the end of October all the gold which had earlier been subscribed by the members of the consortium had been repaid. Thereafter conditions in the market were quieter; and in fact over the year 1965 as a whole the gold pool bought a small amount of gold.

Balance of payments In 1965 the deficit on current and long-term capital accounts amounted to £354 million, compared with £769 million in 1964. Identified short-term capital flows roughly cancelled out over the year; but there was a large positive balancing item and the amount to be financed from the reserves, or by special assistance from abroad, was £248 million, compared with £697 million in the previous year.

The deficit on visible trade in 1965, at £265 million, was half the previous year's figure. Imports (f.o.b.) rose by only £38 million, or 1%: they were subject to the temporary import surcharge of 15% up to 26th April and of 10% thereafter. Exports increased more sharply—by £308 million, or 7%. About half the visible trade deficit was offset by net invisible earnings of £129 million, the same figure as in 1964. The net outflow of long-term capital totalled £218 million—£145 million less than the year before but still large compared with the immediately preceding years. As in 1964, both the invisible and the long-term capital accounts benefited, by about £62 million altogether, from the deferment of debt service due in December on North American loans.

There was a marked contrast between the first three quarters of the year, when £438 million had to be found from the reserves or from special assistance, and the fourth quarter, when there was a rise in the reserves, and repayment of assistance, together totalling £190 million.

In the first three quarters there was not only a large deficit on current and long-term capital accounts but also a substantial withdrawal of overseas funds. Net external liabilities in sterling, excluding the counterpart of special assistance, fell considerably up to August, and although the outflow was sharply reversed in September, there was a drop of about £200 million in the nine months as a whole. Net external liabilities of U.K. banks in non-sterling currencies were roughly unchanged—a large switch of foreign currency into sterling by U.K. banks during the first quarter being offset by switching back into foreign currency during the second and third quarters. On the other hand, there was an inflow, of about £80 million, into deposits with local authorities and finance houses (which are excluded from the figures of net external liabilities in sterling quoted above); and there was the special receipt of £41 million from Western Germany mentioned earlier.

In the fourth quarter, however, the current and long-term capital accounts were in rough balance. Moreover, confidence in the pound had improved, and net overseas holdings of sterling rose by about £140 million (including some £10 million of deposits with local authorities and finance houses). Net external liabilities in non-sterling currencies fell slightly.

The improvement in the trade deficit during 1965—from an annual rate, after seasonal adjustment, of £314 million in the first half of the year to £216 million in the second—did not continue during the first quarter of 1966: imports rose faster than exports and the deficit on visible trade increased.

Relations with international organisations

The study group on the creation of reserve assets, set up in 1964 by the countries known as the Group of Ten,(1) completed their report (the 'Ossola Report') in May 1965. This identified the main issues but did not make recommendations. After the Annual General Meeting of the I.M.F. in September it was announced by the Ministers and Governors representing the Group of Ten countries that their Deputies would resume discussions in order to determine what agreement could be reached on improvements in the international monetary system, including arrangements for the future creation of reserve assets. The Managing Director of the Fund also spoke of the intensive studies of the problem to be undertaken by the Fund staff and Executive Directors.

Meanwhile, action to increase conditional liquidity has been taken by the I.M.F. Following the agreement reached at the 1964 Annual General Meeting, a formal resolution was passed in March 1965 that there should be a 25% general increase in quotas and special additional increases for sixteen countries. The necessary majority of member countries finally gave consent to these increases by the end of February 1966, and the new quotas have since begun to come into effect as and when countries have paid their increased subscriptions. In the case of the United Kingdom, this was done on 23rd March; of the additional subscription of £175 million ($490 million) about £131 million was paid in sterling and £44 million in gold. As a result the United Kingdom's quota was raised from $1,950 million to $2,440 million. In accordance with procedures agreed for the general increase in quotas, the burden on the U.K. reserves of the gold payment to the Fund was mitigated by a simultaneous special drawing, of the equivalent of £44 million. Similarly, steps were taken to mitigate the effect of purchases of gold from the United Kingdom for the same purpose by other members of the Fund.

In October 1965, the General Arrangements to Borrow—under which the Group of Ten countries have agreed in certain conditions to make available to the I.M.F. $6,000 million in their own currencies over and above the amounts which may be drawn from their normal quotas—were renewed in advance for a further four years from October 1966, the date of expiry of the original Arrangements. At the same time, provisions were made for a review of the Arrangements after two years.

In the Organisation for Economic Co-operation and Development, Working Party No. 3 of the Economic Policy Committee met regularly to discuss the economic situation and the evolution of the balance of payments of various

(1) Belgium, Canada, France, Italy, Japan, the Netherlands, Sweden, the United Kingdom, the United States, and Western Germany.

member countries and to keep under 'multilateral surveillance' the means by which surpluses and deficits were being financed. The Working Party were also responsible for setting in train a study of the ways in which member countries could in the future preserve better balance of payments equilibrium and achieve faster and more effective adjustment of imbalance. This study was to be complementary to that by the Deputies of the Group of Ten.

Aid to developing countries It was announced in June 1965 that in future the United Kingdom would, under certain conditions, make interest free loans to less-developed countries.

In the field of multilateral aid, the United Kingdom agreed to subscribe $30 million to the new Asian Development Bank; and paid the first instalment, £11·5 million, of its additional contribution to the resources of the International Development Association.

The United Kingdom again played its part in the aid consortia, sponsored by the International Bank for Reconstruction and Development, to assist India and Pakistan. In 1965 the I.B.R.D., in conjunction with the I.M.F., formed a new group to help Ceylon; through this the United Kingdom promised aid to the equivalent of $10 million. The United Kingdom continued to participate as well in the work of the two aid consortia, under O.E.C.D. auspices, for Turkey and Greece. Agreement was reached in the Turkish consortium on the refinancing and rescheduling of certain of Turkey's international debts as well as on the granting of development aid.

The heavy burden of maturing debt obligations (largely caused through excessive reliance on suppliers' credit) continues to be a pressing problem for a number of less-developed countries. International action to tide over individual countries by refinancing or rescheduling their debts has provided the most immediate form of relief. This has continued to be most effectively achieved through international groups, such as the consortia already mentioned and the Paris Club—in which Argentina and Chile negotiated refinance agreements with their principal creditors, including the United Kingdom, during 1965.

The underlying causes of the problem of servicing debt, however, are bound up with the whole question of development programmes and the rates of growth of the less-developed countries. In this connection, the United Kingdom has supported an I.B.R.D. initiative for consultative groups to discuss the longer-term problems of the development programmes of individual countries: in 1965 the programmes for Tunisia and Nigeria were examined in this way and groups for several other countries were formed.

At the request of the United Nations Conference on Trade and Development, the I.B.R.D. staff prepared during 1965 a report on supplementary financial measures, which is to be considered internationally. This elaborated a scheme originally proposed by the United Kingdom and Sweden, the purpose of which is to provide assistance to less-developed countries whose development programmes are threatened with disruption because of an unexpected shortfall in export earnings. This plan is intended to be complementary to the existing I.M.F. compensatory finance scheme, which is essentially related to short-term fluctuations in export earnings and which may itself be extended in scope.

The domestic economy

1965 Budget The Budget in April 1965 was designed to recast part of the tax system and, in view of the external position, to curb the growth of domestic demand and to reduce the outflow of long-term capital. The tax on capital gains was to be extended, and the structure of company taxation was to be changed by the introduction of corporation tax. The cost of Road Fund licences was increased; higher duties were imposed on tobacco and alcoholic drink; and economies were to be made in public expenditure. The TSR 2 aircraft was cancelled; a general review of defence expenditure was in hand and the Chancellor undertook that the growth of public expenditure would be related to the prospective increase in national production. In his judgment at that time, this meant that the total of public expenditure, excluding investment by the nationalised industries, should not grow faster than $4\frac{1}{4}\%$ a year in real terms, taking one year with another, between 1964/65 and 1969/70. In all, the increased taxes announced in the Budget were expected to bring in £164 million in 1965/66—in addition to the yield of £122 million from the increase in income tax announced in the previous autumn—and £220 million in 1966/67. A further £32 million a year would accrue to the Post Office from the rise in postal charges announced just before the Budget.

Benefit to the balance of payments was to come not only from the restraint on home demand but also from exchange control measures (described more fully towards the end of this *Report*); these were designed mainly to affect the long-term capital account, where it was hoped to save at least £100 million in a full year. In particular, investment outside the sterling area was discouraged; new direct investment, if it was to be financed with official exchange, would have to show substantial short-term and continuing benefits to the balance of payments. The effect would be to increase the demand for investment currency. The supply of investment currency was to be restricted, however, with the object of diverting substantial amounts of foreign exchange into the official market: 25% of the proceeds of sales of foreign securities by U.K. residents and the whole of certain other currency receipts (such as gifts or receipts under wills or trusts), which had previously accrued to the investment currency pool, would have to be sold for sterling at the official rate. In addition, investment currency would no longer be made available for the purchase of houses abroad; and stricter supervision would be imposed over the issue of foreign exchange for travel purposes and over the receipt of export proceeds. Moreover, the corporation tax, once in operation, would make both existing and new overseas investment less attractive. It was later announced that the Government intended to cut overseas military expenditure by £50-100 million a year.

July measures Despite the measures taken in the Budget, the pressure of demand remained uncomfortably high and overseas confidence in sterling weak. Accordingly, the Chancellor acted on 27th July to reinforce his Budget. Further steps were taken to limit the growth of home demand. Public authorities were required to contain their expenditure on building houses, schools and hospitals within existing programmes; and to defer many other non-industrial capital projects for six months.(1) Local authorities were asked to limit their lending on mortgage for house purchase to £130 million in 1965/66 (compared with £180 million in 1964/65). Loan sanction and grants would be refused for non-essential local authority projects, and local authorities would be required to phase their borrowing from the Public Works Loan Board more evenly during the remainder of the financial year. Public authorities were to review their staff position, defer current purchases and, especially, look closely at expenditure overseas. Some social reforms were to be postponed; a more general review of public expenditure had been completed, and expenditure estimates for 1966/67 would be drawn up within its limits; and the Chancellor reaffirmed that cuts in defence expenditure would be made.

To relieve the building industry of strain, the Government would introduce construction licences for large projects other than housing and industrial building, and would take steps to control office building in the Birmingham area and to extend controls over industrial development in the London and South Eastern, Midland, and Eastern regions. The Chancellor also curtailed consumer credit further by reducing the maximum repayment period under hire purchase agreements for most goods from three to two and a half years.(2) This measure, he estimated, would reduce demand by about £65 million.

To improve the external payments position more directly, exchange control was tightened further. Direct investment outside the sterling area could no longer be financed at all out of the official reserves; and the supply of currency to the investment currency market was further restricted. The Bank of England were asked to exercise greater control over borrowing in this country by companies registered here but con-

(1) The deferment of individual projects was replaced, in February 1966, by stricter control over the total capital expenditure of the public sector. This would allow some projects to go ahead, while entailing no greater expenditure in total than under the arrangements of the previous July.

(2) Minimum down-payments had been increased on 3rd June, see page 8.

trolled from outside the sterling area; and, to complement the tighter supervision over the receipt of export proceeds introduced in the April Budget, payment for imports would normally no longer be allowed before the goods were despatched. Finally, to encourage exporters, the Chancellor introduced further improvements in export credit facilities; these are noted later in this *Report*.

Home demand

In spite of the budget measures, high Bank rate, the steps taken to curtail public expenditure, the strengthening of terms control on hire purchase transactions, and the restraint on lending by banks and other financial institutions (see below), demand seemed fully to extend capacity over the period under review. To a marked extent the pressure stemmed from the buoyancy of exports—but its strength came also from the resilience of aggregate home demand. The actual increase in demand was, in fact, quite moderate, but output per head rose only slowly and the labour situation became tighter.

Public sector expenditure continued strong, although public investment rose more slowly than in 1964. Fixed investment by private industry fell during the second half of 1965: the fall was confined to the distributive and service trades and to building work for manufacturing industry; manufacturers' investment in plant and machinery continued to grow. Investment in public sector housing increased during the year, but the rate of private house building dropped sharply in the second quarter and thereafter remained at much the same level. Total output, as measured by the index of industrial production, fell in the second quarter of 1965, but then recovered and moved slowly upwards into 1966.

Personal consumption turned down after the Budget, partly in reaction to heavy pre-Budget buying in the first quarter, but grew during the rest of the year. Stockbuilding fell towards the end of the year, but the accumulation of stocks in 1965 as a whole, although less than in 1964, was still substantial.

The number of unemployed fell during the year and by the early months of 1966 was very small. The tendency to adopt a shorter working week spread. Wage rates and earnings rose much faster than productivity or prices—a factor which undoubtedly contributed to buoyant consumption in spite of restraint on credit. It was in these conditions that the National Board for Prices and Incomes made their early reports, which laid particular stress on the need for increased productivity in return for wage increases and made positive suggestions for rationalising wage and price policies in the industries under review. The full value of the Board's work will be apparent only in the long run; in the short term the prices and incomes policy can claim to have had a restraining influence on prices, though it has been less successful in moderating the growth of incomes. Shortly before the dissolution of Parliament, the Government introduced a Bill to give statutory effect to a system of advance notification of wage claims and price increases. In September 1965 such a system had been arranged, on a voluntary basis, with the Trades Union Congress and the Confederation of British Industry. In addition, any firm which planned to increase the price of certain key goods and services had been asked to inform the Government beforehand.

Credit restraint

In December 1964 the Governor had written to the chairmen of the Committee of London Clearing Bankers and of the other main banking associations asking that—while giving priority to credit for exports and for productive investment by manufacturing industry, and having regard to the Government's aims on regional development—the banks should reduce the rate of increase of their advances, by curtailing lending for purposes of lesser national importance. He had written in similar vein to the chairmen of the British Insurance Association, the National Association of Pension Funds, the hire purchase associations and the Building Societies Association, making it clear to the last-named of these that it was not intended to affect building societies' lending to owner-occupiers.

In the next few months the upward trend of the London clearing banks' advances was noticeably checked; but in the month to mid-April 1965 there was a particularly large increase, after seasonal adjustment, in advances and a very sharp rise in the banks' holdings of commercial bills. On 29th April, as soon as the figures were known, the Bank called for Special Deposits of 1% from the clearing banks and of ½% from the Scottish banks: these were to be made in two stages, one-half by 19th May and the rest by 16th June.

On 5th May, the Governor wrote again to the Chairman of the Committee of London Clearing Bankers, emphasising that the authorities wished the call for Special Deposits to be fully reflected in the banks' lending policies and mitigated as little as possible by the sale of investments. The aim was that the banks' advances to the private sector should not increase at an annual rate of more than about 5% during the twelve months to March 1966. The banks should similarly limit their acceptances and purchases of commercial bills. The guidance given in the Governor's previous letter concerning the direction of lending in general still stood; but it had become more than ever important to give first place to exports and to activities contributing directly to their increase. The Governor also wrote to the Accepting Houses Committee, to the organisations of overseas banks in London, and to the London Discount Market Association, asking that their members should observe a comparable degree of restraint. A similar request was addressed to the Scottish banks, although in their case allowance could be made for the differences between conditions in Scotland and those in the rest of Great Britain. The banks in Northern Ireland were not requested to apply the same degree of restraint to the expansion of bank credit there, but were asked to keep in mind the aims of official policy and to do what they could to further their achievement. The Governor also wrote to the associations of hire purchase finance houses—and subsequently letters were sent to a number of large houses which were not members of those associations—asking them to restrain their financing of the private sector over the year to March 1966 to the same degree as the London clearing banks. Members of the British Insurance Association, the National Association of Pension Funds and the Building Societies Association were also requested to co-operate in their own fields, in particular in relation to the finance of building and of property development, other than housing for the owner-occupier.

On 3rd June, Bank rate was reduced from 7%, at which it had stood since 23rd November 1964, to 6%. This was still a very high rate, and the reduction did not imply any relaxation in the restrictions on credit: indeed, on the same day, minimum down-payments required under hire purchase agreements were increased—from 20% to 25% for cars and motor cycles and from 10% to 15% for most other goods. On 27th July, as already noted, the maximum repayment period was reduced from three to two and a half years.

Also on 27th July, the Governor wrote a further letter to the Chairman of the Committee of London Clearing Bankers and to the other main banking organisations. He re-emphasised the importance of encouraging exports and pointed out that the need to restore the balance of payments to equilibrium at the earliest possible date made it equally important to restrain the growth of finance for imports—especially those of manufactured goods for home consumption and imports for stockbuilding. While appreciating that it was often difficult to distinguish between credit needed to pay for imports and credit for other purposes, the Governor asked the banks to scrutinise requests for credit even more carefully than before where it appeared that the purpose might be to facilitate payment for imports.

On 1st February 1966, the London clearing banks were asked to ensure that, until further review, their advances, acceptances and holdings of commercial bills—taken separately, and after making allowances for seasonal factors—did not rise above the levels set for March 1966 in the Governor's letter of the previous May. The guidance given about the direction of lending remained unchanged. The Accepting Houses Committee and the organisations of overseas banks in London were requested similarly to limit their sterling advances, acceptances and commercial bill holdings. The London Discount Market Association and the hire purchase finance houses were asked to observe a comparable degree of restraint: and the other institutions to which the Governor's letters of May 1965 had been addressed were requested to co-operate by maintaining an appropriate degree of restraint in their own transactions.

On 7th February, hire purchase terms were tightened further. Minimum down-payments were raised from 15% to 25% (the level which had obtained since June for cars and motor cycles); and the maximum repayment period for most goods was reduced from thirty to twenty-four months (twenty-seven months for cars and motor cycles). Rentals required in advance under hiring agreements were increased from twenty to thirty-two weeks.

Exchequer finance

In the financial year 1965/66 the Exchequer's surplus of revenue over expenditure was nearly £700 million. But loans from the Consolidated Fund totalled over £1,250 million; those to local authorities were particularly heavy. Taking into account also net receipts from extra-Exchequer funds, the central government's net borrowing requirement was just under £500 million.

The sterling cost of the rise in the reserves during the year was only partly matched by an increase in overseas holdings of government debt, and the central government's domestic borrowing requirement was nearly £550 million. This amount was provided almost entirely by the banking sector; holdings of notes and coin outside the banks rose by about £240 million, but this rise was almost offset by a fall in non-bank holdings of government debt, both marketable and non-marketable.

The fall in government debt held outside the banking sector owed much to two factors. First, there was a large net withdrawal, of £118 million, from national savings—the first in any financial year since 1955/56. Although some forms of small savings did relatively well, sales of national savings certificates were substantially exceeded by encashments. The current series of savings certificates, even if held for six years, yielded only about 3¾% tax free and thus was unattractive, particularly in comparison with investment in building societies. (On 1st March 1966 the Chancellor announced the issue of a new series of certificates, from 28th March, to yield just over 4½% tax free if held for five years.) Secondly, although investors outside the banks had bought government stocks in the autumn of 1965 they reduced their holdings quite considerably in the first quarter of 1966—which left them lower on balance over the year as a whole. Much of the reduction in the first quarter of 1966 was attributable to 5½% Exchequer Stock 1966, which was redeemed on 15th March. The amount of this stock in the public's hands at maturity was unusually large. When it went ex-dividend on 7th February, the price (less rebate interest) was just above the original price of issue of 99½—and was within the band, between the lowest price of issue and the redemption price, in which a stock may appreciate without attracting capital gains tax. The tax free gain to redemption attracted buyers, who pushed up the price to beyond the level that the authorities were prepared to pay. The authorities therefore were not offered as much of the stock in the last weeks of its life as they would normally have been.

The banks

London clearing and Scottish banks The general public's lack of appetite for government debt contributed to a substantial increase in bank deposits. Net deposits with the *London clearing banks* rose by £534 million, or 6½%, during the year to mid-March 1966. The rate of growth slackened a little in the autumn, when the improvement in confidence encouraged large purchases of government debt by the general public, but it was soon resumed.

The banks' liquid assets increased by £221 million, advances by £155 million, and investments (largely in government stocks) by £63 million. In addition, the clearing banks placed £92 million of Special Deposits with the Bank of England.

The increase in liquid assets was mainly in Treasury bills, notes and coin, and lending to the discount houses. The banks' holdings of commercial bills and their loans at call and short notice outside the discount market were little changed. The combined liquidity ratio of the London clearing banks at mid-March 1966, at 30·1%, exceeded the accepted minimum (currently 28%) by rather more than usual in this month: the fairly high level of bank liquidity was of some concern to the authorities—although it did not pose an immediate problem while lending to the private sector was directly restrained through the Governor's requests.

The banks' advances in fact kept well within the limit that the Governor had requested in

May. After seasonal adjustment, and excluding those to the nationalised industries, they had increased sharply in the month to mid-April 1965; but, following the call for Special Deposits, they fell equally sharply in May. The annual rate of growth, seasonally adjusted, shown by the figures for each subsequent month was never more than about $3\frac{1}{2}\%$ until February, when it rose to 4%: over the year to mid-March 1966 as a whole advances grew by $2\frac{1}{2}\%$.

Net deposits with the *Scottish banks* grew slightly faster than those with the clearing banks—by £65 million, or 8%. But these banks' advances were virtually unchanged over the year; and nearly all the growth in deposits was reflected in liquid assets, mainly money at call and short notice.

Analysis of advances

It has already been noted that the Governor's requests concern not only the total amount of credit granted but also the directions in which it should be channelled. The banks' response can be best gauged from the quarterly analysis of advances issued by the British Bankers' Association. After excluding lending to the nationalised industries, advances increased by £247 million during the year to mid-February 1966. Within this total, lending to personal and professional borrowers, hire purchase finance companies, and the 'other financial' category (which includes property companies) fell by £117 million—compared with an increase of £146 million in the preceding twelve months. On the other hand, advances to manufacturing industry and unclassifiable industry and trade increased faster than in the previous year, by £293 million compared with £252 million: half the latest year's rise was due to the engineering industry.

Accepting houses and overseas banks

The limit on advances covers also sterling lending by the accepting houses and overseas banks. The series of figures available for these banks is of fairly recent origin and cannot appropriately be seasonally adjusted—so that it is difficult to trace the trend of their advances over the year. By the end of March 1966, however, the total of their sterling advances was broadly unchanged from a year earlier; those to U.K. residents had increased by £57 million ($6\frac{1}{2}\%$) but those to overseas residents had fallen by much the same amount.(1)

Commercial bills

Finance by means of commercial bills, to which the 5% limit also applies, increased quite sharply between the end of March 1965 and the end of December, but fell during the first quarter of 1966. These figures, too, are not yet capable of satisfactory seasonal adjustment: part of the earlier rise may have been due to seasonal causes, while part may have reflected the banks' difficulties in curtailing acceptance credit facilities which had already been agreed with their customers.

In the year to the end of March 1966, the total of commercial bills held by the banking sector increased by £100 million (11%). A substantial part of this rise, however, related to bills drawn in foreign currencies;(2) and the increase over the year in the banking sector's holdings of sterling commercial bills was some £60 million, or about 7%. Some further reduction in these holdings was therefore necessary in order to meet the Governor's request. Such a reduction could well be helped by the sharp decline, between December 1965 and March 1966, in outstanding acceptances by the banking sector—the first quarterly decrease of any size recorded in the three years since this series of figures began.

Other sources of credit

Hire purchase finance houses

The Governor's letter to the finance houses, in May 1965, had asked that their lending to the private sector, during the year ending March 1966, should not grow by more than about 5%. The total of outstanding hire purchase debt owed to finance houses had already risen sharply during April 1965, and it continued to grow, partly for seasonal reasons, until September. It then

(1) Rough allowance has been made for the netting-out during the year of the overseas banks' balances on inter-branch accounts—which reduced both sterling deposits by, and advances to, overseas residents by about £60 million.

(2) Noted in the March 1966 *Quarterly Bulletin*, page 8.

fell, and declined further until the end of the year; but in the first quarter of 1966 it rose again. Demand for cars on hire purchase was then heavy, possibly because of fears that purchase tax might be increased in the Budget. At the end of March total lending by the finance houses—both on hire purchase and credit sale agreements, and in other ways—was £74 million ($7\frac{1}{2}\%$) higher than a year earlier. As the Governor's letter of 1st February 1966 had asked that the limit of 5% over the March 1965 figure should continue for the time being, there was thus no further scope for the finance houses to increase their lending: indeed, some reduction was necessary.

Early in 1965 the houses were competing actively for funds in response to a keen demand for credit and, particularly around the end of March, rates of over 8% were offered for three months' deposits. During the summer, when the houses were under pressure to repay bank advances, they remained keen competitors for deposits; and although the three months' rate had fallen to $6\frac{1}{4}\%$–$6\frac{1}{2}\%$ by the autumn, it was still quite high in relation to the rate offered by local authorities. Thereafter rates remained fairly steady until early in March, when they increased because of seasonal pressures, to $6\frac{1}{2}\%$–7% for three months' money.

Building societies

In the early months of 1965 the building societies were under heavy pressure. Demand for mortgages was strong. For social reasons it was not desirable to restrain the societies' lending and, indeed, in the Governor's letters loans to owner-occupiers were specifically excluded from restraint. The societies had raised their borrowing and lending rates on 1st February, but were still unable to attract sufficient funds. Many would-be borrowers had to be refused; even so the societies' average liquidity ratio (cash and investments, other than mortgages, expressed as a proportion of total assets), which had fallen continuously for more than a year, fell further. At the end of March 1965 it was 13·2%, compared with nearly 17% early in 1964.

Further pressure would have come from the restriction on local authority lending for house purchase imposed on 27th July, but by this time the societies had begun to attract funds —mainly as a result of a further $\frac{1}{4}\%$ rise in their borrowing rates (to 4% on shares and $3\frac{3}{4}\%$ on deposits, both tax paid) announced early in June and effective from 1st July. From then on the societies were securing sufficient funds to enable them both to extend their lending and to restore their liquidity position. Some of the smaller societies were charging more for loans, but the rate recommended by the Building Societies Association remained at $6\frac{3}{4}\%$; and for many societies the ratio of reserves to total assets (which by the end of 1965 averaged only a little over 4%) was under some strain. The early months of 1966 brought little change in the situation. Advances continued at a high rate, but the inflow of funds was at first greater, and the average liquidity ratio rose to 17% in February before falling back a little in March. The narrow margin, however, between the societies' earnings and their outgoings, coming at a time when there was a marked growth in lending, meant that the average reserve ratio fell further.

Other financial institutions

Insurance companies and *pension funds* again had large accruals of funds to invest in 1965. Both groups bought substantial amounts of debentures (especially in the second half of the year), of ordinary shares and of gilt-edged. Insurance companies' lending on mortgage increased around the middle of the year; much of the increase was in loans for house purchase, which had been difficult to obtain from the building societies. It fell away again after September, when the building societies were increasing their lending.

Net sales to the public of *unit trust* units were large, despite some slackening around the middle of the year. The inflow to *investment trusts* was less than to unit trusts, because their new capital issues were smaller than for many years. The trusts sold quite a large amount of overseas investments but bought gilt-edged and U.K. company securities and increased their holdings of cash and their temporary deposits with local authorities.

Money and capital markets

Treasury bills

During most of the year under review the discount market remained very short of Treasury bills. The discount houses were therefore inclined to raise the price at which they tendered in order to obtain good allotments, although they realised that the economic situation was such that too large or too rapid a fall in the rate was likely to be unwelcome to the authorities.

Early in 1965 the discount houses' Treasury bill portfolios were so seriously depleted, at just over £200 million (less than one-fifth of their total assets), that they sometimes had difficulty both in finding bills to lodge with the banks as security for call money and in meeting the banks' full requirements for their own account. In these circumstances the houses wished to secure as large an allotment as possible of the relatively few bills on offer. Their tender rate fell by $\frac{3}{32}\%$ early in March, to just under $6\frac{3}{8}\%$. It was then raised sharply to $6\frac{9}{16}\%$ because, with sterling weak, the authorities enforced substantial borrowing at Bank rate; but it fell back steadily, despite further borrowing at the Bank, to $6\frac{5}{16}\%$ by early May. There was then practically no margin between the market's tender rate and the average cost of their borrowed money. On 4th June, after the 1% reduction in Bank rate, the houses reduced their tender rate by just under $\frac{3}{4}\%$, to $5\frac{21}{32}\%$. During the next six months they were still concerned to obtain adequate allotments and the rate tended to fall further—although it was forced up, from time to time, as the houses were made to borrow at Bank rate. By early in December it had fallen to $5\frac{3}{8}\%$.

The declining trend was then abruptly reversed. Following a $\frac{1}{2}\%$ increase in the U.S. discount rate, on 6th December, the tender rate in London rose over two weeks by $\frac{5}{32}\%$, to $5\frac{17}{32}\%$. By the middle of February it had increased further, to $5\frac{5}{8}\%$. But throughout March—when the election was in prospect, and competition for bills at the tenders was a little less keen—the discount houses were able to obtain reasonable allotments with little manœuvring of their bid; their holdings were almost double the level of a year earlier. The rate remained around $5\frac{5}{8}\%$.

Gilt-edged In the early months of 1965 the gilt-edged market was mainly affected by fluctuations in the strength of sterling, which alternately aroused and dispelled hopes of a reduction in Bank rate: in addition, there was widespread uncertainty about the effect of the capital gains tax which had been foreshadowed in the November 1964 Budget. Some of this uncertainty was resolved by the April Budget: but more was created on 26th May, when the Chancellor announced that, for stocks which had been issued at a discount before Budget day, there would be a tax free zone between the lowest price at which a stock had been issued and its redemption price. This decision again altered the relative attraction of different stocks and when dealings were resumed, after being briefly suspended on 27th May while the implications of the Chancellor's announcement were assessed, a certain amount of switching took place. The uncertainty over taxation remained until the Finance Act was passed in August.

The market had rallied a little in April, after the Budget, when the better tone in the foreign exchange market led to strong expectations of a reduction in Bank rate. These hopes faded, however, when Special Deposits were called at the end of April, and by early August the market had been generally weak for the best part of six months. Prices then recovered: there was a growing belief that the economy was beginning to respond to the Government's measures. The recovery was helped by some good trade figures for July and, a month later, by the announcement of the fresh international resources which had been made available to back sterling. Throughout September and most of October the market strengthened steadily, but early in November the demand for longer-dated stocks faltered. The institutions normally provide much of this demand; their accruing funds were needed instead to meet calls on the very heavy issues of company fixed interest securities that had been made since the autumn. At the beginning of December the weakness spread to shorter maturities, inspired first by concern about Rhodesia and then by the increase in the U.S. discount rate and the subsequent rise in short-term rates in London. By the end of December prices had lost much of the ground that they had gained since August.

The market rallied a little in the new year, but prices fell back again in February in the face of disappointing trade figures and rising interest rates in the United States. They fell again, quite sharply, early in March, primarily because of the weakness of sterling.

Over the year to the end of March 1966 there was a substantial net increase in yields. The yield on $2\frac{1}{2}\%$ Consols rose by $\frac{1}{4}\%$, from just over $6\frac{3}{8}\%$ to about $6\frac{5}{8}\%$; on 20-year stocks the rise was much the same, to around $6\frac{3}{4}\%$; while on short and medium-dated issues yields rose by $\frac{1}{4}\%$–$\frac{3}{8}\%$, to touch 7%.

During the course of the year the authorities bought in, or redeemed for cash, almost £350 million of 3% Savings Bonds 1955/65 and over £900 million of $5\frac{1}{2}\%$ Exchequer Stock 1966. They were able, however, to sell substantial amounts of other stocks to the market, particularly during April and from August until December, and over the year as a whole net official purchases of stocks (including the redemption payments) totalled some £180 million.

In June £100 million each of $6\frac{1}{2}\%$ Exchequer Loan 1969 and $6\frac{1}{2}\%$ Treasury Loan 1976 was offered at par for cash, and holders of the maturing Savings Bonds were invited to convert at par into either or both of the new stocks. In September £600 million of 6% Funding Loan 1993 was issued at 96, with the aim of replenishing official holdings of long-dated stocks, which had been negligible for some months; and in November £500 million of a short-dated stock, 6% Exchequer Loan 1970, was issued at 99.

Local authorities The amount, and the timing, of local authorities' borrowing from the market during the year was strongly influenced by the sums that they could raise, at favourable rates, from the P.W.L.B. For the financial year 1965/66, P.W.L.B. quotas were raised to 30% of each authority's long-term borrowing requirement (or £100,000, whichever was the greater);(1) in the previous year the quota had been only 20% (or £100,000).

At the end of March 1965, local authorities were under some pressure. Their new quotas with the P.W.L.B. were not yet available; deposits were probably being withdrawn from them to meet tax payments; and with Bank rate at 7% they were reluctant to borrow other than at short term. In consequence, they paid as much as 9% for seven-day money, and 8% for three months' deposits. In April, however, as new quotas became available with the P.W.L.B., conditions in the temporary money market eased, and rates fell back. In the following three months the authorities drew heavily on the P.W.L.B., and by the end of June they had taken about £180 million, one-half of the amount budgeted for the whole of 1965/66. Substantial sums were also raised through new capital issues—so much so that by July the market was finding some difficulty in absorbing them. Because of the heavy borrowing in these ways, and the reduction in Bank rate at the beginning of June, the rate for three months' temporary money fell by a full 1% (to $6\frac{3}{8}\%$) between mid-April and mid-July; during the same period the Treasury bill tender rate fell by $\frac{7}{8}\%$.

The rate at which local authorities were drawing on the P.W.L.B. caused official concern, and on 27th July they were required to spread the remainder of their borrowing more evenly throughout the rest of the financial year—with those which had already drawn more than half their year's quota being denied further access to the Board until 1st October. The effect was to force local authorities to borrow rather more from the market over the next few months—although to some extent their borrowing needs were lessened as a result of the curb on their expenditure imposed in July.

During August to October local authorities raised quite large sums in the mortgage market and borrowed heavily on short-term bonds.(2) Demand for these bonds increased as, for the first time since they were issued early in 1964, their yields were temporarily above the rate offered for deposits for a comparable term, and they became more easily marketable. In addition, in September and October an inflow of foreign funds enabled the authorities to borrow more cheaply on temporary money. The three months' rate fell to $6\frac{1}{8}\%$ by the middle of October; and although

(1) The quota was later increased to 40% for authorities in less prosperous areas.

(2) Borrowing on bonds was attractive to local authorities, because all issues for more than 364 days then counted as 'longer-term' borrowing and thus increased local authorities' quotas, at a favourable rate, with the P.W.L.B.

it rose a little over the turn of the year—influenced by the increase in the U.S. discount rate and by withdrawals of funds for window dressing—it had fallen back again to around $6\frac{1}{8}\%$ by the end of February. It then rose to $6\frac{3}{8}\%$ during March. This was a smaller increase than might have been expected: the redemption of $5\frac{1}{2}\%$ Exchequer Stock on 15th March, mentioned earlier, apparently resulted in a considerable volume of funds being held temporarily in liquid form, and local authorities had a relatively easy passage over the end of March.

Debentures and equities For most companies the corporation tax had the effect of making it distinctly cheaper to borrow on loan capital than to raise finance by issuing shares, and the supply of fixed interest issues by companies increased substantially in relation to equities. During the twelve months to the end of March 1966, issues of company fixed interest stocks raised a net sum of about £470 million, compared with some £270 million in the previous year: equities raised about £150 million in each year.

The fortunes of the debenture market generally followed those of the gilt-edged market. Yields were high in the early months of 1965. According to the F.T.-Actuaries calculation, the yield on 20-year company stocks touched $7\frac{1}{8}\%$ in mid-April; after a brief improvement it continued to rise until September, when it reached almost $7\frac{1}{2}\%$. High yields, however, did not deter borrowers, some of which were no doubt pressed by their banks to fund bank advances: they raised almost £50 million (net) in July alone, and a further £100 million in the three months from August to October. Yields began to decline during September, but, in sympathy with gilt-edged, they moved up again in November and rose further in the first three months of 1966. By the end of March the yield on 20-year stocks stood just below $7\frac{5}{8}\%$. The flow of new issues continued at a very high rate: the previous monthly record in July was exceeded in November and again in February and March 1966. Turnover in the market, too, continued to be heavy.

Equities were subdued for much of the year. Throughout the summer the market was strongly influenced by the uncertainties arising from the new taxes and from the general economic situation. Prices were generally falling until the end of July, when they were at their lowest for over two years: the F.T.-Actuaries index of industrial share prices, which had stood at 106 at the end of March, had by then declined to 99. Thereafter, the market recovered. There was some return of confidence in the economic outlook, helped by the better tone for sterling; but the main factors were the dearth of new issues, the continuing accrual to the institutions of funds for investment, and the reluctance of investors to sell because of the capital gains tax. By the end of October the index had moved up to 113; it fluctuated little in the following five months and was still at that level at the end of March. Turnover was noticeably higher after September than during the summer months, and fell only slightly during March after the date of the election was announced.

Bank of England

28th February 1966

Issue Department

	£		£
Notes issued:		Government debt	11,015,100
In circulation	2,784,311,196	Other government securities ...	2,787,919,108
In Banking Department	16,050,063	Other securities	805,547
		Coin other than gold coin ...	260,245
		Amount of fiduciary issue ...	2,800,000,000
		Gold coin and bullion ... ... (@ 251*s.* 1*d.* per fine ounce)	361,259
	2,800,361,259		2,800,361,259

1st March 1966 J. Q. Hollom, *Chief Cashier.*

Banking Department

		£			£
Capital		14,553,000	Government securities		380,114,491
Rest		3,921,593	Other securities:		
Public deposits ... ... (including Exchequer, savings banks, Commissioners of National Debt, and dividend accounts)		12,968,818	Discounts and advances	69,734,084	
Special Deposits		97,500,000	Securities	28,115,453	97,849,537
Other deposits:			Notes		16,050,063
Bankers	271,750,010		Coin		834,402
Other accounts ...	94,155,072	365,905,082			
		494,848,493			494,848,493

1st March 1966 J. Q. Hollom, *Chief Cashier.*

Half-yearly payments of £873,180 were made to H.M. Treasury on 5th April and 5th October 1965 in pursuance of Section 1 (4) of the Bank of England Act 1946.

Note circulation

Changes in the note circulation in recent years are shown in the following tables:

Value of notes issued, paid and in circulation

£ millions

Year to end of February	1962	1963	1964	1965	1966
Issued	2,268	2,403	2,672	2,836	3,111
Paid	2,179	2,396	2,551	2,662	2,931
In circulation at the end of year	2,302	2,309	2,430	2,604	2,784
Percentage increase in circulation over the year ...	*4·0*	*0·3*	*5·2*	*7·2*	*6·9*

Value of notes issued by denominations

£ millions

Year to end of February	1962	1963	1964	1965	1966
10*s.*	247	239	245	245	256
£1	1,231	1,301	1,380	1,415	1,551
£5	790	863	1,024	1,069	1,217
£10[(a)]	—	—	16	107	87
Over £10[(b)]	—	—	7	—	—

(a) The issue of £10 notes was suspended between 1943 and 21st February 1964.

(b) The issue of £20, £50, £100, £500 and £1,000 notes was discontinued in 1943; but notes of over £1,000 are still used within the Bank of England on behalf of customers, *e.g.*, they are held for banks of issue in Scotland and Northern Ireland as cover for their excess note issues. The figures for these notes, in all these tables, cover the net changes in the amount held for customers: a net rise is included in notes issued and a net fall in those paid.

Value of notes in circulation by denominations

£ thousands

End of February	1962	1963	1964	1965	1966
10*s.*	103,714	95,481	96,985	99,638	104,731
£1	1,091,365	982,963	1,024,525	1,012,485	1,024,270
£5	998,491	1,124,132	1,179,277	1,274,344	1,397,612
£10	447	400	16,012	105,107	147,387
£20	193	185	178	170	166
£50	382	357	339	310	297
£100	660	628	586	558	532
£500	57	52	50	46	46
£1,000	82	74	73	71	70
Over £1,000	106,750	105,050	111,950	111,650	109,200
	2,302,141	2,309,322	2,429,975	2,604,379	2,784,311

Proportion of notes in circulation by denominations

End of February	1956[a]	1963	1964	1965	1966
		Per cent by value of total circulation			
10s.	5·3	4·1	4·0	3·8	3·7
£1	75·9	42·6	42·2	38·9	36·8
£5	13·5	48·7	48·5	48·9	50·2
£10	} 0·2	} 0·1	0·6	4·0	5·3
£20–1,000			0·1	0·1	0·1
Over £1,000	5·1	4·5	4·6	4·3	3·9
	100·0	100·0	100·0	100·0	100·0

(a) Before the introduction, in February 1957, of a coloured £5 note.

The note circulation reached a peak of £2,946 million on 22nd December 1965; this was £121 million higher than the previous peak figure of £2,825 million reached on 28th July 1965 and £180 million higher than the Christmas peak in 1964.

Fiduciary issue

The fiduciary issue rose on balance over the year by £150 million to £2,800 million. The changes were as follows:

					£ millions
1965	February	27th			2,650
	March	15th	+50		
	April	12th	+50		
	June	15th	+50		
	July	13th	+50		
	August	31st		−50	
	November	26th	+50		
	December	6th	+50		
	December	10th	+50		
	December	20th	+25		
	December	29th		−25	
1966	January	4th		−50	
	January	10th		−50	
	January	17th		−50	2,800

Demand for new notes

Over the past few years the public have displayed a rapidly growing preference for new bank notes, rather than used ones, with the result that since 1957 the average life of a £1 note has fallen from nineteen months to eight, and that of a 10s. note from six months to five. This, coupled with a rising total circulation, has presented serious problems to the commercial banks and to the Bank of England. To meet the demand the Bank print an average of over 8 million notes a day, mostly £1 and 10s., which have to be widely transported with appropriate security precautions—both by the Bank and by the commercial banks—and ultimately returned for destruction.

The greater use of £5 and £10 notes helps to reduce the number of notes both issued and in circulation; and drawings in these denominations will be encouraged by the banks. There is also a need, however, for notes of all denominations to be used longer before being withdrawn. The Bank and the commercial banks are therefore at present encouraging the public to accept used, but clean, notes instead of new ones, thus reducing the number of notes withdrawn for destruction which are still fit for use.

Tax reserve certificates

The number of applications for tax reserve certificates during the year was slightly higher than in previous years, but the total value of certificates applied for was appreciably lower. Surrenders, too, were lower than in earlier years but were still £50 million more than the value applied for. The amount of certificates outstanding thus fell substantially, for the fourth consecutive year, and at the end of February 1966 was less than £200 million for the first time for over twenty years.

The following table shows the number and value of applications for certificates received in the Bank over the last seven years and the value of certificates surrendered:

Year to end of February	Rate of interest in force at end of February	Applications		Surrenders			Change during year	Outstanding at end of period
		Number	Total value	Cancelled in payment of taxes	Repaid without interest	Total		
	%	*000's*	*£ millions*					
1960	2½	75	295	341	3	344	−49	347
1961	3	91	391	337	9(a)	346	+45	392
1962	3¼	104	374	364	3	367	+ 7	399
1963	2¼	94	279	323	4	327	−48	351
1964	2¼	92	249	307	3	310	−61	290
1965	3½	106	270	306	7(a)	313	−43	247
1966	3½	115	191	239	2	241	−50	197

(a) These surrenders were largely offset by purchases of new certificates bearing a higher rate of interest.

Management of stock registers

The nominal totals in recent years (and, for 1966, the number of accounts) of the different groups of stocks managed by the Bank are given below:

End of February	1963	1964	1965	£ millions 1966	Number of accounts 000's 1966
British government securities:					
Stock	17,716	17,965	17,578	18,663(a)	2,072
Bearer bonds	13	15	17	16	—
Total	17,729	17,980	17,595	18,679	2,072
Other securities:					
Government guaranteed	1,851	1,837	1,833	1,777(a)	261
Commonwealth, etc.	237	251	236	216	86
Local authorities	298	352	421	473	152
Public boards, etc.	82	88	98	107	33
Miscellaneous	15	15	15	15	1
Total	2,483	2,543	2,603	2,588	533
Grand total	20,212	20,523	20,198	21,267	2,605

(a) As from 1st April 1965, the full liability for stocks of the British Overseas Airways Corporation (amounting to £52 million) was assumed by H.M. Treasury under the Air Corporations Act 1966.

Note: The figures for British government stock do not include amounts on the registers of the Bank of Ireland, the Post Office Savings Department and the trustee savings banks.

Operations undertaken during the year included:

Repayments

At par

			£ millions
Swansea Corporation 3% Redeemable Stock 1955/65	1965	30th June	2·2
Corporation of London 3% Stock 1962/65		1st August	0·5
Liverpool Corporation 5% One-Year Bonds repayable 5th August 1965		5th August	1·0
3% Savings Bonds 1955/65		15th August	192·5
New Zealand Government 3¼% Stock 1962/65		1st September	17·0
Government of Southern Rhodesia 3¼% Stock 1955/65		1st September	1·4

Issues

For cash

				£ millions
Swansea Corporation 6⅞% One-Year Bonds repayable 10th March 1966	@ £100%	1965	10th March	1
6½% Exchequer Loan 1969	@ £100%		22nd June	100
6½% Treasury Loan 1976	@ £100%		22nd June	100
Swansea Corporation 6¾% Stock 1973/74	@ £99:10*s.*%		30th June	3
New Zealand Government 6¾% Stock 1971	@ £98:10*s.*%		10th August	10
Liverpool Corporation 6⅞% One-Year Bonds repayable 11th August 1966 ...	@ £99:17*s.* 6*d.*%		11th August	1
6% Funding Loan 1993	@ £96%		27th September	600
Agricultural Mortgage Corporation Limited 6⅝% Debenture Stock 1985/90	@ £100%		21st October	12
6% Exchequer Loan 1970	@ £99%		1st November	500
Greater London 6¾% Stock 1976	@ £98:15*s.*% (minimum tender price %)	1966	24th February	50

In exchange

At par

			£ millions
6½% Exchequer Loan 1969 for 3% Savings Bonds 1955/65	1965	11th August	308·9
6½% Treasury Loan 1976 for 3% Savings Bonds 1955/65		15th August	197·9

Automation

In March and April 1966 the Bank took delivery of two new computers of a more advanced design than those previously installed. These will be used to maintain the stock registers (which will be transferred to magnetic tape), to prepare dividend payments and to carry out a number of other tasks. The changes will produce substantial savings of staff and of office space.

Progress has also been made in the use of electronic equipment to improve the efficiency and speed with which dividend warrants are handled when they are presented for payment. The warrant number, the amount, and other details are printed in magnetic ink on the warrants at various stages, enabling them to be sorted, listed and totalled at high speed.

Southern Rhodesia

The Bank are the paying agent and registrar for all but one of the twelve outstanding Government of Southern Rhodesia stocks issued in London. In accordance with the terms of the prospectuses—or, in the case of the four issued in substitution for stocks of the Federation of Rhodesia and Nyasaland, with the terms of the agreements made on the dissolution of the Federation—liability in respect of these stocks and the interest thereon falls on the revenues of Southern Rhodesia; and the Consolidated Fund of the United Kingdom and the Commissioners of H.M. Treasury are not directly or indirectly liable for payment of the stock or of the interest thereon. The position of the British Government was stated by the Commonwealth Secretary, in answer to a Parliamentary Question on 14th December 1965. He said that the British Government had not assumed the government of Southern Rhodesia and had " . . . not in any way succeeded either to the assets or to the liabilities of the Government of Southern Rhodesia ".

On the first occasion after the illegal declaration of independence that a payment of interest on one of these stocks fell due, funds to meet it were received by the Bank from Southern Rhodesia. However, no funds were received by the Bank to meet the next payment falling due—that in respect of Southern Rhodesia 4% Stock 1972/74 on 6th December 1965—or to meet subsequent payments. Thus from 6th December the Bank have been unable to make interest payments on any Southern Rhodesia stocks for which they act as paying agent; up to end-February 1966, interest totalling approximately £432,000, before deduction of tax, had not been paid.

In addition, the Bank have been prevented by exchange control regulations from despatching warrants for interest on British government stocks, and on other stocks managed by them, to stockholders resident in Rhodesia.

Bearer securities

Last year's *Report* gave details of the British government stocks for which bearer bonds were available. In the year to end-February 1966 bearer facilities were made available, for the first time, on 3% Savings Bonds 1965/75 and on the following stocks issued during the year:(1)

6½% Exchequer Loan 1969
6½% Treasury Loan 1976
6% Funding Loan 1993

In addition, bearer facilities were reintroduced for 4% Victory Bonds.

Finance for exports

Further improvements in the provision of finance for exports have taken place since those described in last year's *Report*: they were reviewed in the June 1966 issue of the *Quarterly Bulletin*.

(1) On 28th March 1966 they were made available on 6% Exchequer Loan 1970, which was also issued during the year under review.

The availability of unconditional bank guarantees given by the Export Credits Guarantee Department, against which the banks provide medium-term finance at a fixed rate (currently 5½% per annum), was further extended by the reduction, in August 1965, of the minimum qualifying contract value from £50,000 to £25,000, and by the removal of this limit in March 1966.

Details of a new facility—for the financing of exports on short-term credit—were announced in March 1966. The new scheme will apply to exports on credit terms of thirty days to two years, where the transaction is evidenced by bills of exchange drawn on the foreign buyer or by promissory notes issued by him, and where the exporter holds an E.C.G.D. comprehensive guarantee. The E.C.G.D. will issue additional guarantees direct to exporters' banks, covering a limit of eligible credit for each individual exporter. The banks taking part in the scheme—the London clearing banks and the Scottish and Northern Ireland banks—will then provide finance at Bank rate (but with a minimum of 4½%) for the full face value of the bills or notes. The E.C.G.D. will charge the exporter 2*s*. 6*d*. per annum per £100 of his limit; but the banks will make no charge, apart from the interest on outstanding advances.

The Bank of England's refinancing facility for medium-term exports, described in the *Quarterly Bulletin* for March 1965, will not be extended to short-term finance provided under the new arrangements. However, bills of six months' tenor or less, or advances secured by such bills, may be counted as liquid assets for the purpose of calculating the banks' liquidity ratios. The bills will not be regarded as marketable, though they will be transferable among the participating banks.

There is thus available to U.K. exporters a very full range of facilities for post-shipment export credit finance. Through the co-operation of the banks, and by making full use of the facilities offered by the E.C.G.D., exporters can now obtain finance at special rates for goods at any length of credit from thirty days upwards.

Exchange control

The main changes in the administration of exchange control during the year are set out below. Those in April and July 1965 were aimed directly at improving the external payments position: the measures taken in November and subsequent months followed the illegal declaration of independence made in Southern Rhodesia.

7th April 1965

Purchase of houses and flats abroad by private individuals

U.K. residents would no longer be able to buy property outside the Scheduled Territories with investment currency. Except where such property was being bought from another U.K. resident for sterling, only ' property currency '—which derives from the proceeds of the sale abroad of foreign property in U.K. ownership—could be used.

Travel

A stricter control would be imposed on the issue and use of foreign exchange for all forms of foreign travel. The marking of passports with amounts allocated for travel was reintroduced; and the amount of sterling notes which might be exported and spent abroad by travellers was reduced from £50 to £25 per person.

Transactions in foreign currency securities

With few exceptions (for example, professional dealers making a book in foreign currency securities) any transfer of ownership, whether by sale, redemption or otherwise, of foreign currency securities owned by residents of the United Kingdom would have to be accompanied by a sale at the official market rate of exchange of investment currency in the form of specified currency equivalent to 25% of the proceeds or value of the securities transferred. Except for switches of pre-zero holdings the same rules would apply to deals in London for residents of other Scheduled Territories.

Withdrawal of investment currency facilities for certain foreign currency assets

The following categories of foreign currency accruals to residents of the Scheduled Territories, irrespective of whether they were received in the form of cash, foreign currency securities or other foreign assets, would no longer be able to be sold in the investment currency market in the United Kingdom:

(i) any gifts or charitable donations;

(ii) capital distributions under wills or trusts; and

(iii) ' restitution ' payments.

Such funds would in future have to be sold at the official market rate of exchange.

27th-29th July 1965

Outward direct investment

The allocation of official exchange for direct investment outside the Scheduled Territories was suspended: any approved projects would have to be financed with investment currency or by borrowing abroad.

Further withdrawal of investment currency facilities in respect of foreign currency assets

The categories of foreign currency accruals to residents of the Scheduled Territories which were no longer eligible for sale in the investment currency market in the United Kingdom were extended to cover:

(i) cash balances of any immigrants redesignated as residents of the Scheduled Territories on or after 29th July 1965;

(ii) savings from earnings of persons who had been temporarily employed outside the Scheduled Territories;

(iii) the capital proceeds of life and endowment policies; and

(iv) mineral rights.

Sterling loans and overdrafts to U.K. companies controlled from abroad

The general permission to U.K. banks to advance funds freely to companies registered in the United Kingdom but controlled from outside the Scheduled Territories was withdrawn; and all such transactions were required to be specifically approved by the Bank of England.

Payments to non-residents for imports

Payments to non-residents for imports into the United Kingdom in advance of the entry of the goods into Customs would normally be permitted only against evidence that the goods had been despatched to this country or were to be sent immediately on receipt of payment. Previously, payment could be made at any time after the date of contract.

November 1965–*January* 1966

Southern Rhodesia

Following the illegal declaration of independence on 11th November 1965, Southern Rhodesia was excluded from the Scheduled Territories. The accounts of persons resident in Rhodesia were specially designated and payments to and from such accounts were controlled: the Rhodesian pound became a foreign currency, for the purposes of the Exchange Control Act 1947, and dealings in the United Kingdom were restricted. Access to the London capital market was denied and the export of capital from the United Kingdom to Rhodesia was prohibited. All transactions in Rhodesian securities (that is securities payable solely in Rhodesian pounds) were restricted, as were transactions in other securities, gold and Treasury bills held for persons resident in Rhodesia.

The restrictions were intensified on 1st December, when the ban on payments to Rhodesia was extended to virtually all current payments except those in respect of permitted trade: other exceptions were approved business and official travel and cash gifts to a total of £50. Permitted payments had to be made in sterling to Rhodesian accounts, which could be used only for limited purposes, including payment for any U.K. exports to Rhodesia. Contractual payments, such as pensions and interest and dividends, to residents of Rhodesia were withheld and placed in suspense. In addition, payment for U.K. exports to Rhodesia had to be received before shipment and U.K. residents were not allowed to merchant goods between Rhodesia and any other territory.

On 17th December, export controls were further tightened and payment for U.K. goods and services sold to Rhodesia had to be received in convertible currencies other than sterling. In mid-January an arrangement was agreed whereby both the United Kingdom and Rhodesia paid pensions in sterling through a special account; any balance in favour of Rhodesia could be used to purchase goods and services (except arms and oil) in the Scheduled Territories. From the end of January some further payments to Rhodesian accounts were allowed. These were on a limited scale, to relieve hardship and for charitable, religious, medical and educational purposes.

Developments in financial statistics

During the year some further additions were made to the statistical information available for the guidance of policy and for publication.

Clearing banks' statistics

The clearing banks have provided to the authorities, since the middle of 1965, a confidential monthly analysis of advances on the same lines as the quarterly analysis published by the British Bankers' Association. In addition, opportunities have been taken to strengthen informal contacts between the Bank's economic and statistical staff and the economists of the Big Five clearing banks. These have led to fruitful discussions of the banks' monthly statistics, including the effect of seasonal and other factors; these discussions contributed greatly to the development of a new method of seasonal adjustment of the London clearing banks' figures of deposits and advances, outlined in an article in the March 1966 *Quarterly Bulletin.*

U.K. external liabilities and claims

The total amounts of overseas sterling funds deposited with U.K. local authorities and of net U.K. liabilities in overseas sterling area currencies were made available for regular publication during the year. Such information had been available to the authorities for some time and had been incorporated in the balance of payments estimates. The amounts outstanding in each case have been published in the *Quarterly Bulletin* since September 1965 and March 1966 respectively.

The results of a large-scale enquiry by the Board of Trade into the structure of international trade credit, in which the Bank gave some assistance, were published in the *Board of Trade Journal* of 7th May 1965 and have been incorporated in the official balance of payments estimates. They made it possible to improve the Bank's estimates of the United Kingdom's international position on capital account, which formed the subject of an article in the *Bulletin* for December 1965.

Staff and other internal matters

The total staff of the Bank at 28th February 1966 was about 7,000, of whom some 2,000 were employed at the Printing Works.

The number of banking staff was little changed over the year. At approximately 4,000, it included some 2,500 women. Of the total, 1,000 were employed in the Cashier's Department and nearly 1,400 in the Accountant's Department. The Overseas Department numbered 550, including 300 engaged on exchange control, and the Economic Intelligence Department, 180.

Relations with banks abroad

In furtherance of their policy of maintaining close contacts with overseas central banks, the Bank welcomed 310 visitors from 80 countries during the year. These included 17 representatives from Commonwealth and sterling area countries who attended for three months the fifth in a series of Central Banking Courses held in the Bank. Also, in order to gain first-hand experience of conditions abroad or to assist in various international discussions, officials from the Bank visited some 70 countries. One such visit of topical significance was made to Australia by a member of the Bank staff, in the company of a senior official of H.M. Treasury, in order to observe the transition to decimal currency in that country. The monthly meetings of the Board of the Bank for International Settlements provided regular opportunities for informal discussions—of great importance in the circumstances of the year under review.

The Bank again met a number of requests from overseas countries to provide help or advice in banking and currency matters, especially, this year, from Commonwealth countries in East Africa which were setting up central banks. There and elsewhere the Bank have collaborated to an increasing extent with international organisations in supplying officials to assist in the staffing and management of new institutions. At 28th February 1966, 29 members of the Bank's staff who had been released for such work were serving abroad.

The Bank's archives

General responsibility for the Bank's records and for historical research rests with an Archives Section. So many of the older documents of banking houses have vanished over the years that reliable banking statistics do not usually extend very far back; whereas the Bank of England's main ledgers are complete from the year of foundation in 1694. In addition, the Bank's archives contain a wide variety of eighteenth and nineteenth century banking material of historical interest, which is being examined systematically.

A particular product of current research concerns the antecedents of the weekly Bank Return. It was not until 1844 that the Bank were required to publish details of their accounts, although some figures back to 1778 had previously been made available to Parliament. Recently, however, figures for the Bank's liabilities and assets have been extracted back to 1696, the date of the first full balance sheet in the Bank's books. The information so far obtained suggests that it will eventually be possible to produce a consistent series of annual figures from 1696 to the present day.

The Bank film

In 1960 a documentary film about the Bank was produced and released for public viewing. Inevitably, however, films of this nature become somewhat outdated with the passage of time: moreover, it appeared that there was a widespread demand from educational institutions of all kinds for a deeper insight into the Bank's functions and services. The producer was therefore commissioned to undertake a second film with a greater emphasis on the educational aspect: it is called " The Bank of England at Work " and was completed in March this year. Many of the Bank's various aims and activities are explained personally by the Governor and other executives: the film is in colour and runs for 35 minutes.

The original film will be withdrawn from circulation and replaced by a third film " The Bank of England—An Introduction ". This is a straightforward 21-minute colour documentary which, by omitting the more technical aspects of the Bank's work, is intended for general viewing.

It is expected that both films will shortly be available on request, free of charge, from the main film libraries.

The Bank have continued during the year to receive much help and co-operation from the associations of banks and other financial institutions. This co-operation has brought many advantages in the execution of monetary policy, and the Bank welcome this opportunity of recording once again their appreciation of the help they have received in this way.

Copies of this Report may be obtained from the Economic Intelligence Department, Bank of England, London, E.C.2.

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