BANK OF ENGLAND

REPORT FOR THE YEAR ENDED

29th FEBRUARY

1968

Issued by Order of the Court of Directors, 4th July 1968

Court of Directors

29th February 1968

Sir Leslie Kenneth O'Brien, G.B.E., Governor

Sir Maurice Henry Parsons, Deputy Governor

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The Rt. Hon. Lord Pilkington

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The Rt. Hon. Lord Robens of Woldingham, P.C.

Michael James Babington Smith, Esq., C.B.E.

Sir Henry Wilson Smith, K.C.B., K.B.E.

Sir Ronald George Thornton

The term of office of Sir George Bolton expired on the 29th February 1968 and Sir John Stevens, K.C.M.G., D.S.O., O.B.E., was appointed in his place for a period of four years.

The terms of office of Lord Pilkington, Sir Maurice Laing and Mr. J. V. Bailey also expired on the 29th February 1968 and they were reappointed for a period of four years.

Bank of England

Report for the year ended 29th February 1968

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 29th February 1968, deals with some particular aspects of the Bank's work.*

The most important feature of the year under review was the devaluation of the pound on 18th November. In the months before, the United Kingdom's trading position worsened rapidly and there was a series of heavy blows to confidence in sterling, some of them due to political events abroad.

By the beginning of 1967 the measures taken in the previous July had markedly improved the external position. The improvement, however, depended heavily on the continuance of favourable conditions in the United Kingdom's export markets; and in the spring and summer, as the growth of world trade temporarily stopped, the underlying weakness of the balance of payments was again exposed. Exports fell, while imports remained high.

Confidence in sterling began to weaken in May. Shortly afterwards, the Middle East crisis led first to an outflow of short-term funds and then, after the Suez Canal was closed, to higher freight costs, dearer oil imports and delayed exports. From September onwards, strikes in the London and Liverpool docks placed a fresh strain on the by then precarious balance of payments position. During the summer and early autumn, moreover, pressures on sterling were increased by rising short-term interest rates in the United States and in the euro-dollar market; to reduce the incentive to withdraw funds from London, Bank rate was raised from 5½% to 6% on 19th October and to 6½% on 9th November.

Meanwhile, because exports had fallen away at a time when growth in most other components of demand had ceased, the margin of unused domestic resources continued to increase, and from June onwards the Government took a number of mildly reflationary measures. The rapid deterioration in the external position (with little hope of early relief) combined with the prospect of renewed growth in domestic demand, proved too much for confidence, and losses of foreign exchange became very heavy. Early in November there was much talk of devaluation, and in the third week suspicion hardened into conviction, precipitating a massive outflow of funds.

On 18th November the Government announced that the par value of the pound in terms of the U.S. dollar had been reduced by one seventh, from \$2·80 to \$2·40. At the same time Bank rate was raised to 8% and a number of measures were announced to divert resources from the domestic economy to improving the balance of payments.

The Government now set themselves a new balance of payments objective—a surplus of £500 million a year. This would require a considerable transfer of resources, and it soon became clear that further measures—which the Government had said they stood ready to take—would be necessary. On 16th January, therefore, the Prime Minister announced a number of cuts in the growth of public expenditure, and it was stated that further measures to restrict private consumption—which was rising rapidly—would be taken in the Budget on 19th March. The Budget proposals proved severe—aimed as they were at withdrawing from the economy an estimated £500 million of demand during 1968 and the first half of 1969—and were well received at home and abroad. Bank rate was reduced two days later to 7½%.

The external situation

Foreign exchange market Sterling had strengthened appreciably during the first quarter of 1967 and it continued to improve until the second week of May; for a time the spot rate for U.S. dollars rose above \$2·80. Confidence began to ebb, however, when the trade figures for April showed a steep rise in U.K. imports. It was further weakened by the unfavourable reaction of the French Government to the United Kingdom's application, early in May, to join the European Communities—there was also speculation that a condition of entry might be devaluation of the pound—and by the growing danger of a conflict between the Arab states and Israel.

On the outbreak of war in the Middle East the pound was sold heavily and the spot rate fell almost to \$2·79. The cease-fire a few days later brought some improvement but the market remained nervous in face of reports that Arab funds were being withdrawn from London, and uncertain of the effect of the crisis on the United Kingdom's trade and payments. July saw confidence in sterling weaken further. It had become clear that the closure of the Suez Canal must inflict considerable damage on the U.K. economy; the figures of overseas trade for June were discouraging; and the possibility of devaluation of the pound had come under active public discussion. Meanwhile, U.S. Treasury bill rates had risen sharply.

In the early part of August sterling was sold quite heavily and the spot rate fell below \$2·78½. Though the second half of the month was generally quieter—the news that agreement had been reached by the Group of Ten countries[1] on an outline plan for the creation of Special Drawing Rights within the framework of the International Monetary Fund calmed the market—the announcement of further relaxations of hire purchase restrictions at the very end of the month was badly received. September proved a little better, but in October confidence deteriorated rapidly, influenced by the stoppages in the docks, an unfavourable report on the U.K. economy by the European Commission, and depressing trade figures for September. Sterling was sold heavily on occasions and the spot rate fluctuated around \$2·78¼.

During the first two weeks of November sterling came under very heavy pressure and there was much talk of devaluation. Early in the third week it became widely believed that a substantial support operation for sterling was being negotiated; when this was not confirmed the market became convinced that devaluation was imminent, and the pound was sold, both spot and forward, on a massive scale.

Devaluation of the pound took place on Saturday, 18th November. When the London market reopened on Tuesday, 22nd November, there was an acute shortage of sterling, as those who had entered into commitments before the week-end to deliver sterling that they did not have, now scrambled to buy or borrow pounds. Covering of short positions continued for a time and kept the spot rate very close to the new official upper limit of \$2·42; but the reflux of foreign exchange fell a good way short of the very large outflow before devaluation, and around the turn of the month the spot rate dropped away. In December the rate moved downwards in a thin market, falling almost to the new parity of \$2·40; there was a growing feeling that the need for further measures was now pressing, while the very heavy speculative demand for gold noted later was reflected in sales of sterling.

In January, however, the spot rate recovered to almost \$2·41¼, not because confidence was noticeably stronger but because sterling was now being purchased to close out forward sales entered into before devaluation. During most of February, when a large part of these forward contracts matured, the rate remained between \$2·41 and \$2·41¼.

Towards the end of February, however, sterling came under renewed pressure as the demand for gold again increased; and in the first half of March, when the run on gold grew to crisis proportions, sterling was sold heavily. The spot rate fell back to \$2·39 on 14th March and forward margins against sterling became much wider than before. The pressure began to ease following the closure of the London gold market on 15th March and the satisfactory outcome of a conference of central bankers in Washington; and confidence improved appreciably in response to the Budget proposals on 19th

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

March. The spot rate touched \$2·40¾ on the day after the Budget, but settled around \$2·40¼ for most of the rest of March.

Gold Demand for gold was generally moderate until October, though there were some spells of heavier buying—notably in mid-May, when the suspension by the U.S. Treasury of sales of silver raised doubts in some quarters about U.S. policy on gold, and again in early June, after the outbreak of fighting in the Middle East. The dollar equivalent of the daily fixing price remained high, however, rarely falling below \$35·18 per fine ounce and at times rising above \$35·19.

Shortly before the middle of October demand became heavier, for confidence in sterling was fast deteriorating and there were growing fears about possible changes in U.S. gold policy. After a lull towards the end of the month, buying of gold again grew heavy early in November; and in the week after the devaluation of the pound, when speculative pressures against the dollar became intense, there was a record demand for gold. An expression of confidence by the active members of the central bank gold pool,(1) meeting in Frankfurt on 11th December, that they would be able to maintain the existing gold price and exchange parities, afforded some respite for a week or so, but heavy buying of gold was resumed in mid-December upon rumours that access to the London gold market might be restricted. Demand fell back again early in January, after measures designed to improve the U.S. balance of payments position had been announced; and the fixing price, which had been between \$35·19¼ and \$35·20 for most of November and December, declined very briefly to \$35·13¾.

January and much of February were quieter, but doubts about the U.S. dollar were building up again, while sterling remained under suspicion. Towards the end of February demand became much heavier and the fixing price again reached \$35·19⅞. Early in March buying accelerated rapidly, in the belief that the official price of gold could not be held. The run on gold quickly became very serious and a conference of the active members of the gold pool was convened in Washington for 16th and 17th March. Those taking part expressed their resolve that all gold in their hands should be used for monetary purposes only. Consequently they would no longer sell gold in the market, nor did they feel it necessary to buy it; nor would they sell to monetary authorities to replace gold sold in the market. They invited the co-operation of other monetary authorities in making these policies effective. The conference effectively brought to an end the gold pool arrangements which had been in existence since 1961 and re-established a system of free gold markets in which central banks would not deal.

The London gold market remained closed until 1st April, in deference to the strongly held views of some signatories of the Washington agreement that the inauguration of the two-tier gold system would otherwise be prejudiced. In other markets prices established after the Washington conference were generally around \$40 per fine ounce. By the end of March, however, prices had declined and were in the range of \$37-\$39 per fine ounce; some speculators who had financed purchases of gold with dollars borrowed at high rates of interest took their profit quickly.

Balance of payments There was a marked deterioration in the United Kingdom's balance of payments in 1967; the deficit on current and long-term capital account was £540 million compared with only £133 million in 1966. The greater part of the deficit was concentrated in the fourth quarter and owed much to the strikes in the Liverpool and London docks, which particularly held back exports. But other exceptional factors, such as the displacement of imports from 1966—because of the advance warning of the removal of the import surcharge—and the closure of the Suez Canal, contributed to the set-back. Taken together with the docks strikes, these may have accounted for half or more of the deficit. Even so, exports were disappointingly low throughout most of the year, reflecting the comparatively low rate of activity in Europe, particularly Western Germany, and a pause in

(1) At that time Belgium, Italy, the Netherlands, Switzerland, the United Kingdom, the United States and Western Germany. It was disclosed in November that France had ceased to take an active part in the gold pool in July 1967.

the growth of world trade as a whole; and imports remained high, indicating that the underlying balance of trade continued to be unsatisfactory.

The deficit on visible trade was £552 million, compared with £106 million in 1966. The value of imports was nearly 7% larger, one of the more disturbing features being a sharp rise in the volume of finished manufactures, which seems to have been only partly the result of the surcharge removal. The devaluation of the pound in November led to an immediate increase in the sterling value of those imports invoiced in currencies which were not devalued.

During the early months of 1967 exports continued at a record level, but they fell back in April, and then declined further as the growth of world trade temporarily stopped. In the last quarter, as goods accumulated in the factories and docks because of the strikes, exports fell abruptly; by December, however, some of the arrears had been cleared.

Despite a rise in the cost of freight after the closure of the Suez Canal, the invisibles account showed a slightly larger surplus than in 1966; and the deficit on long-term capital account was only a quarter of that in 1966. The change in the capital account was due partly to increased drawings on the Export-Import Bank credits to finance purchases of military aircraft from the United States, and partly to a substantial rise in investment in the United Kingdom by foreign oil companies—for the first time since 1962 there was a net inflow of private long-term investment.

Monetary movements, at £320 million, were less unfavourable than the balance of payments deficit of £540 million, so there was a positive balancing item of £220 million—much larger than usual. Within monetary movements, the United Kingdom's external liabilities in sterling rose substantially—though they would have fallen but for the increase in the sterling counterpart of United Kingdom drawings on special facilities. The increase in net liabilities to countries outside the sterling area was over £450 million: in the first quarter the balances of central monetary institutions fell sharply, as central bank assistance was repaid; but in the third and fourth quarters, when the United Kingdom again made large drawings under special facilities, there was a very sharp rise in balances. Other sterling holdings of non-sterling countries fell substantially in the second half of the year; during the year as a whole they declined by almost £125 million. Sterling holdings of overseas sterling area countries fell by about £150 million, mostly in the second half of the year.

The banks' net external liabilities in non-sterling currencies changed little over the year. In the first quarter the banks were switching foreign currency deposits into sterling. But later they mainly switched funds back into foreign currency because, from May onwards, the relevant interest rate comparisons—notably that between lending for three months in the euro-dollar market and lending for the same period to U.K. local authorities, after allowing for the cost of forward cover—favoured investment in euro-dollars. There was a bigger change—a substantial rise—in official U.K. external liabilities in non-sterling currencies, mainly because of a loan in October of 450 million Swiss francs (£37 million at the old rate of exchange) offered to H.M. Government by a consortium of three Swiss commercial banks, and a loan, in November, extended through the Bank for International Settlements, to finance a repayment to the I.M.F. (the equivalent of £104 million, at the new rate);[1] the B.I.S. loan was in various currencies.

The reserves rose from £1,107 million to £1,123 million over the year (calculated at the parities ruling at the time), after the transfer to them in November of the remaining assets (£204 million) in the Government's portfolio of dollar investments.

It was noted in last year's *Report* that in the six months to the end of March 1967, the Bank of England made large repayments of earlier drawings on its facilities with other central banks. From the second quarter of 1967 onwards, however, there was fresh recourse to such facilities, and in the second half of the year borrowing became very heavy. By the end of 1967 a net amount of $1,050 million had been drawn under the reciprocal swap facility with the Federal Reserve System and there were, in addition, substantial amounts outstanding under other facilities.

(1) The repayment to the I.M.F. was the balance of the amount outstanding under the United Kingdom's 1964 drawing. In May 1967 the United Kingdom had repaid the equivalent of £145 million—over half the 1964 drawing then outstanding—and of £28 million borrowed in 1964 from Switzerland.

International monetary co-operation In the period covered by this *Report* the strains on the world monetary system called for extensive co-operation between central banks.

In the middle of May 1967 the Federal Reserve Bank of New York extended its reciprocal swap arrangements to three more central banks (those of Denmark, Norway and Mexico); and in July it enlarged its arrangements with the Swiss National Bank and the B.I.S. In June the B.I.S. had drawn on its swap facility with the Federal Reserve, in order to ease a shortage of dollars in the euro-dollar market; intervention in the euro-dollar market by both the B.I.S. and central banks became more frequent during the year.

As noted above, it was announced in November that a loan (equivalent to some $250 million) had been extended to the United Kingdom through the B.I.S. to finance the final repayment to the I.M.F. of the 1964 drawing. Following devaluation, a one-year standby facility of $1,400 million was provided by the I.M.F., and additional credit facilities of about $1,500 million were placed at the disposal of the Bank of England by other central banks. At the end of November and in mid-December, the Federal Reserve enlarged generally its swap arrangements with other central banks—the facility with the Bank of England being increased from $1,350 million to $1,500 million.

Early in February 1968 it was announced that the arrangements—related to fluctuations in overseas countries' sterling balances—which the Bank of England had originally entered into in June 1966 with nine other central banks and the B.I.S.—had been extended for a further year from March 1968. The facilities of September 1965 with the U.S. authorities (which are additional to the reciprocal swap agreement with the Federal Reserve) continued alongside these arrangements, as did the renewable three months' credit with the Bank of France—the total remaining at $1,000 million.

In the middle of March, the central banks taking part in the Washington conference agreed to increase the credits available to the United Kingdom to a total of $4,000 million, including the I.M.F. standby facility of $1,400 million. The additional credits included a fresh increase, of $500 million, in the United Kingdom's reciprocal swap with the Federal Reserve—part of a further enlargement (to $9,355 million) of the Federal Reserve's swap arrangements with other central banks.

International monetary reform After further joint meetings—in Washington in April 1967 and in Paris in June—between the Deputies of Ministers and the Governors of the Group of Ten countries and the Executive Directors of the I.M.F., and after two meetings of Ministers and Governors in London in July and August, an outline plan for the creation of Special Drawing Rights within the framework of the I.M.F. was placed before the I.M.F. Governors in September at their annual meeting in Rio de Janeiro. The Governors instructed the I.M.F. Executive Board to report by 31st March 1968 on amendments necessary to the I.M.F. Articles to establish such a facility, and to give effect to certain changes in the Fund's normal rules and practices. After intensive discussions in the I.M.F. Executive Board, and after a meeting of Ministers and Governors of the Group of Ten countries on 29th and 30th March 1968 in Stockholm, agreement—with French representatives abstaining—was reached on both series of amendments by the middle of April. The Executive Board's report and proposed amendments were subsequently approved by the requisite majority of I.M.F. Governors; the next step will be parliamentary ratification by member countries.

World interest rates The first few months of 1967 had seen a continuation of the decline in interest rates that had begun towards the end of 1966. By the end of April the three months' euro-dollar rate had declined to about $4\frac{3}{4}$%, the lowest for eighteen months; and by early May official discount rates in most of the main centres had been reduced—in some cases more than once. U.K. Bank rate was itself reduced in three stages to $5\frac{1}{2}$%.

Shortly afterwards euro-dollar rates began to move upwards again, for normal seasonal pressures were accentuated by the Middle East crisis; and towards the end of June the downward trend in U.S. short-term rates was sharply reversed, mainly because of the prospect of heavy official borrowing (long-term rates in the United States had begun to harden in February as corporations rebuilt their liquid assets). From June onwards, heavy bidding for euro-dollars by U.S. banks through their European branches helped to keep rates high.

The trend towards higher interest rates in the United States and in the euro-dollar market was followed by increases in discount rates in Canada and Japan during September; and, as was noted earlier, by two increases in Bank rate, in October and again in early November. Nevertheless, in some continental centres rates continued to fall, and official discount rates in several countries were reduced between June and October.

When Bank rate was raised to 8% at the time of devaluation, discount rates in the United States and Canada were increased immediately, and the three months' euro-dollar rate rose to nearly 7%. After central banks had channelled funds back into the euro-dollar market, however, rates began to ease; and in January the normal seasonal decline in euro-dollar rates was helped by the temporary employment in the market of the proceeds of euro-bond issues.

Towards the end of February pressures towards a fresh rise in short-term rates developed in the United States and in the euro-dollar market, as speculative sales of currencies for gold became large; by mid-March the three months' euro-dollar rate was over 7% and discount rates in the United States and in Canada (which had been suffering an exchange crisis) had again been raised, to 5% and $7\frac{1}{2}$% respectively. (Federal Reserve discount rates were raised to $5\frac{1}{2}$% in April.)

Tariff reductions

On 30th June 1967, forty-six nations signed formal agreements on tariff cuts—concluding more than three years of negotiations—within the framework of the General Agreement on Tariffs and Trade, and known as the ' Kennedy round '. The agreements comprised: a protocol embodying the tariff concessions—which will amount in practice to a weighted average reduction of some 35%, to be implemented over a five-year period and affecting about $40 billion of world trade annually; a supplementary agreement relating principally to chemicals; an outline of a world grains arrangement; and an agreement on anti-dumping procedures.

Aid to developing countries

It was noted in last year's *Report* that disbursements under the United Kingdom's official aid programme in 1967/68 were to be related to a target of £205 million. The target is to remain unchanged in 1968/69 but there will be some additional items outside the basic programme of aid—assistance to Malaysia and Singapore related to revised defence arrangements, and the United Kingdom's contributions to ' food aid ' provisions of the Kennedy round agreements and to the increased replenishment of the resources of the International Development Association. (It was agreed by donor governments in March 1968 that, subject to parliamentary approval, the Association's resources should be replenished by $400 million a year during the three years ending June 1970, as compared with $250 million for each of the preceding three years.)

The United Kingdom has continued to play an active part in the various arrangements for international co-operation between donors, such as the consultative groups and consortia organised through the International Bank for Reconstruction and Development and the Organisation for Economic Co-operation and Development, and has continued to support the activities of regional development banks (the Asian Development Bank approved its first loan during the year, and there were negotiations aimed at establishing a Caribbean development bank). The United Kingdom also played a full part in the discussions on aid that formed a part of the second United Nations Conference on Trade and Development in New Delhi in February and March 1968.

The domestic economy

The 1967 Budget and the course of home demand

The 1967 Budget was introduced on 11th April. At that time unemployment was high but activity appeared to be no longer declining. Public expenditure and exports seemed to be the two main factors continuing to make for growth, but there were already some signs of a revival in consumer spending. The improvement in the balance of payments seemed to be continuing and sterling had become appreciably stronger.

The Chancellor took no substantial action to influence demand, because he considered that sufficient expansionary forces existed to achieve a rate of growth during the year that the economy could sustain. No major fiscal changes, and only minor relaxations in hire purchase regulations, were proposed. Measures were introduced to encourage personal savings —higher maximum holdings for national savings certificates and premium savings bonds— and terms for tax reserve certificates held by companies were improved. The trustee savings banks would be allowed to set up a unit trust. (The trust was launched in January 1968 and was well subscribed.)

In the next few months, there was little perceptible quickening of activity. Because of the abrupt set-back to the growth of world trade, exports, which had been expected to be one of the main expansionary elements, turned downwards. Private fixed investment and stockbuilding fell away, and consumers' expenditure rose only slowly. Public spending alone remained buoyant, particularly on fixed assets. As a result, the margin of unused resources showed signs of increasing further; the number of wholly unemployed, on an unadjusted basis, rose from 2·1% of the labour force in June to 2·4% in August—the highest for that time of year for 27 years.

Beginning early in June, therefore, the Government announced a number of modest measures to stimulate demand in the months ahead; these included the easing of hire purchase restrictions on cars, increases in pensions and other national insurance benefits, a further reduction in the waiting period for investment grants and the implementation from early September of the regional employment premium. On 30th August hire purchase restrictions were eased on most consumer durable goods. As a result of the relaxations of hire purchase restrictions, an increase in personal borrowing from the banks, and a particularly rapid rise in wages and earnings after the period of severe restraint had ended in June, consumer demand soon picked up and in the last few months of the year became the major expansionary force. Unemployment, seasonally adjusted, ceased to rise, and industrial production began to expand, albeit rather slowly. Imports, however, continued to be uncomfortably high.

Events after devaluation

The measures announced on 18th November 1967 to restrain the growth of domestic demand and to divert resources into restoring the balance of payments included fresh restrictions on lending by the banks and finance houses other than to the public sector and for exports, more stringent hire purchase terms for cars, and savings of about £400 million a year in the expenditure planned by government and by public bodies. Part of the reduction in public spending was to be achieved by abolishing selective employment tax premiums, except to manufacturers in development areas, (refunds were not affected) and ending the rebate of certain indirect taxes to exporters.

It was clear, however, that further measures to restrain both public expenditure and consumer spending would be required in order to transfer to the balance of payments the considerable resources needed to take up the competitive advantage offered by devaluation. The Government estimated that the United Kingdom must achieve a balance of payments surplus of the order of £500 million a year, and maintain this while the massive amount of external short and medium-term borrowing was repaid, the reserves rebuilt and the basis of sound domestic growth established. The achievement of such a surplus would require the diversion of at least £1,000 million of resources—to produce more for export, to replace imports and to offset the worsening in the terms of trade brought about by devaluation.

On 16th January the Prime Minister announced a number of measures to reduce the rate of growth of public expenditure. These, it was estimated, would save about £300 million of civil expenditure in 1968/69, while total planned expenditure in 1969/70 would be reduced by £415 million—large economies falling on defence. Even so, public expenditure was forecast to continue to grow by about $3\frac{3}{4}$% in real terms in 1968/69,[1] though by no more than 1% in 1969/70. It was also announced that the Budget, which was to be brought forward to 19th March, would contain proposals to curb consumer spending.

[1] Payments to industry of investment grants, selective employment tax refunds and regional employment premiums are excluded, so that the comparison between 1967/68 and 1968/69 is not distorted.

Meanwhile consumer spending—much of it concentrated on cars and other durable goods—surged ahead, prompted by fears of price increases as well as restraints on spending, and strengthened by the rapid rise in incomes.

The 1968 Budget

The Budget of 19th March proposed heavy additional taxation, the main weight falling on indirect taxes: higher rates of purchase tax were introduced; duties on road fuels, tobacco, wines and spirits, and betting and gaming were raised; motor vehicle duties were increased; and 50% was added to the rates of selective employment tax. Among other proposals was a special progressive charge, for one year only, on individuals' investment income in excess of £3,000.

The additional taxes (inclusive of a rise in corporation tax from 40% to 42½%, and a reduction in personal income tax allowances to offset larger family allowances—each announced before the Budget, but consolidated with it) were estimated to bring in £923 million in a full year. Additional revenue from the tax changes was put at £775 million in the financial year 1968/69. In consequence, the Government's estimate of their borrowing requirement in 1968/69 was reduced from over £1,100 million before the Budget changes to £364 million afterwards. (The Government had stated their intention to the I.M.F., when the standby facility was granted in November 1967, of holding down the borrowing requirement in 1968/69 to not more than £1,000 million.)

It was estimated that the Budget proposals would effectively withdraw about £500 million of purchasing power from the economy in 1968 and the first half of 1969. Official forecasts indicated that, as a result of the Budget, gross domestic product would grow during this period at an annual rate of not much more than 3% (more or less in line with the estimated average growth of productive potential). Consumer spending was expected to fall in real terms, but most other components of demand were reckoned to be little affected; imports were expected to reflect the reduction in consumption. The volume of exports of goods and services was forecast to rise during 1968 and the first half of 1969 at an annual rate of nearly 11% (or at 7½%, if shipments in 1968 of goods delayed by the docks strikes at the end of 1967 were excluded).

The Chancellor also announced measures to increase further the attractiveness of national savings—the maximum holding of national savings certificates of the current issue was raised, a weekly prize (in addition to the monthly prizes) would be introduced on premium savings bonds, and a 6% British Savings Bond would replace the 5½% National Development Bond. He also outlined measures to strengthen the prices and incomes policy, including dividend restraint.

The Budget was generally acknowledged to be severe; but necessarily so, if conditions were to be created in which the required transfer of real resources from home demand to the improvement of the balance of payments could take place, and if confidence in sterling was to be restored.

Exchequer finance

The Exchequer's surplus of revenue over ordinary expenditure in the financial year 1967/68 was £330 million—£408 million less than in 1966/67. Loans from the Consolidated Fund, at £1,661 million, were £183 million greater: though local authorities borrowed less, the nationalised industries took considerably more—partly because the newly-formed British Steel Corporation was now numbered among them. In consequence, the central government's borrowing requirement (net balance), at £1,331 million, was almost £600 million larger than in 1966/67; it also considerably exceeded the 1967 Budget estimate, mainly because ordinary expenditure was greater than the forecast. However, receipts of sterling from external transactions exceeded the total borrowing requirement, so that government debt in the hands of domestic holders was reduced by £124 million during the year—compared with a take-up of debt by domestic holders of £690 million in 1966/67.

On balance over the year, the banks reduced their holdings of gilt-edged: a substantial take-up of gilts in the week or so after the 1967 Budget and following devaluation, was insufficient to offset heavy sales in May and June. There was a small net purchase of gilt-edged during the year by other domestic holders.

However, notes and coin in circulation rose by just over £120 million, and some non-marketable government debt was taken up by domestic holders, thanks partly to the measures to encourage savings in the 1967 Budget: tax reserve certificates yielded £20 million, and the decline in national savings, which had been particularly marked in 1966/67, was almost halted.

Main sources of credit

The banks Government debt held by the banking sector was reduced: the banks' holdings of gilt-edged fell by £110 million and their Treasury bills by £41 million.(1) As for the banks' other sterling assets, their advances to the private sector rose very sharply and their lending to local authorities also increased. Domestic deposits expanded considerably, largely because of the rise in the banks' lending to the private sector.

Turning first to the *London clearing banks,* net deposits rose by £831 million (over $9\frac{1}{2}$%) during the year to mid-March 1968, compared with only £48 million the previous year. In their case a large part of the increase was associated with a rise in lending: their total advances rose by £500 million—most of it to private borrowers. The banks' investments, which are mainly gilt-edged stocks, rose by no more than £77 million. Their liquid assets, on the other hand, increased by about £200 million: the rise was mainly in money at call—Treasury bill holdings declined slightly. The banks' combined liquidity ratio fell from 29·5% to 28·7%.

In his Budget speech on 11th April 1967 the Chancellor announced that the ceiling on lending to the private sector (of 105% of the level at March 1965) would be discontinued for the clearing and Scottish banks.(2) The Bank of England subsequently restated their guidance to the banks and other financial institutions regarding the direction of lending. Given this guidance, and the likely developments in the economy, credit was not expected to increase more than very moderately over the ensuing year.

In the event, advances by the clearing banks other than to the nationalised industries remained sluggish in April and May, but began to rise swiftly in the early summer. In the six months up to mid-December advances, after seasonal adjustment and allowing for the nationalisation of the steel companies, rose by some £370 million.

On 18th November severe but selective restrictions were reimposed on bank lending. Lending for most purposes was to be held down, in aggregate, to the level reached before devaluation—allowing for seasonal fluctuations. This ceiling would apply to all sterling lending outside the public sector, except for that specifically identified with the finance of export transactions and fixed rate finance for shipbuilding under the scheme noted below. Within the ceiling, priority was to be given to certain categories of lending such as finance for production and investment necessary to sustain or increase exports, to promote invisible earnings or to secure import savings.

Advances by the clearing banks slackened in the two months to mid-January, but showed new growth between then and mid-March, when local authorities, in particular, unwilling to pay the current high rates in the temporary money market, were turning to their bankers; also, there was some increase in the restricted categories of borrowing, which probably resulted from commitments already outstanding when the ceiling was imposed.

The *Scottish banks*' advances (other than to the nationalised industries) rose by about £40 million (8%) in the year ended mid-March 1968. Against this, their net deposits increased by almost £100 million (11%). Although their Treasury bill holdings changed little on balance, their liquid assets as a whole rose quite substantially, as did their gilt-edged holdings.

On 11th May 1967 it was announced that the London clearing banks and the Scottish banks were prepared to extend medium to long-term credit (guaranteed where appropriate by H.M. Government) up to a maximum of £200 million at a fixed rate of $5\frac{1}{2}$% to domestic purchasers of U.K. ships, thus giving the U.K. shipping industry a facility equal to that already avail-

(1) The figures allow for the inclusion of new contributors among the banks at December 1967, and, in the case of gilt-edged holdings, for the conversion of the shares of nationalised steel companies into government stocks on 28th July 1967.

(2) It was also discontinued for the discount houses.

able to foreign buyers from U.K. yards. In August the same groups of banks announced that they were ready to make special medium-term loans available to purchasers of machine tools that are manufactured in the United Kingdom.

Sterling deposits of U.K. residents(1) with the *accepting houses, overseas banks and other banks* increased strongly during the year to the end of March 1968—by £542 million. However, sterling advances by these banks to U.K. residents,(1) rose by only £99 million; the unadjusted figures show advances rising until September and then falling away. These banks were not released in April 1967, as were the clearing and Scottish banks, from the obligation to observe the 105% ceiling on their lending. However, in the course of the year arrangements were worked out with the Bank of England for the eventual replacement of the ceiling by a scheme of Cash Deposits with the Bank. The scheme had not been finalised at the time of devaluation, when the new measures of credit restriction, noted above, were applied to all banks.(2)

Hire purchase finance houses Until the middle of 1967 the total of outstanding hire purchase debt owed to finance houses continued to decline, as it had done since August 1966. But with the easing of terms control on cars in June, and further relaxations applying to a wider range of goods in August, new business grew rapidly and outstanding debt turned upwards. In October and November, when new credit extended on cars was particularly large, outstanding debt rose very sharply.

Hire purchase terms for cars were tightened once more on 18th November, and the Bank of England requested finance houses to hold down their lending—after allowing for seasonal fluctuations—to the level of end-October 1967, until further notice. Lending to the public sector or that specifically identified with the finance of export transactions was exempt from this ceiling. Though the increase in hire purchase debt owed to the houses was smaller in December, it recovered in the new year and continued to rise until after the Budget.

Until the recovery in their business towards the end of 1967 the houses had little need to bid for funds, so that the interest rates that they offered on deposits merely kept pace with competitive rates elsewhere. When Bank rate was raised to 8% some houses, believing that high interest rates would not last, began to quote rates for three and six months' deposits varying with Bank rate. By the end of December, however, when hopes of an early cut in Bank rate had receded, all houses were again offering fixed rates for three months' money and a few offered them for longer periods. At the end of March 1968 the spread of rates for three months' deposits quoted by the main houses was $8\frac{3}{8}$%-$8\frac{3}{4}$%, compared with a low point of around $5\frac{1}{2}$% in September 1967 and $6\frac{3}{8}$%-$6\frac{1}{2}$% at the end of March 1967.

Building societies The building societies had raised their borrowing rates by $\frac{1}{4}$% on 1st January 1967—to $4\frac{1}{4}$% on shares and 4% on deposits, both income tax paid; at the same time, the rate charged on existing mortgages was raised to $7\frac{1}{8}$%. The new borrowing rates were sufficient to produce a strong inflow of funds, which built up to record levels in the months of August to October. Until November the net inflow was comfortably in excess of mortgage advances.

After the rise in Bank rate to 8% in November new funds became scarcer and there was a sharp increase in withdrawals, for building society shares and deposits had become relatively less attractive. Funds were probably also withdrawn to finance some of the rapid rise in consumer spending. Nevertheless, the societies' lending remained high, because for a time they were able to meet the strong demand for mortgages by running down their liquid resources, which had been built up substantially in 1967.

In the early months of 1968, however, some societies found it necessary to introduce mortgage rationing, and although the reduction of Bank rate in March afforded some relief, it seemed likely that demand for advances would be swollen by the Government's scheme for

(1) Excluding other U.K. banks.

(2) The arrangements for Cash Deposits were subsequently agreed to by the banks approached and are available for use in circumstances that do not call for a rigid ceiling on lending. The scheme is described in the Bank's *Quarterly Bulletin* for June 1968, page 166.

100% mortgages which came into force on 1st April. The Building Societies Association therefore recommended on 19th April an increase in the rates of interest paid to investors: from 1st May the rate paid on shares would be $4\frac{1}{2}$% (tax paid) instead of $4\frac{1}{4}$%; and mortgages to new borrowers would cost $7\frac{5}{8}$% instead of $7\frac{1}{8}$%—existing borrowers would start paying the new rate later in the year. With corporation tax increased to $42\frac{1}{2}$% and an increase expected in the composite rate of income tax paid on interest to shareholders and depositors, the societies' net margins would be little more than maintained at the new rates.

During the twelve months under review the building society movement set up a committee of enquiry into reserve and liquidity requirements. The committee published its report at the end of October. This recommended some reduction in minimum reserve ratios for the larger societies; and, though it did not propose any change in the minimum liquidity ratio ($7\frac{1}{2}$%), it suggested that the larger societies could safely bring down their liquidity ratios nearer to the minimum. The committee was opposed to a change in the system of recommended interest rates, and it considered that the existing margins between borrowing and lending rates were reasonable.

Money and capital markets

Bill markets

Though Bank rate was reduced by $\frac{1}{2}$% on 4th May 1967, the Treasury bill tender rate declined on balance by no more than $\frac{1}{4}$% between the end of March and the end of June. After the early part of May, the authorities were anxious that the tender rate should not fall too fast, because interest rates abroad were tending to rise and sterling was again coming under pressure.

The U.S. Treasury bill rate rose sharply at the beginning of July, while because of the Middle East crisis and poor U.K. trade figures anxiety about sterling increased. The discount houses began to expect a rise in U.K. interest rates, and so in July they gradually reduced their weekly bids and the tender rate increased. The rate fell back a little after the middle of August, but soon afterwards a further increase in U.S. short-term rates and a sharp jump in euro-dollar rates made it clear that the authorities would seek a rise in U.K. rates. In the second half of September the market was obliged to borrow frequently at Bank rate; as a result the tender rate was increased in stages until, on 29th September, it was within $\frac{1}{32}$% of Bank rate. As noted earlier, Bank rate was raised from $5\frac{1}{2}$% to 6% on 19th October and to $6\frac{1}{2}$% on 9th November—the tender rate then rising to $6\frac{3}{8}$%. During this period the discount houses were left with a substantial proportion of the Treasury bills on offer; as rates were likely to rise further, there was a general reluctance by the outside tenderers to bid for bills. At the same time, the average cost of the houses' borrowed funds increased sharply.

After devaluation, the period of upheaval in foreign exchange markets and the tendency towards still higher interest rates abroad required the authorities to maintain the conditions of stringency that had been a feature of the money market since the summer. In the week after devaluation, the Bank's assistance to the market reached record levels. Conditions were very erratic: on the first three days[1] there were unprecedented shortages, as money was called by the banks to settle purchases of foreign exchange made the previous week and gilt-edged purchases made on 21st and 22nd November; by the end of the week, however, shortages gave way to a large surplus, as sterling was paid out by the Exchange Equalisation Account for foreign exchange taken into the reserves.

Outside competition for bills now became very keen, for the next move in interest rates seemed certain to be downwards. The houses were anxious to obtain reasonable allotments, but were well aware that any move to drop the tender rate sharply would be resisted by the authorities; so they increased their bids (reducing the rate) in only small stages. The tender rate became firmer in January, when an imminent cut in Bank rate seemed less likely; but in February and early March expectations of an early fall in interest rates were revived, and outside competition for bills became intense. The market felt obliged to reduce the rate at successive tenders, except on one occasion early in March. After the cut in Bank rate to $7\frac{1}{2}$% on 21st March, the tender rate fell to $7\frac{5}{32}$% and by the end of the month was $7\frac{1}{8}$%.

[1] Markets in London were closed on Monday, 20th November, and reopened on Tuesday 21st.

The discount houses' buying rate for three months' prime bank bills fell from $5\frac{11}{16}\%$ at the end of March 1967 to $5\frac{13}{32}\%$ at the end of June, but it then increased and had reached $5\frac{3}{4}\%$ by the end of the second week of October. During October and November the houses raised their buying rates further, in order to keep them in line with the general rise in short-term interest rates, and to damp down the flow of commercial paper that they were obliged to take from increasingly unwilling holders among the banks. The buying rate for three months' bills rose to about $7\frac{3}{4}\%$ and remained unchanged until the middle of February—even though the Treasury bill rate had fallen. The buying rate was then reduced by $\frac{1}{16}\%$, for by this time a scarcity of commercial paper had developed owing to the high cost of bill finance. During the remainder of February and March the market's buying rates again varied with the Treasury bill rate.

Gilt-edged Official sales of gilt-edged were considerable from the beginning of March 1967 until the early part of May, though not on the same scale as at the beginning of the year. Economic prospects seemed hopeful at this time, the Budget was favourably received by the market and further reductions in Bank rate were expected. Yields continued to decline and they reached a low point immediately after the reduction in Bank rate to $5\frac{1}{2}\%$ on 4th May.

Soon afterwards the market began to weaken. The belief gained ground that the decline in interest rates had come to an end, and this led to profit-taking by some who had earlier been acquiring stock. Furthermore, the announcement at the end of April of the vesting date for steel securities led to switching into these securities from gilt-edged by institutional investors looking for franked income. The poor trade figures for April provoked further selling. Official support of the market took a new form for a time—a readiness to buy certain key stocks at fixed prices—thus limiting the extent to which prices of other stocks could fall. The ensuing improvement was short-lived, however: the Middle East war, increased doubts about the U.K. economy, and the rise in U.S. interest rates, soon produced renewed selling pressures. Yields rose sharply, despite large official purchases.

The market became firmer in July, for stock was now generally short, and it was able to absorb sales by recipients of the steel compensation issue (discussed below) without seriously distorting prices. Indeed, during August and the first three weeks of September official sales of stock were large. Nevertheless, it was clear that the external position was deteriorating and that U.K. interest rates would shortly have to rise; towards the end of September the market again needed some official support. After the increases in Bank rate on 19th October and 9th November the market steadied; and when Bank rate rose to 8% official sales became very large. The long tap stock was almost exhausted and supplies of the short-dated tap and of the steel compensation stock were also depleted. Yields were pushed up sharply when Bank rate rose,(1) and then declined steadily.

By mid-December the market had become quieter; there was some profit-taking and, with confidence in sterling slow to recover, an early reduction in Bank rate had become less certain. Doubts about the economy continued after the announcement in January 1968 of cuts in the growth of public expenditure. Though the undertone continued basically firm and official purchases were seldom large, turnover remained low ahead of the Budget. However, the Budget measures announced on 19th March were well received, and up to the end of the month there were substantial official sales of stock. Yields fell back, encouraged by the cut of $\frac{1}{2}\%$ in Bank rate on 21st March.

On 28th July 1967 it was announced that the compensation stock to be issued in exchange for the securities of the re-nationalised steel companies would be $6\frac{1}{2}\%$ Treasury Stock 1971. A total of £486 million of the compensation stock was issued initially at $99\frac{5}{8}\%$. Because the authorities had been buyers of the securities of the steel companies from 17th July (when they went ex-dividend) in order to support the gilt-edged market, a substantial part of the compensation stock was taken up by official holders; and more was acquired after 31st July, when dealings in the compensation stock commenced. Official holdings of the stock were substantially

(1) There was also a marked change in the pattern of the yield curve; yields on short-dated stocks rose well above those of longer-dated, indicating an expectation that rates would fall.

reduced after devaluation but were not exhausted until February.

Because of the depletion of official supplies of the existing long tap stock after devaluation, a further tranche of £600 million 6¾% Treasury Loan 1995/98 was issued on 24th November. In February a new short-dated tap stock—£700 million 6¾% Exchequer Stock 1973—was issued.

There were three redemptions during the twelve months under review. Many holders of 2½% Savings Bonds 1964/67 accepted an offer to convert into either 6¼% Exchequer Loan 1972 or 6½% Funding Loan 1985/87. At the time of redemption (1st May 1967) less than £100 million of the unconverted balance of 2½% Savings Bonds remained in the market's hands. On the other hand, at the redemption dates of the other two stocks (5% Exchequer Stock 1967, redeemed for cash on 21st November, and 4% Exchequer Loan 1968, redeemed for cash on 18th March[1]) the amounts still in the hands of the market were unusually large—about a quarter and two fifths, respectively, of the totals outstanding. This was because the prices (less rebate interest) of both stocks re-entered their 'neutral (tax-free) zones'[2] when they went ex-dividend, thereby becoming attractive to surtax payers and to tax-paying financial institutions. Prices were pushed above what the authorities were prepared to pay to buy in before redemption.

Local authorities Early in April 1967 the arrangements under which local authorities borrow from the Public Works Loan Board were changed. From that date an authority's borrowing quota was related primarily to its capital expenditure, and not, as previously, to its total long-term borrowing requirement. In 1967/68 the quota would be a maximum of 34% of expenditure (44% if the authority was in a less prosperous region). Additionally, where its temporary debt exceeded 20% of its total debt—the future limit for temporary borrowing—an authority could borrow up to 30% (40% in a less prosperous region) of the funding it had accomplished in reducing to this limit. The period in which the limit on temporary borrowing had to be reached was extended by one year, to 31st March 1969.

At the end of May 1967 P.W.L.B. lending rates for quota loans, which had been unaltered for nearly three years, were raised to the point where they again reflected the cost of the Government's own borrowing; thereafter rates were to be kept in line with Government borrowing rates. The new rates, initially in the range 6¼%-6¾%, were some ¾% higher than the points at which rates had previously been pegged. From then onwards P.W.L.B. rates were close to rates for market mortgages of similar term; by the end of October rates for most P.W.L.B. lending had been increased to 7%, and at the end of March 1968 they were in the range 7¼%-7½%. Because of the higher cost of P.W.L.B. loans local authorities borrowed much less from this source in 1967/68 than in previous years.

Local authority stock issues were few during the twelve months, though in the second quarter of 1967 calls on earlier issues were quite substantial. At the end of March 1968 there was a large issue by tender of £40 million 7¼% Stock 1977 by the Greater London Council, to be paid for by instalments over a period of four months.

At the beginning of August the limit on the amount of short-term bonds that a local authority may issue on the London market was raised. At the same time the procedures under which the Bank of England are notified of the requirements of local authorities were modified to enable the Bank, in marshalling the queue of borrowers, to take greater account of readiness to proceed with issues. Also in August, local authority securities were freed from stamp duty on issue and transfer. Even allowing for redemptions, bond issues provided a fairly large amount of finance in the spring and summer of 1967, but then fell away.

Mortgage rates declined until early May but then rose quite steeply until July 1967; there was another sharp rise in the last quarter. Borrowing on mortgages tended to decline in the autumn.

(1) The redemption date was 15th March, but 15th and 16th March were declared bank holidays in the United Kingdom, because of the gold crisis, and markets were closed.

(2) The band, between the lowest price of issue and the redemption price, in which a stock may appreciate without attracting the taxes on capital gains. Legislation to abolish the neutral zone in respect of short-term capital gains was proposed in the March 1968 Budget.

Because of the increase in interest rates during the twelve months, and especially after the steep rise towards the end of 1967, local authorities tended to borrow as short as possible. Thus their temporary borrowing was a good deal larger than in 1966/67, particularly towards the end of the year. The extension of the time limit for reducing their short-term debt probably encouraged some authorities to resort to the temporary money market.

Debentures and equities The market for company fixed interest securities was generally quiet during the twelve months under review, apart from some heavy dealings in July in the securities of the steel companies that were due to be re-nationalised, and apart also from the period just after devaluation. According to the F.T.-Actuaries index,[1] the yield on twenty-year debentures and company loan stocks rose on balance over the year by about $\frac{5}{8}$%—less than the rise on a twenty-year government stock, so that the margin between debentures and gilt-edged declined to about $\frac{5}{8}$%. The 1967 Budget, by increasing the stamp duty on new issues so as to bring it into line with that on issues of ordinary shares, reduced, very slightly, the relative attractiveness of borrowing on loan capital. New fixed interest issues were small compared with earlier years.

New issues of ordinary shares were also low by historical standards, partly because the change in company taxation has made it more costly to raise finance by means of equity capital, but also because companies did not appear to be greatly in need of market finance. The equity market was extremely firm, to some extent because of the lack of new issues and a record amount of take-over activity, which reduced the amount of stock in the hands of the market; some £350 million of equities, moreover, was taken out of the market when steel was re-nationalised. The large funds at the disposal of institutional investors continued to be a source of underlying strength.

Equity prices began to rise before the 1967 Budget, and during the summer the official policy of mild reflation persuaded investors that the worst effects of the period of restraint were over. There was also some precautionary buying of equities as a hedge against the possibilities of renewed inflationary growth and of devaluation. The market continued to advance, with few interruptions, during the autumn.

After devaluation there was a heavy demand for shares of companies with a large (or potentially large) export business, or with substantial overseas assets. But a reaction set in when the full implications of devaluation and the delays likely in obtaining and fulfilling export orders had been assessed. In January some large take-over deals improved sentiment; and in the middle of the month, when the announcement of the cuts in growth of public expenditure was not accompanied by further restraints on consumer spending, prices made record gains. The Budget, in spite of the severity of the proposals, was regarded as favourable to equities in the longer term, and prices went ahead.

At the end of March 1968 the F.T.-Actuaries (500) industrial share price index stood at 147$\frac{3}{4}$ compared with 105 a year earlier. Turnover in equities was much higher than in the previous twelve months.

(1) This calculation is based on representative stocks bearing various coupons, but giving a yield that was somewhat above that obtainable on high coupon stocks issued recently.

Bank of England

29th February 1968

Issue Department

	£		£
Notes issued:		Government debt	11,015,100
In circulation	3,016,177,290	Other government securities ...	3,037,995,042
In Banking Department	34,243,560	Other securities	728,114
		Coin other than gold coin	261,744
		Amount of fiduciary issue ...	3,050,000,000
		Gold coin and bullion ... ... (@ 292*s.* 6*d.* per fine ounce)	420,850
	3,050,420,850		3,050,420,850

1st March 1968 — J. S. Fforde, *Chief Cashier.*

Banking Department

		£			£
Capital		14,553,000	Government securities		525,833,621
Rest		3,923,701	Other securities:		
Public Deposits ... ... (including Exchequer, savings banks, Commissioners of National Debt, and dividend accounts)		13,078,788	Discounts and advances	88,076,131	
Special Deposits		218,200,000	Securities	31,534,689	119,610,820
Other deposits:			Notes		34,243,560
Bankers	302,168,457		Coin		644,679
Other accounts ...	128,408,734	430,577,191			
		680,332,680			680,332,680

1st March 1968 — J. S. Fforde, *Chief Cashier.*

Half-yearly payments of £873,180 were made to H.M. Treasury on 5th April and 5th October 1967 in pursuance of Section 1 (4) of the Bank of England Act 1946.

Note circulation

The note circulation reached a peak of £3,214 million on 19th December 1967; this was £163 million higher than the previous peak of £3,051 million reached on 1st August 1967 and £145 million higher than the Christmas peak in 1966.

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	1964	1965	1966	1967	1968
Issued:					
New notes	2,585	2,707	2,971	2,633	2,833
Reissued notes	87	129	140	311	323
Paid	2,551	2,662	2,931	2,858	3,010
In circulation at the end of year	2,430	2,604	2,784	2,870	3,016
Percentage increase in circulation over the year ...	*5·2*	*7·2*	*6·9*	*3·1*	*5·1*

Value of notes issued by denominations

£ millions

Year to end of February	1964	1965	1966	1967	1968
10*s*.	245	245	256	219	221
£1	1,380	1,415	1,551	1,319	1,374
£5	1,024	1,069	1,217	1,296	1,427
£10(a)	16	107	87	110	127
Other notes(b)	7	—	—	—	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.

Value of notes in circulation by denominations

£ thousands

End of February	1964	1965	1966	1967	1968
10*s*.	96,985	99,638	104,731	104,470	107,258
£1	1,024,525	1,012,485	1,024,270	971,966	972,251
£5	1,179,277	1,274,344	1,397,612	1,490,147	1,577,541
£10	16,012	105,107	147,387	193,406	242,451
£20	178	170	166	162	156
£50	339	310	297	286	277
£100	586	558	532	512	491
£500	50	46	46	45	39
£1,000	73	71	70	69	63
Over £1,000	111,950	111,650	109,200	108,550	115,650
	2,429,975	2,604,379	2,784,311	2,869,613	3,016,177

Proportion of notes in circulation by denominations

Per cent by value of total circulation

End of February	1956(a)	1964	1965	1966	1967	1968
10s.	5·3	4·0	3·8	3·7	3·6	3·6
£1	75·9	42·2	38·9	36·8	33·9	32·2
£5	13·5	48·5	48·9	50·2	51·9	52·3
£10	0·2	0·6	4·0	5·3	6·7	8·0
£20-£1,000		0·1	0·1	0·1	0·1	0·1
Over £1,000	5·1	4·6	4·3	3·9	3·8	3·8
	100·0	100·0	100·0	100.0	100·0	100·0

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

Fiduciary Issue

The fiduciary issue rose on balance over the year by £150 million, to £3,050 million. The changes were as follows:

				£ millions
1967	February 28th			2,900
	March 13th	+50		
	April 3rd	+50		
	April 26th		−50	
	May 22nd	+50		
	July 10th	+50		
	July 24th	+50		
	August 15th		−50	
	September 19th		−50	
	November 6th	+50		
	November 28th	+50		
	December 6th	+50		
	December 12th	+50		
	December 18th	+50		
1968	January 1st		−50	
	January 4th		−50	
	January 9th		−50	
	January 16th		−50	3,050

Note economy campaign

The Bank have continued their efforts to encourage the public to accept more used, but clean, notes and to make greater use of £5 and £10 notes. During certain short periods of the year the commercial banks were again asked to refrain from issuing new £1 and 10*s*. notes. The results of the campaign, though not as striking as in the previous year, were nevertheless valuable.

The use of notes of higher denominations has continued to grow, though more slowly. Because of the trend towards higher sum notes, and to encourage it further, the Bank plan to introduce a £20 note in 1970.

New series of bank notes

A new series of bank notes, generally smaller in size than the notes at present in issue, is to be introduced over the next few years. The new £20 note will be the first of the series to be issued.

There will be no 10*s*. note in the new series. The present 10*s*. note will continue to be issued until it is replaced by the 50 new penny coin in October 1969. Because the £1 note in the new series will be similar in size to the present 10*s*. note, it will not be introduced before 1972—some time after the 10*s*. note has been withdrawn. The £5 and £10 denominations will follow later.

Withdrawal of 1957 series £5 note

Notice was given on 25th April 1967 that £5 notes of the series introduced in 1957 and issued until 1963 would cease to be legal tender after the 26th June 1967. At that date, some 14½ million of these notes were still in circulation; 8·7 million of them were outstanding at the end of February 1968. These notes may still be exchanged at the Head Office of the Bank of England.

Tax reserve certificates

The only important change during the year under review arose from the April 1967 Budget, which improved the terms of company tax reserve certificates. A new prospectus allowed, for the first time, interest on certificates repaid in cash. Rates of interest paid on certificates held by companies were changed during the year as follows:

	Interest rate when used in payment of taxes	Interest rate for cash repayments
Until 15. 4.67	4¼%	None allowed
From 15. 4.67	4%	2½%
From 24. 6.67	3¾%	2½%
From 29.11.67	4⅜%	3%

All rates tax free.

The rate of interest on personal tax reserve certificates used in payment of taxes was increased by ½% to 4% tax free on 29th November 1967; no interest is allowed on certificates encashed.

Certificates issued before 27th June 1966, when separate certificates for persons and for companies first became available, continue to be usable in accordance with the terms of their prospectus and to be available for payment of corporation tax. Some 23,000 certificates of this series, to the value of £19,750,000, were still outstanding at 29th February 1968, but it is expected that the bulk will be surrendered before the end of next February.

The total number of applications for tax reserve certificates during the year was again higher than in the previous year but the total value of certificates applied for fell slightly. The value of certificates surrendered increased over the previous year but was still below the rate for earlier periods; the new facility available to companies for cash repayments with interest accounted for £14 million of the total. There was a modest rise in the amount of certificates outstanding, to a total more than half as much again as the low point reached two years earlier. Details for the past two years are shown in the table.

Year to end-February	Applications			Surrenders				Change during year	Outstanding at end of period
	Number	Average value	Total value	Cancelled in payment of taxes	Repaid without interest	Repaid with interest	Total		
	000's	*£000's*	*£ millions*						
1967: Old series[(a)]	40	1·0	38	155	3	—	158	−120	77
New series:[(b)]									
Company	15	14·5	218	62	2	—	64	+154	154
Personal	80	0·8	62	8	—	—	8	+ 54	54
Total	135	2·4	318	225	5	—	230	+ 88	285
1968: Old series[(a)]	—	—	—	56	1	—	57	− 57	20
New series:[(b)]									
Company	23	8·6	198	145	6	14	165	+ 33	187
Personal	134	0·7	93	39	1	—	40	+ 53	107
Total	157	1·8	291	240	8	14	262	+ 29	314

(a) Issued before 27th June 1966.
(b) Issued from 27th June 1966.

Local authority bills

Three tenders, each for £25 million 91-day bills, were held at the Bank during the year on behalf of the Greater London Council. The average rates of discount on allotment varied between $\frac{1}{16}$% and $\frac{1}{4}$% above the most recent comparable Treasury bill tender rates, but were substantially below the corresponding rates that local authorities were paying for three months' temporary money.

On 12th July 1967, £3$\frac{3}{4}$ million 91-day bills were issued by the Bank on behalf of the Liverpool Corporation, the first bill issue for the Corporation since 1940. The bills were placed with the discount market at 5$\frac{3}{8}$%, approximately $\frac{1}{16}$% above the Treasury bill rate at the previous tender. The bills were replaced on 11th October 1967 and again on 10th January 1968 at approximately $\frac{1}{8}$% and $\frac{3}{16}$%, respectively, above the most recent Treasury bill rates.

Panel on take-overs and mergers

On the proposal of the Governor of the Bank, and following discussions with the Chairman of the Issuing Houses Association, the Chairman of the Stock Exchange, and subsequently with the City Working Party,[(1)] it was agreed in September 1967 to establish a Panel to supervise the operation of a new City Code on Take-overs and Mergers, as soon as the Code was produced. At the Governor's request, Sir Humphrey Mynors[(2)] agreed to serve as the first Chairman of the Panel.

(1) In October 1959, the City Working Party, drawn from the Executive Committee of the Issuing Houses Association, the Accepting Houses Committee, the Association of Investment Trusts, the British Insurance Association, the Committee of London Clearing Bankers and the London Stock Exchange, prepared and issued "Notes on amalgamations of British businesses". This was a general guide to the principles and practices which should be followed by those concerned in take-over and merger transactions. In October 1963 it was superseded by "Revised notes on company amalgamations and mergers". In 1967, the City Working Party was reconvened to prepare the new City Code and, on this occasion, representatives of the Confederation of British Industry and the National Association of Pension Funds were invited to join the discussions.
(2) Deputy Governor of the Bank from 1954 to 1964.

The revised Code was published on 27th March 1968, by which time the Panel (whose members are drawn from the bodies represented on the City Working Party) had been constituted and was in being. A permanent secretariat is being provided by the Bank.

Committee on Invisible Exports

On 9th February 1968, a new permanent Committee on Invisible Exports was set up jointly by the Governor of the Bank of England and the British National Export Council. This followed a recommendation by the original Committee on Invisible Exports (a sub-committee of the Financial Advisory Panel on Exports) in its report "Britain's Invisible Earnings":

> "That some permanent organisation should be responsible for keeping a continuous watch on the whole field of invisibles with a view to suggesting means of further promoting invisible earnings at home and abroad."

The Financial Advisory Panel on Exports has itself been disbanded, and its task of promoting invisible exports will in future be carried out by the Committee, whose terms of reference are:

> "In the light of the report of the Committee on Invisible Exports, to suggest, and where possible implement, measures for the encouragement of 'invisible earnings'."

Mr. Cyril Kleinwort agreed to serve as the first Chairman of the Committee, whose members are drawn from representatives of a wide range of service industries and from government departments. The Bank of England are represented and also provide the secretariat.

Management of stock registers

The nominal totals in recent years (and, for 1968, the number of accounts) of the different groups of stocks managed by the Bank are given below:

					Number of accounts
				£ millions	*000's*
End of February	**1965**	**1966**	**1967**	**1968**	**1968**
British government securities:					
Stock(a)	17,578	18,663(b)	19,595	20,288	2,071
Bearer bonds	17	16	15	15	—
Total	17,595	18,679	19,610	20,303	2,071
Other securities:					
Government guaranteed	1,833	1,777(b)	1,762	1,759	237
Commonwealth etc.	236	216	221	242	91
Local authorities	421	473	542	549	175
Public boards etc.	98	107	123	121	34
Miscellaneous	15	15	15	15	1
Total	2,603	2,588	2,663	2,686	538
Grand Total	20,198	21,267	22,273	22,989	2,609

(a) 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.

(b) 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.

The number of transfers registered by the Bank rose by 11%—more sharply than in the previous year—to just over 750,000. Activity was greatest in the first half of the period and was particularly marked during August 1967 after the issue of the Iron and Steel compensation stock—6½% Treasury Stock 1971.

Operations undertaken during the year included:

Repayments

At par

			£ millions nominal
Agricultural Mortgage Corporation Limited 3½% Debenture Stock 1965/67	1967	15th March	1·3
London County 3% Consolidated Stock 1962/67		5th April	15
Swansea Corporation 6½% Bonds 1967		10th March	0·5
2½% Savings Bonds 1964/67		1st May	171·9
Liverpool Corporation 7⅛% Bonds 1967		11th August	1
Palestine Government 3% Guaranteed Stock 1962/67		1st November	0·8
5% Exchequer Stock 1967		21st November	848·7
London County 3½% Consolidated Stock 1958/68	1968	1st February	7·9

Issues

For cash

				£ millions nominal
Corporation of London 6½% Stock 1980/82	@ £97%	1967	8th March	16
Swansea Corporation 6⅝% Bonds 1968	@ par		10th March	0·5
Liverpool Corporation 6¼% Bonds 1968	@ par		11th August	1
Liverpool Corporation 6½% Bonds 1969	@ £99: 17*s*. 6*d*.%		11th August	1
Government of Malaysia 7½% Stock 1978/82	@ £99%		11th October	7·5
Swansea Corporation 6¾% Bonds 23rd October 1968 ...	@ par		20th October	0·5
New Zealand Government 7¼% Stock 1988/92	@ £98%		1st November	15
6¾% Treasury Loan 1995/98 (Second tranche)	@ £94: 10*s*.%		24th November	600
City of Westminster 7¼% Stock 1975	@ £98: 5*s*.%	1968	7th February	12
6¾% Exchequer Stock 1973	@ £97: 5*s*.%		19th February	700

Bearer facilities were made available on the second tranche of 6¾% Treasury Loan 1995/98.

In exchange

			£ millions nominal
6¼% Exchequer Loan 1972 (for 2½% Savings Bonds 1964/67 at par) ...	1967	1st May	514·8
6½% Funding Loan 1985/87 (for 2½% Savings Bonds 1964/67 at par) ...		1st May	58·2
6½% Treasury Stock 1971 (in accordance with the provisions of the Iron and Steel Act 1967)		28th July	485·7
	1968	29th January	22·5

Iron and Steel Act 1967

On 28th July 1967 virtually all the securities of the fourteen steel companies named in the Iron and Steel Act 1967 were vested in the British Steel Corporation; and holders of the quoted securities, for which comparative values had been determined, received 6½% Treasury Stock 1971 by way of compensation. Approximately 195,000 accounts were removed from the steel companies' own registers to the Bank: over 90% of the accounts had been received at the Bank by 29th December, when the balance for the first payment of interest on 6½% Treasury Stock 1971 was struck; almost all of the remainder were received by the end of February 1968.

The amount of Treasury Stock issued in place of these quoted securities was some £486 million. In addition, £22½ million of the stock was issued in January after compensation terms had been agreed for the English Steel Corporation Ltd., whose shares were not quoted on the stock exchange. Further stock will be issued in due course for unquoted securities of other companies.

Southern Rhodesia

No funds were received during the year to meet interest on or sinking fund contributions to Government of Southern Rhodesia stocks for which the Bank act as paying agent. The gross interest due but unpaid on these stocks up to the end of February 1968 totalled approximately £5,389,000, and the total of contributions outstanding for those sinking funds managed by the Bank was some £651,400. In addition the redemption money for Southern Rhodesia 3½% Stock 1961/66, amounting to £1,378,400, which was not received in July 1966 when the stock fell due for repayment, is still outstanding; the register for this stock is being kept open for transfers until further notice.

Finance for exports

The range of available facilities for export finance was enlarged in July 1967 when the Export Credits Guarantee Department introduced a scheme extending their unconditional bank guarantees to the finance of short-term export transactions on 'open account'. The new scheme is designed to complement the scheme introduced in March 1966 applying to short-term transactions evidenced by bills or promissory notes; and the arrangements are broadly similar—the London clearing banks, the Scottish banks and the Northern Ireland banks have undertaken to provide finance at Bank rate (with a minimum of 4½% per annum) against the E.C.G.D.'s unconditional guarantees. The scheme is described more fully in the Bank's *Quarterly Bulletin* for December 1967.

It was announced in November 1967 that the London clearing banks and the Scottish banks had agreed to continue to provide medium and long-term export finance for a further period at a fixed rate of 5½% per annum.

The Bank of England's refinancing facilities, described in the *Quarterly Bulletins* for March 1961 and March 1965, have continued unchanged. At the end of March 1968 the total of export credit eligible for refinance with the Bank stood at £156 million, compared with £114 million at the end of March 1967. The refinance facility has continued unused.

Exchange control

The main changes in the administration of exchange control during the year were as follows:

12th April 1967

Abolition of security sterling

The security sterling market and official foreign exchange market were unified, so that the proceeds of the sale of sterling securities owned by non-residents (except residents of Rhodesia) become external sterling instead of security sterling, and thus freely convertible into foreign currencies at official rates of exchange. Dealings in security sterling had for some years taken place in markets abroad at rates close to official rates.

Specification of foreign currencies

The list of fifteen principal foreign currencies which were specified currencies for the purposes of the Exchange Control Act 1947 was extended to include all foreign (*i.e.* non-Scheduled Territory) currencies. As a result, United Kingdom residents are obliged to offer for sale to an authorised dealer holdings of all foreign currencies; and securities expressed in any foreign currency are prescribed securities.

29th September 1967

Determination of residence

Administrative procedures were changed so that a person moving to a new country might be treated as a resident there if his actual or intended stay was for a minimum of three years; previously he was not normally treated as resident in his new country unless he was able to state that the move was permanent.

24th October 1967

Travel outside the Scheduled Territories

As foreshadowed by the Chancellor on 29th June 1967, the basic foreign currency travel allowance for the year beginning 1st November 1967 was again set at £50.

30th January 1968

Direct investment

Official exchange would be allowed for the finance of projects outside the Scheduled Territories which were directly concerned with promoting exports of United Kingdom goods and services, up to a limit of £50,000 or 50% of the total investment, whichever was the greater. Approval would be given only where the benefits to the balance of payments were likely to exceed the cost of the investment within 18 months, and would continue thereafter.

Exchange control notices

The Bank have begun a programme of revising (and where possible simplifying) the notices issued to banks and others concerned with the administration of exchange control. On 5th April 1967 the exchange control notices that had been issued by the Foreign Exchange Committee were discontinued; where necessary their substance was incorporated in notices issued by the Bank. On 26th January 1968 the Bank's notices (except those dealing with commodities) were amalgamated into one series.

Commodity markets

New schemes were introduced with effect from 5th July 1967 to cover the establishment of markets in fishmeal and vegetable oil. From 19th February 1968 the metals scheme was extended to cover trading in silver.

Loans to commodity traders

After devaluation of sterling, a number of United Kingdom commodity traders faced losses because they had contracted to purchase goods from certain sterling area countries in local currencies for which they were unable to obtain forward cover and which, in the event, were not devalued.

To assist traders over their difficulties—which might well have endangered the future of these commodity markets in the United Kingdom—the Bank offered loans up to a total of £5 million, subject to a maximum of 80% of losses incurred. Firms' initial estimates of their losses totalled £6½ million; but, partly because some losses proved on re-examination not to be eligible, and partly because a number of firms decided to meet theirs from their own resources, applications were finally received by the Bank in respect of losses totalling only £4½ million; and by the end of February 1968 the Bank had advanced over £2¼ million. The loans are unsecured, and subordinate to claims of other creditors. They are repayable by half-yearly instalments over five years, with interest at 5%.

Voluntary programme of restraint

In his Budget statement on 11th April 1967 the Chancellor said that the voluntary programme of restraint on the export of capital to the more developed countries of the sterling area was to be continued for at least a further year. He acknowledged the co-operation received from industry, and from institutional investors; and paid tribute to the understanding attitude of the governments concerned. An announcement that the programme would be continued was included in the Budget statement in March 1968.

Developments in financial statistics

The scope of available statistical information was further enlarged in 1967. The Bank wish to thank the banks, other financial institutions and companies for their help both in supplying new information and in continuing to provide statistics for the guidance of policy and for publication.

Banking statistics

The new quarterly analysis of bank advances, which was developed in 1966/67, was enlarged to include the advances of the Northern Ireland banks.

As noted earlier in this *Report*, bank lending which was specifically identified with the finance of export transactions was exempted from the measures of credit restraint which were introduced on 18th November 1967. All banks (except the Northern Ireland banks) were asked to provide the Bank with statistical information which related to lending in this exempt category.

The regular meetings between the Bank's economic and statistical staff and economists of the clearing banks continued during the year.

Sector financing

Efforts to improve the quality of the sector financing statistics have continued. During the year a set of six-sector accounts covering the years 1952-66 was constructed; this was published in the Bank's *Quarterly Bulletin* for December 1967.

O.E.C.D. Capital Markets Study

In 1967 the O.E.C.D. published a report on capital markets. One of the recommendations was that statistics relating to capital markets should be improved and, where possible, made internationally comparable. A special group of financial statisticians, including a representative from the Bank, was set up during 1967 to pursue this matter. The group, which meets in Paris, has so far been mainly concerned with statistics of capital issues, transactions in securities, and sector financing accounts.

Quarterly Bulletin

The circulation of the Bank's *Quarterly Bulletin* has continued to expand. Over 7,500 copies of the December 1967 issue were sent out at the time of publication, including nearly 2,500 copies despatched overseas. Of the 5,100 or so copies circulated within the United Kingdom, more than 1,250 went to financial institutions, and over 1,200 to universities, colleges, schools and libraries. In addition, there is a steady demand, particularly from the universities and schools, for off-prints of the principal articles appearing in the *Bulletins*.

At the beginning of 1967, the lay-out of the *Bulletin* was redesigned and a different type face employed.

Staff and other internal matters

The total staff of the Bank at 29th February was around 7,250, including about 1,900 non-clerical staff employed at the Printing Works. The banking staff of around 4,400 included 2,650 women. Of the total, approximately 1,400 were employed in the Accountant's Department; about 1,300 in the Cashier's Department, including nearly 330 at the Branches; 660 in the Overseas Department, including over 400 engaged on exchange control; over 200 in the Secretary's Department, including the Organisation and Method Section, one of whose functions is the operation of the new Head Office computer referred to below; and about 180 in the Economic Intelligence Department.

The Bank continued to second temporarily two members of the staff from the Economic Intelligence Department to H.M. Treasury. They have also lent two of their staff to the Monopolies Commission to give secretarial assistance in connection with the Commission's consideration of mergers between banks.

The Bank's branch premises at Manchester, Birmingham, Leeds and Newcastle are to be rebuilt. The existing buildings are over 80 years old and cannot be suitably enlarged or redeveloped to provide facilities for dealing with the greatly increased circulation of bank notes. Sites have been acquired, plans approved and architects appointed for all four projects. At Manchester, building began in December 1967; it is expected that work will start at Birmingham in July, Newcastle in August and Leeds in September 1968. The new buildings are due to be completed by the end of 1970.

Automation

The transfer of the stock registers to magnetic tape began in April 1967 with 3½% War Stock. Later in the year eight more stocks were transferred, and six new issues, including the steel compensation stock (6½% Treasury Stock 1971) raised directly on tape. By the end of February 1968 there were approximately 1·2 million accounts on tape, comprising 45% of the whole stock registers.

The Bank's third computer was installed in Head Office at the end of January 1968. By the end of February it was effectively carrying out several small operations, and was also engaged in a heavy load of program testing preparatory to the transfer to it of the major tasks of current account banking, cheque clearing and the payment of salaries.

Relations with central banks and other institutions abroad

Events during the year demonstrated the value of the close and cordial relations that have been fostered over many years by the Bank with overseas central banks and international financial institutions. Following the decision to devalue sterling, the need for close liaison with countries in the sterling area, co-operation with other countries whose currencies are in international use, and the negotiation of support facilities with other central banks and with international monetary institutions, made heavy demands on the Bank's resources, especially in the overseas field.

Over 400 visitors from more than 90 countries were received in the Bank during the year, while visits to nearly 60 countries were made by officials from the Bank in the normal course of keeping in touch at first hand with developments abroad, and of participating in international discussions and negotiations.

The Bank continued to meet, as far as possible, requests from overseas countries for advice and practical help in banking and currency matters. At 29th February 1968, 27 members of the Bank's staff, who had been released for this purpose, were serving with central banks and other financial institutions overseas.

The Bank's archives

The Bank have arranged with Professor R. S. Sayers, F.B.A., Cassel Professor of Economics in the University of London, to undertake a continuation of the History of the Bank, begun with Sir John Clapham's two volumes published in 1944. Professor Sayers will start work on this project after his retirement from the University in the autumn of 1968.

The co-operation received from various bodies in the provision of financial statistics has already been acknowledged. In other respects too, the Bank continued during the year to receive much help and co-operation from the associations of banks and other financial institutions. This has brought many advantages in the execution of monetary policy, and the Bank welcome this opportunity of recording once again their appreciation.

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

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