COMMENTARY

APRIL—SEPTEMBER, 1960

The Bulletin will normally include a Commentary on recent events, covering a period of three months and comprising a description of the situation in which monetary policy was operating, followed by an analysis of the principal financial statistics for the period. On this first occasion the Commentary, at rather greater length, covers a period of six months from the end of March, 1960, linking up with the similar material published in the last Annual Report. The end of September, 1960, is the latest date for which quarterly statistical information is yet available, but the narrative is continued into October to cover the important monetary developments of that month.

The Budget

The Chancellor of the Exchequer presented his Budget on the 4th April. In reviewing the economic situation, he stated that the prospective increase in demand,

> ". . . is likely at least fully to absorb, and might even involve a danger of outrunning, the increase in production which can be expected."[a]

The Chancellor concluded that he could not propose a net reduction in taxation. He estimated government expenditure would increase by some £350 million, but considered that this would be covered by the growth of revenue arising from a higher level of national income, so that the overall budget deficit in 1960/61 would be almost the same as in the previous year.

At the time of the budget statement it was not clear that the fiscal and monetary measures already adopted would sufficiently restrain private expenditure. The rises in wages and salaries recently negotiated appeared likely to maintain the upward trend of total expenditure by consumers. A further rise in housing and commercial building seemed assured; and welcome evidence was accumulating of the renewed expansion in the capital expenditure of manufacturing industry. Some slackening might be in prospect in the growth of stocks and of demand for durable consumer goods; but it was clear that this would have to occur soon, and to a considerable extent, if the growth in home demand as a whole, over the summer and autumn of 1960, were not to lead to trouble. In these circumstances the Chancellor included in his speech a warning in the following terms:

> ". . . I think it likely that the time may soon arrive when it would be right that we should take other steps to restrain further expansion of private credit; and we stand ready to do so."[b]

Special Deposits and hire purchase controls

Fresh evidence becoming available during the weeks following the Budget did not inspire confidence that the growth in demand would slacken quickly enough. The upward trend of expenditure on consumer durables had persisted, the demand for cars appearing actually to have gained strength. The accumulation of stocks seemed to be growing. Scarcities of skilled labour in certain areas were becoming more marked.

Imports too were rising steeply. The steepness reflected the building up of stocks at home and perhaps also the measures of liberalisation taken during the previous year; but there were signs that the rise was being aggravated by domestic shortages. Imports of sheet steel, for example, and of cars had risen abruptly, the latter to an extent which could hardly be attributed to liberalisation alone. The general trend of exports at this time was not causing the same degree of concern, but it was likely to do so before long if the domestic situation then obtaining were to develop unchecked.

It was therefore judged that a further measure of restriction was required. This

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[a] Hansard, Vol. 621, No. 91, Col. 45.

[b] Hansard, Vol. 621, No. 91, Col. 46.

judgment was supported by monetary evidence. First, reported bank advances continued to rise steeply during the five weeks ended the 20th April—a period in which little or no seasonal rise is expected. Secondly, new credit extended on hire purchase was still tending to increase, mainly because of a sharp rise in sales of cars. It was therefore considered that the rise in interest rates which had occurred earlier in the year should now be followed by direct measures to restrict credit. The system of Special Deposits which had been devised in July, 1958, was brought into operation on the 28th April. A call was made on the London Clearing Banks to deposit with the Bank of England by the 15th June the equivalent of 1% of their gross deposits. Owing to the different circumstances affecting them, a call for only ½% was made on the Scottish banks. On the occasion of this first call, the banks were allowed a period of nearly seven weeks, until the 15th June, in which to make their arrangements. Other groups of banks were officially informed of the call being made upon the clearing banks and Scottish banks and were made aware of the authorities' desire to encourage restraint in bank lending.

Simultaneously with the Bank's call for Special Deposits, the Board of Trade announced the immediate reintroduction of controls over hire purchase terms. The new regulations required a 10% or 20% initial deposit, according to the category of goods, and repayment in most categories over a maximum of two years. Although these terms were less severe than had in general been imposed in the past, they followed a period in which, in the absence of official restrictions, terms had been very much easier; they could therefore be expected to have a considerable impact. There appeared to be a clear case for a selective control of this kind, both to provide some relief to the balance of payments and to ease the problem of regional labour shortages. Also, it was desirable that restraint should be applied not only to the banks, but as widely as possible over the whole field of short-term lending.

Impact on the capital market

The announcement of these measures ended an uncertainty which had prevailed in the security markets; the immediate reaction was a moderate rise in prices. Ordinary share prices, after a temporary setback, rose steadily between the second week in May and the second week in June. Expectations of further credit restriction then revived and prices fell back once more. In the gilt-edged market prices began to fall much earlier, about the middle of May. This was due to fears that the banks might sell more stock in order to make their Special Deposits, as well as to expectations of a further rise in Bank Rate. The authorities, while giving some support, did not resist a gradual fall in prices, the yield on 2½% Consols rising from 5·3% on the 11th May to 5·6% by the 22nd June.

Competition at the tender between the discount houses and other tenderers caused the Treasury Bill tender rate to fall below 4·6% in the second week of May. Official operations were then directed to discouraging a further fall. The market had recourse to the Bank on fourteen occasions in the period mid-April to mid-June, whereas this had occurred only once in the month from mid-March to mid-April. By mid-June the rate was nearly 4·7%.

The building societies had made no change in their rates following the rise in Bank Rate in January. By the spring they were feeling the cumulative effects of successive measures of credit restraint, and the slower rate at which they were attracting funds was often insufficient to satisfy the very big demand for mortgages. In May the Building Societies Association therefore recommended an increase in the rate of interest on shares from 3¼% to 3½% (Income Tax paid), and on mortgages from 5½% to 6%.

The attitude of the banks towards applications for new advances continued to become more restrictive during the second quarter but the total of reported bank advances, fed by the use of overdraft facilities already in being, rose again in May. After allowing for seasonal influences, the rise was less rapid than that in April, but still faster than the average of recent months. New issues of capital by public companies in the second quarter were only a little below the high rate reached in the previous quarter; within the total there was a marked fall in issues by the category "Insurance, Banking and Finance", and a rise in issues by 'non-financial' companies, especially in manufacturing industry.

The domestic situation in June By June the growth of consumer demand had begun to moderate. The reimposition of hire purchase controls, and perhaps also less easy access to bank accommodation, had helped to cause a fall in the demand for cars and other durable goods in May. Sales of new cars were maintained but there were reports that waiting lists were beginning to shorten; and the market in used cars was particularly weak, prices falling abruptly. Retailers' stocks of household durable goods were high and the fall in final purchases therefore appeared likely to have a magnified effect on manufacturers' sales.

Other forms of consumer spending continued to grow and consumers' expenditure as a whole, which (seasonally adjusted) had risen sharply in the first quarter of 1960, appeared still to be increasing. With earnings continuing to rise, both on account of recent negotiations and because of the tendency, in prevailing conditions of labour scarcity, for actual earnings to rise faster than negotiated wage rates, consumer spending appeared likely to continue slowly upwards for a time. The pressure of demand for labour was becoming so great that it was prudent to expect a further increase in wage rates after a relatively short interval; and meanwhile total employment was rising rather faster than in the same period of 1959. The resulting further rise in personal incomes could be expected to cause the growth of consumer spending to accelerate once more.

The growth of fixed investment was proceeding. In the public sector the expansion was thought to be slackening but the trend of fixed capital expenditure in the private sector had risen steeply in the first quarter of 1960 and the evidence suggested that this trend was persisting. New orders for almost all kinds of building work had risen sharply in the first quarter; new orders for engineering capital goods had also risen markedly and appeared to be continuing at a high level. Some general lengthening of order books was to be expected; but there was a risk present that order books and delivery dates, both for building and for equipment, would become altogether too long, in anticipation of which a further rise in interest rates and a reinforcement of credit restriction could be appropriate. If further restraint on capital expenditure were necessary, the balance of advantage would lie in checking for a time the very rapid growth of private house building and commercial building, an outcome which these measures might promote, rather than in holding back the growth of factory building.

The accumulation of stocks had been very large over the previous six months, so far as could be seen, and on some grounds could be expected to fall away. Yet if the general economic prospect were judged to be still one of overstrain there were reasons for positively encouraging, by further monetary measures, a fall in expenditure on stocks. Such measures would have a direct effect through the cost and availability of money; but if regarded as one further step in a series of actions, demonstrating official determination, they could also be expected to deter people from stocking-up against the risk that goods would become dearer or difficult to get. In its application to imported materials a fall in stockbuilding would bring relief to the balance of payments and, with international commodity prices generally steady, or even falling slightly, it did not look as though the effect of domestic monetary measures would be outweighed, in this field, by expectation of rising prices.

The external situation in June By June, the outlook for the balance of payments suggested that such relief would be welcome. The trend of overseas trade was becoming unsatisfactory. Imports were continuing to rise, although the rate of increase, after allowing for seasonal factors, did seem to be slackening. While the rate of expansion in imports of some industrial materials (for example textile fibres), appeared to be moderating, arrivals of other materials, particularly iron and steel, of which home production was already at full capacity, were continuing to increase. Imports of finished manufactures, though not rising as fast as before, were still almost 50% higher than a year earlier. There were increased imports of capital goods, of which American aircraft were an outstanding example, and also of consumer goods, notably cars and clothing. Some fall in stockbuilding, less rapid growth in the consumption of raw materials (associated with a slower growth of industrial output in 1960) and a waning effect of liberalisation could be expected to cause the rise in imports to go on diminishing as the year went by; but if serious deterioration in the balance of visible trade were to be avoided, this would have to occur quickly and the growth of exports would have to be maintained.

The rise in exports was not being maintained. It had stopped. The seasonally adjusted figures even suggested that a fall was beginning, despite reports that the inflow of new orders for export, particularly for engineering goods, continued to be strong. It seemed that the ability to export some kinds of goods was being impaired by the weight of home orders while the overseas markets for other kinds of goods were weakening. Divergent tendencies were beginning to appear in North America on the one hand and Western Europe on the other. A sharp expansion in economic activity in the United States had been widely expected to follow the settlement of the steel strike in January; this had not happened and uncertainty was developing whether the prospect was of continued expansion, though rather slower than before, or of decline. In continental Western Europe the situation was not unlike that in the United Kingdom; excess capacity was rapidly being absorbed in most countries and shortages of labour were apparent. Expansion seemed to be slowing down for these reasons.

These divergent tendencies were echoed in the movement of interest rates, influenced at this time much more by domestic than by international considerations. In the United States the Federal Reserve Banks reduced their discount rates from 4% to $3\frac{1}{2}$% early in June. In Europe the discount rate in Western Germany was put up from 4% to 5% and the mandatory minimum reserve ratios were raised. Also responding to these tendencies, sales of British exports to Western Europe were well maintained while there was some fall, seasonal factors apart, in sales to North America. Moreover the outlook for sales of cars to the North American market was becoming uncertain: competition from American 'compact' cars had been growing and dealers had become over-stocked with some imported models. More disquieting, British exports to the Overseas Sterling Area were not increasing at a time when total exports to these countries were growing.

To these unsatisfactory features of the United Kingdom's overseas trade was added the prospect of no significant improvement in net invisible receipts on current account. Together with the probability that the net outflow of long-term capital would be larger, this implied that the deficit of the United Kingdom on current and long-term capital accounts combined would not only continue over the period ahead but might be large—particularly, for seasonal reasons, in the second half of 1960. This prospect strengthened the arguments for additional restraining measures at home, for these should help to contain the deficit over the ensuing six months.

The sterling holdings of the Overseas Sterling Area had begun to fall and were not expected to start rising again over the period ahead. The holdings of countries outside the Sterling Area, on the other hand, had been rising; the ease with which funds could move internationally had increased[a] following the wider convertibility of currencies introduced in December, 1958, and a considerable further rise in these sterling holdings was not unlikely if confidence in sterling were maintained and if the yield from short-term investment in London remained relatively attractive. This rise in short-term liabilities would need careful watching but, given the general outlook for the balance of payments, these external monetary considerations did not conflict with the domestic arguments in favour of further restraining measures.

The immediate position in the exchange markets and the trend of the reserves were not unsatisfactory. The reserves were rising; and in the second quarter as a whole they rose by £40 million despite the repayment of £15 million to the I.M.F. Except on one occasion in June, when the West German discount rate was raised from 4% to 5%, sterling stood above parity against the U.S. dollar throughout the second quarter of the year. Forward sterling was also strong against the dollar and, allowing for the difference in yields on Treasury Bills in London and New York, for the purpose of a notional comparison, a margin in favour

[a] This increase is illustrated in the half-yearly figures of overseas deposits and advances (including balances with banks abroad), reported by the overseas banks in London and by the accepting houses (see Statistical Annex, Tables 10 and 11).

of covered investment in London persisted. Yet the satisfactory performance of sterling very much depended upon the heavy inflow of money to London from countries outside the Sterling Area, mostly from North America and Western Europe. In the second quarter as a whole the sterling holdings of countries outside the Sterling Area rose by £118 million.

Reinforcement of credit restriction Having regard to all the above internal and external considerations, it was decided to take a further series of measures to make private credit more expensive and difficult to obtain; and to discourage any impression that the authorities were ready to acquiesce in a resumption of inflation. Accordingly, on the 23rd June Bank Rate was increased from 5% to 6% and further calls were made on the London Clearing Banks and the Scottish banks for Special Deposits. These calls were the same as those made in April, 1% and ½% respectively, but the time limit was tightened by requiring half the Deposits to be made by mid-July and the remainder by mid-August. On the same day and parallel with the monetary action the Chancellor of the Exchequer announced the Government's decision to hold capital expenditure in the public sector for 1961/62 at the level planned for the present financial year.

Capital markets in the third quarter Following the increase in Bank Rate the Treasury Bill tender rate moved up by the full 1% to nearly 5·7%. By mid-July it had fallen back and during most of the third quarter it was between 5·5% and 5·6%. On the 9th September, through strong competition for Bills from overseas and other tenderers, the rate fell to 5·5%. For the first time since early July, the market was then obliged to borrow from the Bank on several occasions and by the end of September the rate had returned to nearly 5·6%.

In the gilt-edged market prices fell initially after the rise in Bank Rate, but soon steadied, with the yield on 2½% Consols between 5·6% and 5·7%. The announcement on the 12th July of the terms of issue of a new short-dated stock, 5½% Treasury Bonds, 1962, was followed by falls in the prices of short-dated issues. About mid-August the prices of gilt-edged stocks began to rise. Some of the support, particularly for 'undated' stocks, was reported to have come from overseas. Official sales of stock, however, tended to moderate the fall in yields, that on 2½% Consols moving down, over the quarter as a whole, from 5·7% to 5·5%.

The decline in the prices of ordinary shares, which had begun in mid-June, ended soon after the rise in Bank Rate. Towards the end of July there was a general recovery. As in the gilt-edged market, some of the demand was reported to have come from overseas. Expectations of an early relaxation of monetary policy probably also contributed to the strength of the market; but by early September these expectations had faded and prices fell back a little.

Public companies' new issues of capital during the third quarter were slightly greater than in the second quarter; there was again a marked rise in the total raised by manufacturing industry. In line with the increasing strength of the gilt-edged market, a feature of this period was an increase in the proportion of fixed interest securities issued.

The external situation in the third quarter In the exchange market sterling strengthened considerably in the last week of June. This proved the beginning of a phase which persisted through and beyond the rest of the period under review. Characteristic of this phase was a weakening (partly seasonal) in the United Kingdom's external position on current account which was more than counterbalanced by an increased inflow of capital. So the reserves, instead of falling, rose faster than before even though opportunity was taken to accelerate repayments to the International Monetary Fund. Before considering these and other international monetary developments in greater detail it is convenient to refer to the background; that is to say, to international trade and to economic conditions abroad.

The United Kingdom's deficit on visible trade rose to £135 million in the third quarter, following one of £40 million in the second. Only about half the change could be attributed to seasonal influences. Making some allowance for these, imports appeared to be still rising. They might perhaps have reached a peak, but clearly had not passed it. Imports of industrial materials and of most capital goods were still growing, while arrivals of cars and some other consumer goods had begun to fall off, or at least to rise more slowly. Exports fell between the second and third quarters by 2½% (seasonally adjusted). Worst affected were the North American markets. Exports to these in the third quarter were more than one-fifth below the level of a year earlier, with cars down by about two-fifths. Sales to other markets fell marginally. So far as could be estimated in October the deficit on identified current and long-term capital transactions in the third quarter was likely to be substantially larger than that of £100 million recorded in the second.

Parallel with these changes in the external accounts of the United Kingdom, the contrast already noted between economic developments in North America and in continental Western Europe tended to become sharper. By the end of September it had become clear that economic activity in the United States had entered a period of decline, though it did not seem that the fall in output would be large. Industrial production there had by then fallen about 4% below the peak reached in January. In Canada, industrial production in September was about 3% lower than in January. In continental Western Europe, however, despite the absorption of excess capacity and despite growing labour shortages which had already become apparent by June, the growth of output appeared still to be continuing.

This contrast between economic conditions continued to be accompanied by contrasting monetary policies. While in the United States the Federal Reserve Banks reduced their discount rates from 3½% to 3% in August and September, in Western Europe the tighter policies and higher short-term interest rates, which had in most cases been adopted earlier, were maintained and short-term interest rates remained high. In Western Germany liquidity ratios were increased and rediscount quotas reduced. In the Netherlands liquidity ratios were increased and hire purchase controls reimposed. The Belgian bank rate was increased by 1% in August, but this was prompted wholly by external considerations following the Congo crisis.

With economic activity slackening in the United States but remaining high in most other industrial countries, the U.S. balance of visible trade improved sharply: in the first nine months of 1960 imports were about 1% lower than in the same period of 1959 and exports no less than 20% higher. A similar trend was apparent in Canada. Meanwhile in continental Western Europe and Japan the balance of visible trade became less favourable. In most of these countries the continued high level of industrial activity, combined with effects of the earlier trade liberalisation, led to a sharp increase in imports; exports, even when they continued to grow, did so at a reduced rate. Imports into primary producing countries were also rising; on the other hand, with some decline in commodity prices, their export earnings were tending to decrease and the reserves of many of these countries fell.

The improvement in the trade balance of the United States did not, however, lead to a reduction in the overall deficit[a] in the U.S. balance of payments; nor was the less favourable West European trade position reflected in the movements of official reserves. On the contrary, the U.S. overall deficit, already running at an annual rate of nearly \$3 billion in the second quarter, is estimated to have risen further to a rate of over \$4 billion in the third quarter. The outflow of gold, which earlier in the year had been on a small scale, increased sharply. Meanwhile the official reserves of most continental West European countries and of the United Kingdom increased considerably. These contrasting movements were due mainly to substantial transfers of capital, largely but probably not entirely of a short-term nature, and apparently generated in large part by the disparities between interest rates to which reference has already been made.

The exchange markets and international capital movements

In addition to the pull of interest rates, exchange markets became influenced to some extent by concern about the long continuing overall deficit in the U.S. balance of payments and the persistent external strength of Western Germany; the onset of a period of political uncertainty in the United States was a contributory factor. Among the strongest continental currencies were the deutschemark, Dutch guilder, Italian lira and French franc. The rate for all of these against the U.S. dollar persisted throughout the third quarter at or close to the point at which the

[a] Measured by the decrease in U.S. official gold holdings plus the increase in foreign holdings of U.S. dollar balances and U.S. government securities.

authorities undertook, within I.M.F. rules, to buy dollars. The Swiss franc was also strong and the authorities in that country (which is not a member of the I.M.F.) lowered their buying rate for U.S. dollars on several occasions.

In Western Germany and Switzerland special measures were taken to discourage the inflow of funds, mainly because this was causing an increase in bank liquidity which was inconsistent with domestic policies. In Western Germany as early as the beginning of June payment of interest had been prohibited on all non-resident sight deposits, and on non-resident time deposits (other than individuals' savings deposits) after their earliest maturity; the sale of money market paper to non-residents had also been prohibited. At the beginning of July further action was taken through the banking system to discourage borrowing abroad. Towards the end of August, as an inducement to move funds out of Western Germany, the authorities offered forward rates which amounted to a premium equivalent to 1% per annum, subsequently increased to 1½%, to German banks switching deutschemark into U.S. dollars for periods of two weeks up to six months.

In Switzerland, effective from the middle of August, foreign deposits made after the 1st July or exceeding their average level during the first half of 1960 were, with certain exceptions, subject to at least three months' notice of withdrawal, to bear no interest and, if deposited for less than six months, liable to a commission charge of ¼% per three months. Swiss banks also undertook to do their best to prevent foreign funds from being invested in Switzerland in other ways than as bank deposits.

Although these special measures in Western Germany and Switzerland did not entirely stop the flow of money into those countries, their general effect was that even more funds were attracted to London than might otherwise have been the case. For here the authorities did not consider that any similar action was appropriate for a currency so widely used internationally as sterling, in which many countries of the world hold substantial parts of their exchange reserves. Nor was the inflow into London weakening to an appreciable degree the pressure upon the liquidity of the clearing banks—though it may to some extent have reduced the effect of the restriction of bank advances upon the availability of finance generally.

Forward sterling remained strong and on the Treasury Bill comparison there persisted a substantial margin in favour of covered investment in London rather than in New York. There is little doubt, however, that many investors were now prepared to place short-term funds in London uncovered; and on that basis the margin was even larger. This margin proved attractive over a wider range of securities than Treasury Bills and other strictly short-term investments that can be bought and sold by non-residents for external account sterling. In consequence the exchange rate for security sterling against the U.S. dollar strengthened markedly and about the middle of August reached equality with the market selling rate for external sterling. There thus ceased to be any advantage in using security sterling compared with external sterling for portfolio investment in the United Kingdom. Thereafter the weight of funds seeking such investment was felt directly in the market for external sterling. In that market, such fluctuations as there were in the exchange rates for sterling could usually be attributed to changes, actual or expected, in comparative interest rates. For example, a relatively sharp, but short-lived, fall during the latter part of September was associated with continental rumours of a reduction in Bank Rate, which coincided with a renewed movement of funds to Western Germany stimulated by discussion of that country's creditor position at the Annual Meeting of the International Monetary Fund.

The inflow of funds during the third quarter was partly reflected in the statistics of "overseas sterling holdings". The increase in these (excluding the holdings of non-territorial organisations) was £129 million, not much more than in the previous quarter but very different in pattern. The holdings of the Overseas Sterling Area now fell, by £97 million; this was partly due to seasonal factors and partly to a tendency for some countries in this area to run into external deficit. Holdings of countries outside the Sterling Area rose by £226 million, much faster than before, and this rise was by no means confined to private account; indeed, official holdings rose by £80 million in the third quarter following a rise of £52 million in the second. The rise in private holdings was widely spread while that in official holdings was confined to Western Europe and Latin America.

The inflow was also reflected in a receipt of some £80 million under the heading of "Other monetary movements"[a] during the third quarter compared with only £10 million in the second. This receipt included a fall of £19 million in sterling acceptances for account of residents abroad and an increase in the amount of dollar deposits which London banks found it suitable to switch into sterling. Furthermore, it seems likely that there was an unusually large positive "Balancing item" in the third quarter —perhaps about £100 million compared with only £35 million in the preceding quarter—for which the inflow of funds must have been partly responsible. Not all of the unidentified inflow of capital contributing to an enlargement of this item was necessarily short-term in nature. There were reports of overseas buying of equities and long-term gilt-edged stocks.

In the event, and despite the large deficit on identified current and long-term capital transactions, the reserves rose by £77 million during the quarter even though, as has been noted, opportunity was taken to accelerate the repayment of debt to the I.M.F.; £50 million was repaid in this quarter compared with only £15 million in the preceding one.

The gold market The more rapid rise in the reserves of many countries other than the United States brought a rise in their demand for gold. The gold reserves of the United States began to fall more rapidly and the price of gold in the London market to rise. There had been no outstanding features in this market during the second quarter, but during the third quarter, with a more or less continuous demand for gold against dollars, mainly by continental central banks, the price rose from the equivalent of \$35·09 per fine ounce to \$35·26 at the end of September. The fall in U.S. reserves attracted attention and in mid-October concern about the U.S. dollar became more pronounced as the Presidential election in the United States drew nearer. This showed itself partly in a recurrence of interest in the possibility of a rise in the international monetary value of gold; buying orders thought to be on private account then led to a sharp rise in the London price, which at one time on the 20th October touched the equivalent of \$40 per fine ounce. On the following day, after a denial by the U.S. Treasury of any intention to change the gold parity of the dollar, the price fell to the equivalent of \$37. By the end of October it had declined to \$36.

On the 27th October, 1960, the following statement was made by the U.S. Treasury:

> "We have been asked concerning reports on the United States position with respect to the London gold market. Any buying and selling by the Bank of England in the London market is of course the responsibility of the British authorities. It is well known that over the years since the market was opened in 1954, the British authorities have entered that market as buyer and seller in accordance with their best judgment. The United States Treasury has no criticism of such policy.
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> "In accordance with the Treasury statement issued on Thursday, October 20th, reaffirming long standing practice, the United States buys gold from the Bank of England and sells gold to the Bank of England at the official price.
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> "As is known the Secretary of the Treasury and Mr. M. H. Parsons, a Director of the Bank of England, conferred in Washington early this week, as in this meeting and by other means it is the continuing intention of financial officials of the United Kingdom and the United States to keep each other informed on matters of mutual interest."

Reductions in European interest rates The movements of short-term capital across the exchanges not only constituted in some of the receiving countries a source of unwanted liquidity, or of unwanted exchange reserves; they were now also becoming, through their effect upon exchange markets and reserves, a threat to confidence in the U.S. dollar and hence to confidence in exchange stability generally. In these circumstances some reductions in European short-term interest rates became appropriate on international grounds. The French bank rate was the first to be reduced, from 4% to 3½% on the

[a] Consisting mainly of the item "Miscellaneous capital", for a full definition of which see "United Kingdom Balance of Payments 1957 to 1960" (Cmnd. 1188), page 26.

6th October. Interest rates in Western Germany were of more consequence internationally in view of the very strong underlying external payments position of that country and the West German discount rate was widely expected to fall before long. This did not in fact occur until the 11th November (when the rate was reduced from 5% to 4%). Before then Bank Rate had been lowered in the United Kingdom, from 6% to $5\frac{1}{2}$% on the 27th October. The Bank had been mindful of the scale on which short-term capital was flowing into the United Kingdom; and, as the Governor remarked in his speech at the Mansion House on the 20th October:[a]

> "... we cannot be wholly confident that these movements of funds between markets can always be kept within reasonable bounds. Any major and persistent movement which went unchecked might threaten stability."

Unless, therefore, domestic considerations pointed decisively towards the retention of a 6% Bank Rate, some reduction was now desirable.

The domestic situation in the autumn

During the third quarter of 1960 there was no further growth, and perhaps some slackening, in the pressure of domestic demand. Consumer expenditure continued to be affected by the restraining measures that had been taken. The demand for cars fell; this was reflected mainly in a further fall in the price of used cars, but towards the end of the quarter new registrations began to fall as waiting lists were worked off. Purchases of household durable goods continued well below the volume prevailing early in the year and, while purchases of other goods continued to rise, the volume of retail sales as a whole appeared to be remaining level. The amount of new credit extended for hire purchase fell to the level of repayments and the long continued rise in hire purchase debt outstanding came to a halt in the third quarter. The rate of increase in bank advances was slowing down. For the first time for several quarters there was a net decrease in the total of advances to the categories of borrowers most closely concerned with consumer credit; and there was also a markedly smaller increase in advances to personal and professional borrowers. It remained probable, however, that within a few months further negotiated increases in wages would lead to a renewal of the upward trend of personal expenditure.

The expansion of fixed investment in the private sector continued. Order books for engineering and electrical goods grew longer. In September, the results of a Board of Trade survey undertaken at mid-year indicated that the steep upward trend of investment in manufacturing industry was likely to continue into 1961. The survey also indicated, however, that the long rise in investment by the distributive and service trades might come to an end during that year. In the public sector, only a small further rise in capital expenditure was in prospect. Private house building, judging from the figures of 'starts', seemed to be slowing down; and with the shortage of building society funds and the rising cost of land, it seemed that here there could be some easing of the pressure on the building industry in 1961.

There was still no evidence that total expenditure on stocks was beginning to fall; the high level of imports of industrial materials in the third quarter seemed rather to imply that stockbuilding of these materials was continuing much as before. The fall in exports was confirmed during the third quarter and as before appeared to be due partly to a fall in overseas demand for some classes of goods and partly to a difficulty of increasing the supply of other classes for which demand was still growing.

By the third quarter production as a whole had probably stopped rising; but outside the motor car industry and other producers of consumer durable goods, the trend, supported by the strong home demand for capital goods and for building work, was still upwards. Output in some sectors of industry was being restricted by shortages of capacity and more particularly of skilled labour, which persisted in spite of a rise in the total numbers in employment.

The strength of the unsatisfied demand for labour, together with the growing pressure for

(a) Printed in full on page 19.

an early and substantial rise in wages, constituted a serious risk that wage costs would soon go up by an amount in excess of any probable gain in productivity. The price of coal was raised in September. On the other hand, raw material costs were tending to fall and manufacturers were now beginning to encounter more competitive conditions both at home and overseas. The outlook for prices was therefore uncertain; but it seemed on balance that the risk of a general increase remained serious. Any such increase would be particularly dangerous at a time of less buoyant overseas markets and growing competition at home from imported manufactures.

The unsatisfactory state of the balance of payments on current account, and the outlook for costs and prices in the months immediately ahead, were grounds for approaching any relaxation of credit restriction with great caution. On the other hand the pressure on resources had not become heavier and, so far as could be seen, the prospective rise in domestic demand now seemed rather less dangerous than it had in June. Longer-term problems remained serious but the short-term situation was changing.

In these circumstances it was decided that a reduction of ½% in Bank Rate, desirable on international grounds, would not be inconsistent with the maintenance of adequate restraint at home. This move, which was made on the 27th October, was not intended to signal any change in the general policy of credit restraint. In the gilt-edged market the government broker continued as a seller of certain medium and long-term stocks at unchanged prices, indicating that a further fall in medium and long-term interest rates was not being encouraged. The other restrictive measures in force were maintained intact: no release was made from Special Deposits, and the hire purchase controls were continued unchanged.

Official action since the close of 1959 was largely confined to the monetary field, with an eye on a short-term movement towards excessive home demand. There remain, however, notable longer-term problems in the field of the balance of payments; in seeking solutions to which a greater concentration upon action outside the monetary field may be needed.

QUARTERLY ANALYSIS OF BANKING AND EXCHEQUER STATISTICS

17th March—15th June, 1960[(a)]

Banking In the six months to March, 1960, a diminishing growth in deposits with the clearing and Scottish banks had been accompanied by a continuing rise in advances, and the need to preserve their liquidity had led these banks to reduce their holdings of gilt-edged stocks. In the second quarter of 1960, against the background of credit restriction already described, net deposits with the clearing banks rose by £103 million. This was little more than could be attributed to seasonal factors and the underlying growth of deposits virtually ceased. Bank advances continued to grow. Those of the clearing banks rose by £128 million in this quarter as a whole; but the underlying growth, rapid at the beginning, slackened towards the end. The quarterly classification of bank advances by all members of the British Bankers' Association[(b)] shows that in the three months mid-February to mid-May advances rose by £213 million. Excluding an increase of £11 million to nationalised industries, the three groups of customers most closely concerned with consumer credit took 47% of the increase, a proportion somewhat less than that for the year to mid-May.

With deposits of the clearing banks tending to rise seasonally, broadly in line with the rise in their advances, and with their liquidity ratio 31·5% at the outset, the immediate need for them to sell gilt-edged stocks would have been small (compared with the preceding quarter) had not the call for Special Deposits intervened. This call, together with previous indications of official views, contributed to the slackening of the rise in advances; but it also obliged the

(a) Figures for the Scottish banks used in this and the following section relate to slightly different dates.

(b) Advances by the London Clearing Banks currently account for some 88% of advances by all members of the British Bankers' Association.

banks to sell gilt-edged stocks on a larger scale than would otherwise have been necessary. The clearing banks' holdings of government debt, direct and indirect,[a] fell by £75 million during the quarter while their Special Deposits amounted to £70 million. The former comprised a fall of £123 million in holdings of gilt-edged stocks and a net rise of £48 million in holdings of other government debt, chiefly Treasury Bills, and of Bank of England notes. The combined liquidity ratio of the clearing banks on the 15th June, at 31·4%, was virtually the same as it had been on the 16th March. The Scottish banks also sold gilt-edged stocks, to the extent of £21 million; but this fall was fully offset by a rise in their lending at call. Their total holdings of government debt, direct and indirect, rose by £3 million.

Exchequer financing

The overall budget deficit during the quarter was £228 million, much the same as in the corresponding period of 1959 and broadly in line with budget expectations. External items cost £63 million, partly because of the rise in the external reserves, while extra-budgetary funds, etc. provided £15 million. The Government's total cash requirement thus came to £276 million.

The Government's net indebtedness to the Bank of England, Banking Department, rose by £69 million, an unusually large rise that reflected the call for Special Deposits. The Banking Department's advances to the discount market rose by £8 million. With the clearing banks' and Scottish banks' direct and indirect holdings of government debt falling by £72 million, total borrowing by the Government from the banking system[b] was only £5 million during the quarter, leaving £271 million of government debt absorbed by other holders, as follows:

ESTIMATED ACQUISITION OF GOVERNMENT DEBT BY HOLDERS OTHER THAN THE EXCHEQUER GROUP[c] AND THE BANKING SYSTEM: 17th MARCH-15th JUNE, 1960

		£ millions
Bank of England Notes		+ 48
National Savings ...	+ 75	
Tax Reserve Certificates	+ 45	
Treasury Bills	− 66	
Gilt-edged Stocks ...	+163	+217
		+265
Indirect holdings		
Total holdings of discount market ...	+ 33	
Less indirect holdings of banking system ...	− 27	+ 6
Total		+271

The amount of government debt acquired by those outside the banking system was somewhat larger than in the corresponding period of 1959 but did not differ very markedly in composition. The rise in holdings of Bank of England notes and Tax Reserve Certificates was much the same. Net receipts from National Savings were slightly lower and were tending to fall during the quarter. This development was not unexpected, even though the maximum permitted holdings of National Savings Certificates and of deposits with the Savings Banks were raised during the quarter. The supply of funds becoming available both for lending to the Government through National Savings and for lending to other borrowers competing for funds of that type was likely to be somewhat reduced as pressure was placed upon personal finances by restriction of bank credit, by regulation of hire purchase credit, and through a growing burden of debt repayment. Also, and in response to an actual or expected shortage of funds, the yields offered by borrowers competing with National Savings, notably building societies and finance houses, were rising and becoming more attractive than before.

(a) Changes in the discount market's holdings of government debt are treated as changes in the "indirect holdings" of those from whom the market has borrowed. Thus, "indirect holdings" of government debt means, for the clearing banks, their call money with the discount market; for the Scottish banks, their total call money; for the Bank of England, Banking Department, advances to the discount market; for other holders their *net* lending to the discount market. Notes and coin (including some Scottish bank notes not separately identifiable) are treated as direct holdings of government debt.

(b) "Banking system" means only the London Clearing Banks, the Scottish banks and the Banking Department of the Bank of England, the appropriate figures being not yet available for other banks.

(c) The Exchequer, the Paymaster General, the National Debt Commissioners, the Exchange Equalisation Account and the Issue Department of the Bank of England.

An analysis of changes in holdings of Treasury Bills and gilt-edged stocks is given in the following table:

CHANGES IN HOLDINGS OF TREASURY BILLS AND GILT-EDGED STOCKS: 17th MARCH-15th JUNE, 1960

£ millions

	Treasury Bills	Gilt-edged Stocks	Total
Clearing banks ...	+17	−123	−106
Scottish banks ...	− 6	− 21	− 27
Discount market ...	+21	+ 12	+ 33
Overseas official ...	− 4	+ 59	+ 55
Other home and overseas non-official ...	−62	+104	+ 42
	−34	+ 31	− 3

With additional funds obtained mainly from the banking system, the discount market increased its holdings of Treasury Bills and short bonds. The rise of £55 million in overseas official holdings of marketable government debt was in line with the substantial rise, over the calendar quarter, in overseas official holdings of sterling.[a] There was little change, compared with the previous quarter, in the total purchases of the residual category "Other home and overseas non-official". The overseas element in this category can be only roughly assessed. Reported non-official overseas sterling holdings rose by £72 million in the second calendar quarter, after falling by £16 million in the first. Some part of this inflow may well have found its way indirectly to local authorities or to private borrowers such as finance houses. Nevertheless it is probable that there was a marked increase, compared with the first quarter, in the amount of non-official overseas money seeking investment in government marketable debt. Since total purchases by the category "Other home and overseas non-official" did not increase, and were, indeed, slightly less than in the first quarter, there was an apparent fall in purchases of government marketable debt by "other home" holders.

Changes of this kind, occurring over as short a period as a quarter, cannot be explained with confidence, but some possible reasons can be advanced. As suggested above, the restriction of bank credit was beginning to put pressure on personal finances, and this may have somewhat reduced the demand for marketable government debt. At the same time the flow of money into new capital issues was rising[b] and probably absorbed a greater share of the available funds of persons and 'non-bank' financial institutions, and particularly of accruals to insurance and pension funds. Industrial and commercial companies, on the other hand, were receiving more from capital issues and (for seasonal reasons) paying less in tax; nevertheless, they may not have been in a position to add much to their liquid financial assets, because of the rise in expenditure on fixed capital and the continuing increase in stocks, and perhaps also because rising wage costs were checking the growth of profits. In these circumstances some fall in the "other home" demand for marketable government debt would not be surprising.

Although there was little change between the first and second quarters of 1960 in the demand for marketable government debt as a whole by "Overseas official" and "Other home and overseas non-official" holders, there was a complete reversal in the distribution of this demand between Treasury Bills and gilt-edged stocks. In the first quarter there had been substantial purchases of Treasury Bills by holders in these two categories accompanied by heavy sales and redemptions of gilt-edged stocks. In the second quarter by contrast they increased their holdings of gilt-edged stocks and reduced their holdings of Treasury Bills. The reasons for this sharp change are probably to be found in special factors which affected the results for the first quarter of 1960. Then, it will be recalled, two gilt-edged stocks matured and the change in monetary policy led to uncertainty in the market. But during April and the first part of May, with gilt-edged prices relatively steady, conditions favoured some reversal of the temporary switch out of gilt-edged stocks into Treasury Bills. Towards the end of the quarter, when there was again some uncertainty caused by fears of a further rise in Bank Rate, purchases of stock tended to fall away.

(a) Excluding non-interest bearing notes held by the I.M.F. and I.B.R.D.

(b) This is not apparent from the statistics of capital issues in Table 14 of the Statistical Annex because as at present compiled these record new issues in full at the time when subscriptions are invited and not at the times when the actual payments are made.

16th June—21st September, 1960[a]

Banking At the beginning of this quarter there occurred the further rise in interest rates associated with the raising of Bank Rate to 6% on the 23rd June; while the restriction of credit was reinforced by the second call for Special Deposits. At the same time the rise in national income was moderating. In these circumstances the diminishing growth in deposits at the clearing banks gave way to a very slight downward trend. Net deposits with these banks rose by £101 million during the quarter, rather less than the estimated seasonal movement. Making some allowance, as is necessary in this period, for a rise in deposits held by overseas residents, the downward trend in domestically held deposits was rather greater than that in the total.

Advances by the clearing banks rose £69 million, including an increase of £5 million to the nationalised industries. The seasonal element cannot be isolated with any great degree of confidence, but it seems that in this period the underlying rate of increase had slowed down to not much more than half that prevailing in 1959 (£60 million per month). This was accompanied by a change in the pattern of lending closely associated with the concurrent change in the pattern of expenditure. The analysis of advances by all members of the British Bankers' Association, for the quarter to mid-August, 1960, shows that lending to the retail trade and to hire purchase finance companies fell, by £11 million (3%) and £5 million (3%), respectively. From August, 1958, to May, 1960, advances to these two groups had increased in every quarter, the average quarterly increases being 11% and 28%, respectively. Advances to personal and professional borrowers rose by only £11 million (2%), far below the recent quarterly average. By contrast, advances to the engineering industry rose by £47 million (14%).

Net deposits were now rising appreciably faster than advances. The pressure upon the liquidity ratios of the clearing banks might therefore have ceased for the time being had not Special Deposits again intervened. The second call amounted to £72 million, and these banks continued to sell gilt-edged stocks although at a considerably slower pace. Their direct and indirect holdings of government debt fell by £33 million, holdings of gilt-edged stocks falling by £62 million. The combined liquidity ratio rose slightly, from 31·4% on the 15th June to 31·6% on the 21st September. Even in June this ratio had been unusually low for the time of year; and the slight rise over the following quarter, when seasonal influences favourable to a rising liquidity ratio became stronger, was much less than normal. Indeed the ratio at mid-September was 1½ points below the lowest figure for any other September since 1951, with the unfavourable seasonal influences of the last quarter of the financial year still ahead.

Although their advances and their deposits fell slightly, the Scottish banks also continued to sell gilt-edged stocks during this quarter. The pace of these sales did not slacken and despite the call for Special Deposits the Scottish banks were able to increase their liquid assets by an amount that was more nearly normal for the time of year.

Exchequer financing The overall budget deficit came to £388 million for the quarter, compared with £228 million in the previous quarter. This was now appreciably larger than in the corresponding quarter of 1959, though part of the change was probably due to differences in the timing of government transactions. Extra-budgetary funds, etc., on the other hand, provided the large sum of £75 million. The cost of external items rose steeply, to £188 million compared with only £63 million in the preceding quarter, mainly reflecting the faster rise in the reserves (from which a larger repayment to the I.M.F. was made). The Government's total cash requirement rose sharply to £501 million.

The Government's net indebtedness to the Bank of England, Banking Department, continued to be influenced by the increase in Special Deposits and rose by £64 million. The Bank's advances to the discount market were virtually unchanged over the quarter. The clearing banks' and Scottish banks' direct and indirect holdings of government debt together fell by £42 million. Total borrowing by the

[a] A period containing fourteen weeks compared with thirteen in the preceding quarter and thirteen in the corresponding quarter of 1959.

Government from the banking system[a] was therefore small—only £21 million—and no less than £480 million of government debt was acquired by other holders as follows:

ESTIMATED ACQUISITION OF GOVERNMENT DEBT BY HOLDERS OTHER THAN THE EXCHEQUER GROUP[b] AND THE BANKING SYSTEM: 16th JUNE-21st SEPTEMBER, 1960

		£ *millions*
Bank of England Notes		+ 5
National Savings ...	+ 52	
Tax Reserve Certificates	+ 79	
Treasury Bills	+137	
Gilt-edged Stocks ...	+241	+509
		+514
Indirect holdings		
Total holdings of discount market ...	− 33	
Less indirect holdings of banking system ...	− 1	− 34
Total		+480

The upward trend in holdings of Bank of England notes outside the banking system continued, though for seasonal reasons the net rise during this quarter was small. Net receipts from National Savings were rather lower than in the preceding quarter; but seasonal factors were unfavourable and after allowing for these there seems to have been no further slackening, at this time, in receipts from this source. Net receipts from Tax Reserve Certificates were considerably larger than in the corresponding quarter of 1959; this may be attributed partly to the accumulation of a higher level of tax reserves, following the steep rise in profits during 1959/60, and partly to the attractive yield now obtainable on these Certificates.[c] The above changes were small compared with the rise in the total acquisition of government debt outside the banking system; the big change occurred in direct acquisition of marketable debt—£378 million in this quarter compared with only £97 million in the previous one. Indirect holdings through the discount market fell by £34 million, the market experiencing a withdrawal of funds by overseas and by domestic 'non-bank' lenders. The yield on short bonds proved particularly attractive to discount houses at the same time as they were experiencing strong competition for Treasury Bills at the weekly tender. Accordingly their holdings of short bonds rose sharply while their holdings of Treasury Bills fell.

An analysis of changes in holdings of Treasury Bills and gilt-edged stocks is given in the following table:

CHANGES IN HOLDINGS OF TREASURY BILLS AND GILT-EDGED STOCKS:
16th JUNE-21st SEPTEMBER, 1960

£ *millions*

	Treasury Bills	**Gilt-edged Stocks**	**Total**
Clearing banks ...	+ 24	− 62	− 38
Scottish banks ...	+ 22	− 21	+ 1
Discount market	− 77	+ 44	− 33
Overseas official ...	− 40	+ 53	+ 13
Other home and overseas non-official ...	+177	+188	+365
	+106	+202	+308

Only £13 million was acquired by "Overseas official" holders who nevertheless continued as a group their practice of the preceding quarter and acquired gilt-edged stocks while disposing of Treasury Bills. The low total was in line with the smaller rise, over this calendar quarter, in total overseas official holdings of sterling.[d] The remaining amount of marketable debt, no less than £365 million (£188 million gilt-edged stocks), was acquired by the category "Other home and overseas non-official", compared with £42 million in the preceding quarter.

In discussion of the previous quarter it was said that there were grounds for expecting the "other home" demand for marketable government debt to fall during 1960. In the second quarter of the year a fall seemed to have occurred. To what extent, then, can the very large increase in purchases of marketable debt by "Other home and overseas non-official", in the third quarter, be attributed to the greater inflow of funds from overseas and to what

[a] See footnote [b] on page 13.
[b] See footnote [c] on page 13.
[c] This had been raised from $2\frac{1}{2}\%$ to $3\frac{1}{4}\%$ in two stages in May and June. Tax Reserve Certificates bear interest, tax free, for a maximum period of two years.
[d] Excluding non-interest bearing notes held by the I.M.F. and I.B.R.D.

extent can it be attributed to a hitherto unexpected rise in home demand?

Non-official overseas sterling holdings rose by £118 million in the September quarter; but, as has been explained earlier, the inflow of private money from abroad was not reflected solely in this statistical series. The inflow under "Other monetary movements" increased sharply: also, probably a very large positive "Balancing item" emerged in the balance of payments accounts. Taking all these together, it seems that the total net inflow of private overseas money (including, in this term, any reduction in U.K. short-term lending abroad) might well have been of the order of £250 million. It is unlikely that more than a small proportion of such a total was placed on deposit with, or used to reduce liabilities to, the banking system (as defined).[a] It is not possible to estimate the extent to which the remainder was invested in marketable government debt; but it is likely to have been substantial at a time when acquisition of marketable government debt by "Other home and overseas non-official" became exceptionally large. Moreover, to the extent that the remainder was not so invested, it was used to acquire a wide range of other securities, or found its way to those banks and other financial institutions outside the banking system (as defined); and this is likely to have facilitated a larger acquisition of government debt by "other home" investors. Two other factors affecting this acquisition should now be mentioned.

First, lenders outside the banking system reduced their net lending to the discount market by £34 million during the quarter. It is probable, given the relatively attractive yields, that a large part of the funds so withdrawn was used to acquire marketable government debt. Secondly, the abrupt rise in interest rates at the beginning of the quarter (and in particular the rise in yields on short-dated stocks), together with, and especially with, some expectation that rates would now tend to fall rather than rise, may well have constituted a special inducement to home investors to prefer marketable government debt to deposits. The behaviour of deposits with the banking system, allowing for some rise in those held by overseas residents, is not inconsistent with this possibility.

All in all, it may be inferred that a considerable part of the investment of £365 million, by the category "Other home and overseas non-official", in marketable government debt was due to a combination of the inflow of overseas funds and of special incentives affecting the home investor. Both of these were associated with the particular attractiveness of the yields obtainable, although the inflow of overseas funds cannot be attributed entirely to this influence.

[a] For definition see footnote [b] on page 13.