COMMENTARY

JANUARY—MARCH 1961

Domestic situation Looking ahead in the autumn of 1960 it had seemed that there would be a further rise in home demand in 1961, perhaps interrupted in the earlier months by a fall in stockbuilding. In January the change in hire purchase regulations and the Board of Trade survey of investment intentions together suggested that the extent of the rise would be greater than had previously seemed likely.

The sale of cars quickly responded to the relaxation in hire purchase terms. In March new registrations were the highest ever recorded, but this was partly due to Easter falling immediately after the end of the month and indeed in April sales of cars on hire purchase were not fully maintained. Sales of other consumer durables did not respond in a similar manner, though by the end of the quarter there were some reports of recovery. In January and February the value of retail sales as a whole, after seasonal adjustment, remained at approximately the same level as in the last quarter of 1960. As prices were rising throughout this period, the volume of sales was probably slightly reduced. In March and April, however, there was a much more than seasonal rise in the value of sales, most of which can be attributed to an increase in volume. By the end of the quarter it was clear that consumers' expenditure was rising again.

The high level of new home orders for plant and machinery confirmed previous indications that industrial investment would continue to rise this year; but there were some signs that the rise in factory building might not continue during 1962. Over the quarter delivery dates for many capital goods continued to lengthen and it seemed that capacity to produce such goods would be insufficient to satisfy both home and export demand.

Notwithstanding the higher home demand for capital goods and cars and some increase in exports, industrial production (seasonally adjusted) was little changed during the quarter, largely because of changes in the rate of stock accumulation. In the last quarter of 1960 stocks of finished goods and work in progress had risen sharply. By March reports suggested that production in some industries, particularly steel, textiles and paper, was being reduced owing to a lower rate of stockbuilding. Furthermore the renewed rise in home demand for cars (which had not been accompanied by a revival in exports) had at first been met partly by the running down of stocks.

Agreements for higher wage rates reached early in 1961, together with the effects of some earlier settlements and a rise in some commodity prices, resulted in a further upward pressure on costs in circumstances in which there was unlikely to be an off-setting rise in productivity. If these trends continue, further increases in prices must be expected. During the quarter prices of some manufactured goods were increased and the index of retail prices rose slightly.

The economy was thus moving in a way that had been broadly foreseen; and in a direction which did not justify any further easing of credit restraint.

Capital and money markets The capital and money markets were, as is usual in the main tax-gathering quarter, strongly influenced by the surplus of the Exchequer. The manner in which this surplus reacted on the banking system and affected the financing of the rest of the private sector is described more fully on page 9.

Total hire purchase debt outstanding fell in January and February but began to rise in March and was virtually unchanged over the quarter; seasonal factors apart, the total of bank lending to individuals appears to have been little changed. On the other hand, National Savings rose sharply and for the first time in the financial year 1960/61 approached the level of the corresponding quarter of the previous financial year. If some allowance is made for Easter falling early this year receipts from National Savings were running at a high level. At the end of the quarter it seemed that persons were both borrowing and lending more.

'Non-financial' companies probably sold more government debt than is usual in the first quarter of the calendar year. Reduced profit margins meant that less self-finance was available to meet the substantial amount of fixed investment being undertaken. Large sums continued to be raised through new issues and further amounts were borrowed from the banks. Nevertheless, prices of industrial shares rose strongly, for investors were again showing a marked preference for equities as opposed to fixed interest stocks. Optimistic views on the growth of the economy and the belief that pressure on industrial costs would raise prices rather than bring further reductions in company profits seem to have been prevalent. The publicity that continued to be given to the Trustee Investments Bill, the distribution of cash to former shareholders of Fords and a rise in stock market prices in New York also played a part.

In mid-December the combined liquidity ratio of the clearing banks was 31·9% and they were therefore less well placed than usual to meet the seasonal pressures of the first quarter of the year. In spite of the disbursement of the Ford money and the inclusion of refinanceable export credits due for repayment within eighteen months among their liquid assets, the clearing banks sold government stocks. Indirectly some of the counterpart of these sales was represented by purchases by the Issue Department of $2\frac{1}{2}$% Funding Loan 1956/61 which had to be redeemed in April. The large-scale switching between stocks of different maturities and coupons that takes place within the gilt-edged market can result in gradual purchases by the authorities of the next maturity having as their counterpart sales of short and medium-dated stocks by the banks.

During the second half of 1960 there had been an underlying growth in clearing bank advances of some £35 million per month. This rate of increase seemed to be falling during February and March, but was resumed in April and May. The analysis of advances by the members of the British Bankers' Association for the quarter ended mid-February showed that advances by the clearing banks rose by 3·1% whereas those of all other banks combined rose by 11·1%. The pressures on the clearing banks may also have accounted for part of the increase in the amount of commercial bills held by them; for some of this seems to have been associated with business which in other circumstances might have been provided for through advances.

On the 31st January the Iron and Steel Holding and Realisation Agency announced that twelve fixed interest stocks of seven steel companies would be offered for sale at the beginning of March.[a] These involved cash subscriptions totalling £85 million spread over eight months. During the quarter the authorities announced that a further tranche of $5\frac{1}{2}$% Exchequer Stock 1966 would be offered to holders of $2\frac{1}{2}$% Funding Loan 1956/61, which matured on the 15th April, and that a further £300 million $4\frac{3}{4}$% Conversion Stock 1963 would be issued for cash. The terms on which both these stocks were issued were in line with the market prices prevailing at the time. A large part of each issue was initially taken up by the Issue Department for later re-sale; these issues therefore made it easier for the authorities to restrict a fall in short-term rates. By early January the Issue Department's holding of 5% Conversion Stock 1971 had largely been exhausted and the market had expected that it would be replaced by an issue of another medium-dated stock. When this did not occur medium-dated stocks became stronger. During March, sales by the banks and the absence of overseas buying tended to depress both short and medium-dated stocks; the market in these stocks was steadied by official purchases. Over the quarter as a whole yields on short-dated stocks fell by about $\frac{3}{16}$% and on medium-dated stocks by $\frac{3}{32}$%. There was a slight rise, not resisted by the authorities, in yields on long-term stocks.

The Treasury Bill rate continued to fall in the first few weeks of the quarter and reached a low point of just under $4\frac{3}{16}$% at the tender on the 27th January. About this time the market expected that Bank Rate might again

[a] Some aspects of this Offer for Sale are described more fully on page 17.

be reduced, but the domestic outlook made the authorities unwilling to encourage any further fall in short-term rates and the market borrowed from the Bank on five occasions during the next fortnight. The rate then gradually rose to $4\frac{1}{2}$%, and during March the outlook for short-term rates consequent upon the withdrawal of foreign money from London led the market to hold the rate at around this level. After the end of the quarter the rate began to fall again, largely because the market considered that the Chancellor of the Exchequer's proposal to take powers to adopt a more flexible fiscal policy could lead to lower short-term rates.

The Budget The Chancellor stated that he intended to take powers to vary most of the Customs and Excise duties and purchase tax by 10% either way between Budgets by statutory order, and also to impose (again by statutory order) a surcharge, analogous to a payroll tax, at a rate not exceeding 4*s*. a week on employers' National Insurance contributions. The Chancellor said that experience had shown that, while the annual Budget should remain the chief instrument of economic policy, measures often had to be taken at shorter intervals than twelve months, and that it was not always satisfactory to rely on monetary measures alone to secure immediate effect on the economy during the period between Budgets. Variations in hire purchase controls had proved to be an effective instrument, though with discriminatory consequences that were not always welcome.

The overall budget deficit in 1961/62 was estimated at £69 million after allowing for the net effect of the various changes in taxation proposed by the Chancellor of the Exchequer. When account is taken of receipts which can be expected from extra-budgetary funds, from some net increase in the note issue and from sales of National Savings and Tax Reserve Certificates, the Exchequer should, during the financial year 1961/62, be able to redeem or absorb a substantial amount of marketable government debt now held by home holders.

The amount of debt redeemed will also be directly affected by the state of the United Kingdom's balance of payments. If, as seems likely, there is a deficit on current and long-term capital account during the financial year 1961/62, funds will be transferred from the private sector to the Exchequer either directly through purchases of foreign exchange from the Exchange Equalisation Account or indirectly through a rise in overseas sterling holdings, a substantial proportion of which is normally lent to the Exchequer.

There may also be inflows or outflows of foreign-owned short-term capital over and above any movements which represent the counterpart of a U.K. 'overall' external deficit. So long as the resulting sterling payments or receipts are matched by rises or falls in overseas holdings of marketable government debt, flows of this nature do not affect the level of marketable government debt held by home holders.

The economic outlook in April strongly suggested that it would be wise if the overall budget deficit were kept at a low level; any consequential large-scale redemption of government debt does not, however, necessarily imply a downward trend in short, medium or long-term interest rates, for the circumstances which enable the Government to repay debt to home holders equally require home holders to realise government debt. The gilt-edged market will therefore be subject to all the customary factors that influence interest rates, though it will be aware that as a result of the budget proposals the Exchequer may not need to be a net borrower in the market during the current financial year.

International capital movements In January and February 1961 the large-scale international movement of funds which had occurred during the second half of 1960 was much reduced. The net inflow to the United Kingdom was probably slight in January and may indeed have been reversed by the end of February, but the inflow to Western Germany continued.

The movement of money to London ceased, even though the interest rate margin in favour of London, judging by the Treasury Bill comparison and the cost of covering such an investment in the forward exchange market, remained around 1% throughout most of January and February. The feeling that earlier fears of a fall in the value of the U.S. dollar in terms of gold and possibly other currencies were no longer relevant meant that one important reason for moving funds out of U.S. dollars had been removed. At the same time hopes that economic activity in the United States might shortly start to rise, and the feeling that steps to strengthen the position of the U.S. dollar might react unfavourably on sterling, together provided renewed inducements to hold U.S. dollars. As a result, by the end of February the U.K. reserves were no longer being shielded, by an inflow of overseas funds, from the impact of the deficit arising from current and long-term capital transactions.

Many factors affect the demand in the market for foreign currencies and the early beginnings of a marked outflow of foreign funds from the United Kingdom can be lost amongst them. Statistical information may later throw light on events, but in the first instance the authorities need to interpret general market information.

At the end of February, it was suspected that some net withdrawal might be taking place; by mid-March it was evident that substantial amounts were being withdrawn and movements in the foreign exchange markets were being confirmed by various other indicators: by reports from and movements in the gilt-edged market; by some tightness in the local authority mortgage market, first noticed in February and followed in early March by increases in rates offered for short-term money; by sales of bills by the overseas banks and the accepting houses and by some withdrawal of overseas banks' money with the discount market.[a] Information about non-official overseas sterling holdings which became available later suggested that these may have risen during February as a whole though they fell sharply in March. Altogether, the evidence pointed to a net outflow of foreign funds having begun on a small scale a few days before the substantial withdrawals which followed the revaluation of the deutschemark and the guilder in early March. It is possible that some part of the outflow may have taken the form of payments, which had been delayed, for goods imported by the United Kingdom during 1960. Delayed payments are akin to an inflow of short-term funds and it could be expected that the position would be reversed when confidence in sterling became less strong.

In Western Germany, on the other hand, the inflow of funds continued. It remained an important cause of the lack of balance in international payments and at the same time within Western Germany its effects hindered significantly the authorities' attempts to restrain a rise in domestic economic activity by monetary means. The West German authorities therefore took further steps to curtail the inflow; bank rate was reduced from 4% to 3½% on the 20th January, the minimum reserves which commercial banks were required to hold were reduced by 5% on each of three occasions over the quarter and the Deutsche Bundesbank progressively lowered its selling rate for money market paper. Nevertheless, the inflow continued. The large surpluses which had been continuously earned on current account over a long period caused hopes of an appreciation of the external value of the deutschemark to persist. At the same time the inflationary tendencies in the West German economy restricted the scope for relaxations in monetary policy unless the latter could be reinforced by other methods of restraint. In these circumstances the West German authorities announced on the 4th March that the value of the deutschemark in terms of the U.S. dollar was to be raised by 5%. A similar revaluation of the guilder was announced on the 6th March. On that day and during the remainder of that week there were very large movements of funds between financial centres as rumours of the imminent revaluation of other currencies gained or lost ground.

Foreign exchange markets

The disturbances in the exchange markets following the revaluation of the deutschemark and the guilder came at a time when, as has been stated earlier, sterling was already showing some signs of weakness in these markets. In spite of occasional intervention by the Bank of England, through the Exchange Equalisation Account, steady net selling of sterling had caused the rate for the U.S. dollar to fall to U.S.$2·79½ by the end of February.

After the 6th March pressure fell mainly on sterling and the U.S. dollar. Funds flowed

[a] See Table 5 of the Statistical Annex.

into Western Germany in the hope of a further revaluation and into France, Italy and Switzerland in the hope that these countries might follow the example of Western Germany and the Netherlands. Much of this movement of money took the form of purchases of U.S. dollars against sterling in London and the sale of these and other dollars in the main West European financial centres. Although there had been signs during February that confidence in the U.S. dollar was being restored, the dollar was still at or near support point in many West European centres at the end of May.

An indication of the size of the movements can be obtained from an announcement by the Swiss authorities that over \$300 million had entered Switzerland between the 6th and the 11th March, of which no less than \$180 million was received on the 6th March alone. The Bank of England were strong buyers of sterling and on occasion forced up the rate by determined selling of foreign exchange. As a result, the U.S. dollar rate in London actually rose slightly over the week ended the 11th March. By acting in this way the Bank aimed to restore confidence in exchange stability more quickly than would otherwise have been the case. The Swiss National Bank with a similar objective made it known that it was a ready buyer of U.S. dollars at a point above the level at which it normally purchased dollars.

By the middle of March there were signs that exchange markets were becoming calmer and speculative pressures less. The announcement of the withdrawal of South Africa's application for continued membership of the Commonwealth came at this time. In spite of a statement that South Africa would remain in the sterling area there was renewed heavy selling of sterling and, partly on this account, sterling remained weak during the remainder of the month. Subsequently, although selling grew less, sterling remained under pressure throughout April and May.

In the forward markets the discount on three-month forward sterling rose steadily from the 10th March, with the result that during the second half of March the Treasury Bill comparison on some days showed a small margin in favour of New York. Heavy sales of forward sterling may well have reflected covering of holdings by foreigners who had previously been content to leave their short-term investments uncovered. The events in the exchange market were accompanied by weakness in security sterling which fell from U.S.\$2·78¼ on the 6th March to U.S.\$2·75⅜ at the end of that month.

International monetary co-operation

The appreciation of the deutschemark and the guilder had thus provoked further movements of short-term capital. In particular, expectations that the flow to Western Germany would be curtailed were proved wrong and Western Germany's reserves increased by no less than \$526 million in the six weeks ended the 15th April notwithstanding some special factors which in themselves would have caused a fall. The greater part of this increase in reserves represented a further inflow of capital including purchases of bonds and a continued acceleration in the timing of receipts from exports.

The disorder in the foreign exchange markets which followed the revaluations made forward dealings in some currencies, especially the deutschemark, both difficult and expensive. In consequence, West German firms exporting goods normally paid for over medium or long term found it difficult to obtain orders if the goods were to be invoiced in deutschemarks. They therefore switched to invoicing in the importer's or a third country's currency and were themselves faced with the problem of selling those currencies forward. In many instances they found it easier and cheaper to cover their exchange risk by borrowing the currency in question and selling it outright for deutschemarks, leaving the borrowing to be repaid at a later date from the proceeds of the exports. In effect this gave an immediate benefit to the West German reserves.

It was in these circumstances that, during the March meeting of the Bank for International Settlements in Basle, it was announced that the central bank Governors present had discussed the situation following the recent currency adjustments and were satisfied that rumours about further currency adjustments had no foundation. They also wished it to be known that the central banks represented, namely those of Belgium, France, Italy, the Netherlands, Sweden, Switzerland, the United

Kingdom and Western Germany, were co-operating closely in the exchange markets. In the following months the impact on the U.K. reserves of large short-term capital movements was mitigated by off-setting arrangements between central banks.

The movements of funds which took place from the 6th March to the end of the quarter are reflected in the figures for overseas sterling holdings given in Table 17 of the Statistical Annex. If the payment of £131 million by Fords is excluded, total non-official sterling holdings of countries outside the sterling area fell by £69 million, including falls of £29 million in holdings by North America and £35 million in holdings by Western Europe.

Gold market The London gold market was not affected by the disturbances in the exchange markets. The price of gold in London had fallen in U.S. dollar terms to around \$35·15 per fine ounce by the middle of February. Firm declarations by the new U.S. Administration that the gold value of the U.S. dollar would not be changed had drastically reduced speculative interest and the normal offerings of newly mined gold in London, combined with occasional sales by central banks, were fully adequate to meet demand. On the 6th March gold was quoted around \$35·08 per fine ounce and in the following days the price tended to move downwards; towards the end of the month events in the Far East led to an increase in demand and at the end of the month the price in London was around \$35·09 per fine ounce. The calmness of the gold market was not due to special operations by the Bank of England. In March rumours that the currencies of some West European countries would be increased in value in terms of the U.S. dollar and sterling were not accompanied by suggestions that a devaluation of the dollar in terms of gold was imminent. Hopes of exchange profits therefore led to heavy purchases of currencies, but there was no similar reason for purchases of gold. At the same time the central banks which were absorbing large amounts of dollars refrained from purchasing gold on the London market, mainly because they expected that in due course a large proportion of the inflow would be reversed.

Balance of payments In the first quarter of 1961 the sharp contrast in the pace of economic activity between North America and Western Europe was once again the main feature of the overseas background. During January and February industrial production in the United States remained at the low level to which it had fallen in December 1960; and for the quarter as a whole the U.S. gross national product, allowing for seasonal influences, declined. In March, however, there were indications of a revival, including rises in industrial production and retail sales.

In Western Europe, on the other hand, expansion continued in most countries, although there were signs that the pace might diminish mainly because of shortages of labour which persisted despite the continued encouragement of immigration into some countries.

The United Kingdom's identified current deficit was £56 million, about half that of the previous quarter. The deficit on visible trade was £43 million smaller, an improvement which owed little, if anything, to seasonal causes and was mainly attributable to a welcome recovery in exports, especially of machinery. Although in this quarter there were no interest payments to be made on the North American loans, this was not fully reflected in the improvement on account of current invisible transactions. The current deficit was largely covered by a net inflow of long-term capital, primarily the receipt of £131 million from Fords. The "Balancing item" continued to be positive, although less so than in the same period of recent years; its lower level suggests that there was some reversal of last year's unrecorded inflow of funds and perhaps also an adverse change in the timing of payments for imports and exports.

The beginning of the year is normally the best time for exports from overseas sterling area countries and largely for this seasonal reason their external position improved during the quarter. The reduction in their sterling holdings was £39 million compared with £95 million in the preceding quarter. At the same time, political uneasiness was affecting the balance of payments of South Africa and Rhodesia, while Australia and New Zealand were experiencing disappointing export earnings and a continuing high level of imports resulting from high domestic demand.

In the United States the loss of gold was stemmed by March, but the surplus on the U.S. trade balance may not continue to rise in 1961 and 1962 if activity there grows more rapidly than in Western Europe. Western Germany earned a surplus on current account of $500 million during the first quarter, the largest surplus ever earned in this period of the year: exports rose by over 7% compared with the preceding quarter, whereas imports rose by less than 3%.

The problem of the lack of balance on current and long-term capital account thus seems likely to remain for some time. Central bank co-operation in March and April was directed towards restricting and countering the massive movements of funds that were then taking place. Co-operation of this nature can enable a currency to withstand large disturbances of a purely short-term character but, in itself, cannot correct basic disorders that have caused or contributed to such a speculative movement. In any assessment of the position of sterling a cause of mistrust has been the deficit on current and long-term capital account in the U.K. balance of payments. There is reason to expect some improvement in this account during the course of the present year, but, to consolidate that improvement and to eliminate the deficit, much further effort must be directed towards an increase in U.K. exports. This may only be possible if the pressures that lead to a rising trend in industrial costs are kept under control and if industrial capacity continues to be improved and expanded. If these aims were achieved they would also improve industry's competitiveness in the home market and so reduce the growth of imports.

QUARTERLY ANALYSIS OF BANKING AND EXCHEQUER STATISTICS

15th December 1960—15th March 1961

Analysis of financial statistics for 1960

Before discussing developments during the March quarter of 1961, it is appropriate to look back at the trends in financing that emerged in 1960, and to look at these in terms of the financial surplus of the private sector in that year. Estimates of this are shown in Tables I and II on page 16. It is difficult to draw precise conclusions from these figures, which are subject to large margins of error corresponding mainly to the uncertainty about the size of the inflow of overseas funds during 1960, but it appears that the financial surplus of the private sector (excluding banks) was probably some £300 million lower in 1960 than in 1959.

Within the private sector, the financial surplus of companies (excluding financial institutions) fell sharply, by substantially more than £300 million, as the increase in internal finance available was far exceeded by the increase in expenditure on fixed investment at home and on stock accumulation. The rise in this expenditure was financed in part by bank borrowing (advances to industrial and commercial companies being relatively unaffected by the pressure which held down those concerned with consumer finance); and in part by a marked rise in new capital issues. Investment overseas by companies was probably little changed. Despite their increased borrowing, 'non-financial' companies as a whole must have added much less than in most previous years to their holdings of bank deposits, government debt and other financial assets.

In contrast to companies, the financial surplus of persons (including unincorporated businesses) rose in 1960 as a result of an increase in personal savings. After the imposition of hire purchase controls the rise in consumers' expenditure levelled out, but disposable incomes continued to grow. The financial counterpart of this development was that after the middle of the year personal borrowing through hire purchase and bank advances virtually stopped rising. Borrowing from building societies, however, was not reduced. The decrease in personal borrowing was of the same magnitude as the increase in the financial surplus of persons and there was therefore little margin for any increase in purchases of financial assets. There was some reduction in net subscriptions to National Savings and to the shares and deposits of building societies. On the other hand saving through life assurance and pension funds continued to rise; the institutions concerned probably devoted an increasing proportion of their receipts to investment in equities.

While the financial surplus of the private sector, as a whole, was lower in 1960, the financial deficit of the public sector (Central Government, local authorities and public corporations) increased by about £140 million. This was mainly the result of the Central Government's reduced revenue surplus; there was also a slight increase in the financial deficit of local authorities, but little real change in that of public corporations. The public sector's deficit in 1960, at some £700 million, substantially exceeded the private sector's reduced surplus; and there was an identified current deficit in the external balance of payments, estimated at £344 million. It was possible to sustain this deficit, to continue to lend and invest overseas at long term, to reduce obligations to the I.M.F. and yet to add substantially to the gold reserves only because of a heavy inflow of mainly short-term capital, which may be estimated at some £600 million[a] in all. A large part of this inflow went directly into government debt. The inflow increased the Exchequer's cash requirement, to the extent of the sterling counterpart of the rise in exchange reserves. At the same time, however, the overseas demand for government debt helped to finance the Exchequer through sales of debt outside the banking sector.

Banking trends during 1960, at least so far as they concern the London Clearing Banks, have already been described and need only be briefly recapitulated here. With net deposits at the clearing banks broadly stable, and with Special Deposits adding to the pressure on liquidity ratios, the increase in their advances was financed largely by sales of gilt-edged stocks. The experience of the Scottish banks and the Northern Irish banks was broadly similar.

The overseas banks and the accepting houses[b] did not conform to this general pattern. Deposits rose by as much as £564 million. Of this total £424 million represented deposits received from abroad, including deposits in foreign currencies. During the first half of 1960 much the greater part of the deposits received from overseas was re-lent abroad. A large part of these deposits was in the form of Euro-dollars, and the American banks in London were particularly active in this market. In the second half of the year the growth in lending to overseas borrowers was sharply reduced while lending to residents of the United Kingdom, especially at short-term to local authorities, was increased.

The private sector Many of the financial trends apparent in 1960 seem to have continued into the first quarter of 1961. The picture in this quarter is, however, strongly influenced by the Exchequer's surplus which results in the private sector, including both persons and companies, being in financial deficit. In the first quarter of 1961, this financial deficit was probably rather greater than it had been in the corresponding quarter of 1960, because expenditure on fixed investment rose faster than savings. The fall in bank deposits and the rise in bank advances were, however, considerably smaller than a year before. The increased financial deficit of this quarter was therefore financed in other ways. One of these was an exceptional receipt of long-term capital from overseas (the payment in January for the Ford shares). The other main source of finance was a reduction in holdings of government debt.

While the private sector's holdings of government debt as a whole fell, holdings of National Savings continued to rise; net receipts, which had for several months been running below the level of a year earlier, recovered to almost the same level as that of the first quarter of 1960. Also, the seasonal decline in the amount of Tax Reserve Certificates outstanding was slightly less than a year before. Home holders, however, appear to have reduced their holdings of marketable government debt (including indirect holdings[c] through the discount market) substantially more than in the same quarter of 1960, though the evidence for this depends on uncertain estimates of the movement of overseas funds. This may have been because tax payments were financed in this way rather than by drawing on bank deposits or overdraft

[a] Excluding the funds earmarked for the purchase of Ford shares.

[b] See Tables 11 and 12 of the Statistical Annex.

[c] 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.

facilities. There is, however, no firm basis for saying whether this was done on a larger scale than usual.

The available evidence suggests that the flow of funds to 'non-financial' companies (in the form of bank advances, capital issues and probably also bill finance) increased rather more than seasonally in the first quarter. Seasonal factors apart, the financial surplus of these companies was probably still tending to fall (or, as may be the case, their financial deficit to increase). On the other hand persons did not, on balance, increase their hire purchase debt during the first quarter (though it had begun to rise before the end of the quarter); and they appear to have borrowed little from the banks. This, taken in conjunction with the recovery in National Savings and the strength of the industrial share market, suggests that the financial surplus of persons may, seasonal factors apart, have been maintained.

Exchequer financing Some of the general developments noted above in the financing of the private sector during the quarter are considered in greater detail in the following discussion of Exchequer and banking statistics.

In the thirteen weeks ended the 15th March the overall budget surplus (£535 million) was less than in the corresponding period of 1959/60. Extra-budgetary receipts increased this surplus by £27 million to £562 million. The impact on the Exchequer of external finance was sharply changed by the outflow of reserves which began early in March. In the quarter as a whole the Exchange Equalisation Account took in £190 million of sterling, whereas in each of the three preceding quarters it had paid out substantial amounts. After providing £65 million for other external transactions (mainly debt repayments) the Exchequer's total cash surplus came to £687 million.

Of this surplus, £404 million was absorbed by a reduction in the banking system's[a] holdings of Bank of England notes and its direct and indirect holdings of government debt in the following way:

ESTIMATED CHANGE IN HOLDINGS OF GOVERNMENT DEBT AND BANK OF ENGLAND NOTES BY THE BANKING SYSTEM

15th DECEMBER 1960 - 15th MARCH 1961

£ millions

Bank of England, Banking Department:		
Direct holdings ...	+ 50	
Indirect holdings ...	—	+ 50
Clearing banks and Scottish banks:		
Bank of England Notes		− 69[b]
Treasury Bills ...	−219	
Gilt-edged Stocks ...	− 98	
Indirect holdings ...	− 68	−385
		−404

The decrease in the banks' holdings of notes and the broadly corresponding increase in the Government's indebtedness to the Bank of England, Banking Department, were normal seasonal changes. The fall in the clearing banks' and Scottish banks' holdings of government debt was also seasonal; it was, however, substantially less than the large decreases of each of the two previous years.

The discount houses reduced their borrowing both from the banking system and from other sources, at the same time adding to their holdings of commercial bills. The rise in the market's commercial bills may have been associated with the increase in the total amount of commercial bills outstanding and with sales by overseas banks from which foreign funds were being withdrawn; it may also indicate a resort to bill finance by domestic borrowers who in other circumstances might have taken bank advances. In consequence the discount houses' holdings of government debt fell sharply. Their holdings of Treasury Bills fell by £130 million (these usually fall in the revenue quarter) and their holdings of short-term bonds, which had risen to an unusually high level during the past year, were reduced by £54 million.

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

(b) Including coin.

The remaining £283 million of the Exchequer surplus was absorbed by a reduction in holdings of government debt and Bank of England notes outside the banking system. This reduction was distributed as follows:

ESTIMATED CHANGE IN HOLDINGS OF GOVERNMENT DEBT AND BANK OF ENGLAND NOTES BY HOLDERS OTHER THAN THE EXCHEQUER GROUP[a] AND THE BANKING SYSTEM

15th DECEMBER 1960 - 15th MARCH 1961

£ millions		
Bank of England Notes		− 51
Government debt		
Overseas official holders:		
Treasury Bills ...	+ 61	
Gilt-edged Stocks ...	− 2	+ 59
Other home and overseas non-official holders:		
National Savings ...	+101	
Tax Reserve Certificates	−165	
Treasury Bills ...	−155	
Gilt-edged Stocks ...	+ 44	
Indirect holdings[b] ...	−116	−291
		−283

The total of marketable government debt taken up by "Other home and overseas non-official" holders was £20 million, compared with £67 million in the last quarter of 1960 (both these figures exclude £131 million on account of Fords; this figure will also be omitted from all calculations in the remainder of this section). Net purchases of gilt-edged stocks were much less than in the previous quarter but there was a smaller reduction in Treasury Bill holdings. Net lending to the discount market fell by £116 million,[c] in contrast with the previous quarter, when it had risen by £48 million. If this reduction in indirect lending to the Government is taken into account, "Other home and overseas non-official" holders reduced their direct and indirect holdings of marketable government debt, whereas these holdings had increased both in the previous quarter and in the corresponding quarter a year earlier.

Overseas funds The inflow of short-term capital from overseas which had been such a striking feature in 1960 was probably slight in January and may have been negligible in February. Following the German and Netherlands revaluations in early March foreign-owned funds were withdrawn and the evidence shows that there was a net outflow in the calendar quarter ended the 31st March.[d] Whether there was any significant net outflow in the 'banking' quarter ended the 15th March is less certain. In this period £46 million was withdrawn from the discount market by overseas banks, though this does not necessarily mean that there was a net outflow of overseas funds as a whole. This factor probably explains some part of the decline, compared with the previous quarter, in purchases of marketable government debt by "Other home and overseas non-official" holders (including their net withdrawal of funds from the discount market). This conclusion is consistent with a reduction, partly seasonal, in direct and indirect holdings of marketable government debt by home holders outside the banking system.

Banking Net deposits with the London Clearing Banks fell by £118 million in the quarter ended the 15th March 1961, substantially less than in the same quarter last year (£314 million) and less than expected on seasonal grounds. The underlying slight downward trend apparent in the second half of 1960 thus seems to have given way to a rising tendency. In interpreting the figures it is necessary to allow not only for the large seasonal element but also for the exclusion of deposits with the Eastern branches of Lloyds Bank; these were transferred in January to the National and Grindlays Bank, so causing a

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

(b) Including some overseas official.

(c) Comprising a withdrawal of £73 million from the discount market and an increase in borrowing of £43 million through a rise in the discount market's holding of commercial bills.

(d) Excluding the withdrawal from temporary investment in Treasury Bills of the funds used for the purchase of Ford shares.

once-for-all reduction in deposits with the clearing banks. A further complication is the cash distribution to the Ford shareholders, of which the immediate effect was an abnormal rise in deposits. It is unlikely, however, that the out-turn for the quarter as a whole can have been much affected by this. There can be little doubt, particularly in the light of the banking figures for April and May, that an upward trend of net deposits had been resumed.

There are similar difficulties in interpreting the trend of the clearing banks' advances. The actual increase during the quarter (excluding loans to the nationalised industries) was £133 million. Some part of this rise can be attributed to seasonal influences, though it is difficult to say how much, because the seasonal pattern is irregular and may be changing. On the other hand there were some special factors tending to reduce advances. One of these was the removal of advances by Lloyds Bank's Eastern branches from the series. Another was the transfer of re-financeable export credits due for repayment within eighteen months from advances to "Other Bills" (which rose by the unusually large figure of £58 million). Taking all factors into account it seems possible that during the quarter to mid-March there was a slight slackening in the rate of growth of advances, which in the previous six months had been estimated at about £35 million a month. The ratio of advances to deposits rose during the quarter from 43% to 47%, at which level it was the highest for nearly thirty years.

Advances by all members of the British Bankers' Association increased during the quarter ending in mid-February 1961 by £161 million (excluding advances to the nationalised industries). The rise would have been rather greater, but for the exclusion from this series in February of the clearing banks' re-financeable export credits. Seasonal influences probably account for the rise being steeper than in the previous quarter, so that the underlying trend continued at the slower rate of increase which first appeared in the second half of 1960. Industrial borrowers continued to borrow more. Loans to the engineering industry rose by £56 million (14%) and would no doubt have shown an even sharper increase if re-financeable export credits had been included. Other industries which increased their borrowing were food, drink and tobacco, textiles and builders and contractors. Among the categories concerned with consumer finance, hire purchase finance companies again reduced their borrowing, while the increase in lending to retail trade and to personal and professional borrowers probably did no more than meet seasonal requirements.

The rise in the clearing banks' lending to the private sector (on this occasion by way of bills as well as advances) and the fall in net deposits were associated, as is usual in this quarter, with a decrease in their holdings of government debt, direct and indirect, and Bank of England notes. This reduction amounted to £413 million—substantially less than in the corresponding period of 1960. Although liquidity ratios were continuously under pressure, and the combined ratio started the quarter as low as 31·9%, sales of gilt-edged stocks totalled only £85 million, much less than in the same quarter of the previous year. Several factors helped to ease the pressure on liquidity ratios. First, as suggested above, it is possible that tax payments were financed to a greater extent than usual by drawing on call money with the discount market or by sales of Treasury Bills or gilt-edged stocks, rather than by running down deposits or taking advances. Secondly, some part of the effects on bank liquidity of the cash distribution to U.K. holders of Ford shares may have persisted until the end of the quarter. Thirdly, the clearing banks' liquidity was strengthened by an increase in their commercial bills of £58 million, not wholly due to the transfer to this heading of re-financeable export credits. Finally, there is the technical factor that gross deposits, on which the ratio is calculated, fell much more than did net deposits.