COMMENTARY

APRIL—JUNE 1961

External position The large identified deficit on current and long-term capital account which emerged in the second half of 1959 and continued into 1961 was due to a fall in net receipts from current invisible transactions and to a deterioration in the balance of visible trade.

Net invisible receipts, which had previously helped to offset deficits on visible trade and long-term investment overseas, had dwindled from £285 million in 1958 to £59 million in 1960, owing mainly to increased government expenditure, a fall in net receipts from interest, profits and dividends, and a worsening of the shipping position.

The balance of visible trade would have had to improve considerably in 1959 and 1960 if it were to compensate for the fall in net invisible receipts. In fact it also deteriorated; and a surplus of £35 million in 1958 had become a deficit of £398 million by 1960, though admittedly this is to contrast two exceptional years. Exports rose; but imports rose by much more, even though the rise in imports of industrial materials did not appear to be much out of line with the expansion of domestic output and the accompanying increase in stockbuilding which had taken place.

The need to increase exports, already present in 1959 and 1960, became urgent in 1961, when the effects on the reserves of a large underlying deficit were no longer offset by an inflow of short-term capital. It was necessary not only to raise the upward trend in exports, bringing it into line with that in imports, but also to make good the decline in net invisible receipts. To sustain a satisfactory rate of economic growth and at the same time restore external balance, an increase in exports of some 10% per annum may well be required for two or three years, assuming no change in the present terms of trade. If an increase in exports on this considerable scale is to be achieved there will have to be a comprehensive and aggressive export drive leading to a substantial rise in the proportion of the output of U.K. manufacturing industry exported and a reversal of the persistent fall in the United Kingdom's share of world markets for manufactures; the latter will require a sharp change in the international competitive position of U.K. industry. The changes required would be more easily achieved if there were to be an increase in the productivity of manufacturing industry unaccompanied by an increase in costs.

Against this background, developments in the U.K. balance of payments in the second quarter of 1961 and the outlook for the succeeding twelve months were unsatisfactory. There were as yet no signs that the deterioration in net invisible receipts was being reversed. There had been a rise in exports in the first quarter, but this ceased in the second. Between the first and second quarters, exports of ships rose sharply and there was some improvement in those of cars, but exports of machinery, textiles, commercial vehicles and chemicals fell. On the other hand, notwithstanding a further growth in imports of capital goods, total imports fell, mainly because of lower imports of industrial materials, reflecting a fall in the rate of stockbuilding. In consequence the visible trade position improved, though it remained in net deficit. This improvement could not be counted on to continue for long. Imports could be expected to start rising again fairly soon, although more slowly than in 1960, as production rose and stockbuilding was resumed at a rate higher than that of the first quarter. Markets for industrial goods were continuing to expand in the United States, where economic recovery was proceeding rapidly, and also in Western Europe; this could be expected to provide wider opportunities for U.K. exporters. In the overseas sterling area, on the other hand, imports were being restrained by many countries. In all, therefore, any rise in exports could hardly be expected to be more than moderate. The

United Kingdom continued to suffer by comparison with its competitors from the slower growth of its traditional markets and from its difficulties for both political and commercial reasons in holding its position in these markets.

On current account, therefore, a continued deficit seemed likely. On long-term capital account there was no reason to expect a succession of further large receipts such as the Ford money and the advance debt repayment by Western Germany. The outflow of long-term capital, including assistance to developing countries, was likely to remain at a high level. A substantial net deficit on long-term capital account could therefore be expected to continue.

Recorded non-official sterling holdings of countries outside the sterling area fell by £142 million in the period April—June. These countries' official sterling holdings fell by £33 million; this figure reflects the use by Western Germany of £45 million of its sterling holdings to meet part of the advance repayment of £67½ million post-war debt. Excluding this repayment, official holdings of countries in North America and Western Europe both rose. Both the official and the non-official sterling holdings of countries outside the sterling area included some part of the assistance received under the Basle arrangements.[a] Total holdings of overseas sterling area countries rose by £163 million; the reserves of Australia alone, which are primarily held in sterling, rose by £130 million in this period, partly because the equivalent of approximately £63 million was purchased from the International Monetary Fund in April. The change in total overseas holdings of sterling was quite small so that the fall of £89 million in the gold and convertible currency reserves was about the same as the deficit of £86 million on current and long-term capital account.

Domestic situation In the early summer of 1961 consumers' expenditure appeared to be rising further. In the second quarter total registrations of cars were very near the high level of a year previously and there was a partial recovery in sales of household durable goods due partly to increased hire purchase and partly to some price cutting. Total hire purchase debt outstanding had been rising since the beginning of March and the renewed rise in bank advances to the retail trade, to hire purchase finance companies and to personal and professional borrowers no doubt also helped to finance consumers' expenditure. At the same time consumption in the public sector was increasing.

Fixed investment in the public sector was also rising rapidly. In the private sector investment had risen during the first quarter although running somewhat below the level expected in view of manufacturing industry's reported plans. The gap between intended and actual expenditure seemed to have been due to difficulties on the supply side. The building industry was finding it difficult to satisfy a very strong demand. In the capital goods industries new domestic orders continued in April at a high level, causing a further lengthening in order books, but although they declined in May there was no significant contraction in the amount of orders in hand.

During the first quarter a marked slackening had occurred in the rate of stock accumulation; this had reduced pressure on imports and reconciled the rise in final demand with a rather slow growth of industrial production as a whole. There had been only a slightly more than seasonal rise in manufacturers' stocks of materials and work in progress and a less than seasonal rise in their stocks of finished goods. There had been some rise in stocks held by the distributive trades, perhaps in anticipation of a further increase in demand. Revised figures suggested that industrial output had begun to rise early in the year, but the seasonally adjusted index of production was on average little more than 1% higher for the months of April and May than it had been for the last quarter of 1960.

In mid-July some economic indicators, notably the retail sales index for June, which had by then become available, suggested that the sharp rise in consumption in the first quarter might have levelled off; it would, however, have been premature to conclude that this was more than a temporary slackening. There were also further signs that private investment might begin to moderate some time in 1962, but they did not imply any substantial

[a] See page 10.

modification of the longer-term outlook as a whole.

There had been a sharp rise in personal incomes mainly because of increases in wages and salaries earlier in the year. Throughout the first half of the year the pressure of demand for labour was extremely high, with severe shortages, particularly of skilled labour, in many parts of the country. Although total employment might be increased through larger numbers of school-leavers and higher immigration, shortages which, in some regions, had been restricting production for some two years seemed likely to persist. It was again apparent that industries which were not using their labour to the full were not releasing skilled workers. This pressure of demand for labour and a renewed rise in the retail price index suggested that a further general rise in wage and salary rates had to be expected. The rise in incomes therefore seemed likely to accelerate during the winter of 1961/62. Furthermore it seemed probable that net borrowing on hire purchase would continue to expand in the second half of 1961 so that the increase in the proportion of incomes saved, that had occurred in 1960 when hire purchase debt was contracting, was unlikely to be repeated.

The length of order books in the capital goods industries indicated that those industries could in general be expected to be working near to capacity during most of 1962 notwithstanding any slackening in new domestic orders that might occur. Delays in the delivery of capital goods could be expected to lead to continued high imports of manufactures.

It therefore seemed likely that over the year to June 1962 the pressure of home demand, which was already excessive, would rise still further and that the rise in home prices and costs would continue. If the increase in exports needed to redress the precarious state of the balance of payments were to be achieved these tendencies would require firm action through short and long-term measures.

The July measures

The immediate problem in July was the strain on sterling. In the second calendar quarter the reserves fell by £89 million and they were still falling steeply early in July; in addition by the end of June borrowing outstanding under the Basle arrangements totalled £323 million. The need therefore was for action that would in the short run contain the increase in the pressure of domestic demand, relieve pressure on sterling and improve the balance of payments position, without at the same time making long-term aims more difficult to achieve. Time would then be available to work out the longer-term measures.

The measures announced by the Chancellor of the Exchequer on the 25th July included a number taken with a view to reducing public expenditure. In particular, government expenditure overseas was to be held in check; the increase in supply expenditure in 1962/63 was to be kept within 2½% in real terms; and there were to be certain savings in expenditure below the line (in particular, the scheme under which the Exchequer lent funds to building societies for the purpose of assisting the purchase of older houses was suspended). The effect of all these measures was to reduce by about £300 million the total of government expenditure then estimated for 1962/63. The Chancellor also said that proposals for new private investments outside the sterling area would be more stringently examined than before and U.K. firms operating overseas would be encouraged to remit home a higher proportion of their overseas earnings.

The Chancellor also announced that, in order to restrain consumers' expenditure, an Order had been made imposing a surcharge of one-tenth (the full amount permitted under the Finance Act, 1961) of the existing rates on most Customs and Excise revenue duties and on purchase tax. It was estimated that the surcharge would increase government revenue by £210 million in a full year and by £130 million in the financial year 1961/62. The Chancellor said that a pause in the growth of wages, salaries and dividends was essential, and that in those areas for which the Government had direct responsibility they would act in accordance with this policy.

Also on the 25th July Bank Rate was raised from 5% to 7% and further calls for Special Deposits were made on the London Clearing Banks and the Scottish banks. A rise in short-term interest rates could be expected to reinforce the other restrictions on credit and might after an initial fall in prices improve conditions in the gilt-edged market. The rise in Bank Rate would also help to check the outflow of short-term capital, but it was not desired to attract any substantial amount of overseas funds. The call on the London Clearing Banks for Special Deposits was for the equivalent of an additional 1% of total gross deposits in England and Wales, bringing the total called to 3%, and that on the Scottish banks for ½% of total gross deposits, bringing the total called to 1½%: half the increases were to be deposited by the 16th August and the balance by the 20th September. The banks were informed that the authorities wished the impact of this call for Special Deposits to fall primarily on advances. The aim was that the recent rate of increase in advances should be greatly reduced.

In addition, the banks were asked to be particularly severe towards proposals for new advances, or the renewal of existing commitments, for purposes of personal consumption, including hire purchase, and for speculative building, property development and other speculative purposes. If advances for these purposes could be reduced it would be possible for advances concerned with exports, and with production which would aid exports, to be increased without any marked rise in the level of total advances outstanding. The Bank of England drew the attention of other banks in the United Kingdom, including the associations of the overseas and foreign banks and the Accepting Houses Committee, to the requests made to the London Clearing Banks and the Scottish banks; and requested that they should also seek to achieve a considerable reduction in the rate of growth of their advances in the United Kingdom and should apply the same general criteria when considering advances as had been requested of the London Clearing Banks and Scottish banks. The attention of the banks was also drawn to the expansion that had occurred over recent months in the volume of commercial bills and to the undesirability of any continued increase which would weaken the effect of the restrictions on bank advances. At the same time the Bank of England asked the British Insurance Association that its members should observe, in respect of their own lending, a policy similar to that requested of the banks; and the attention of the Finance Houses Association and the Industrial Bankers Association was drawn to the wish of the authorities that restrictions on credit should fall primarily on consumers' expenditure. These associations were informed that the authorities did not wish hire purchase finance companies to have recourse to the public in order to finance expansion of business other than that to which they were already committed.

At the same time the Chancellor announced that a request was to be made to the International Monetary Fund for a drawing, described in more detail on page 8.

All these short-term measures could be expected to relieve the pressure on sterling and improve the balance of payments in the short run. The relatively sharp restriction of home demand which they entail will have direct effects on imports and in some industries facilitate the diversion of a higher proportion of output to exports.

The Chancellor stated that if the necessary long-term improvement in the balance of payments were to be achieved it was vital that the rise in the rate of investment in industry should be maintained. Measures which would directly curtail investment were avoided; in particular, no reduction was made in initial or investment allowances, nor in the main investment programmes of the nationalised industries.

The Chancellor emphasised that the success of the short-term measures was no more than the essential pre-condition for solving the longer-term problems. He stated that the Government intended to introduce measures to deal with these problems. In particular, control over public expenditure was to be improved and it was planned that in future not only should the rate of increase be slowed down so that it did not exceed that of the growth of national resources but within the public sector measures should be taken to concentrate resources on expenditure that would strengthen the competitive power and efficiency of the country.

The Chancellor also said that an urgent joint examination of the United Kingdom's economic prospects by the Government and industry would be initiated. The examination would cover the growth of production and the distribution of resources. It would try to establish the essential conditions for realising potential growth. The Government would share with industry the task of relating plans, including prospective increases in incomes, to resources. It was essential for the U.K. economy to be more competitive. The pause in increases in wages, salaries and dividends did not of itself provide any lasting solution to the problem of rising costs and prices. It would have to mark the beginning of a new long-term policy which would ensure that increases in incomes would follow, and not anticipate nor exceed, increases in productivity. There was need for more effort in the training of skilled labour and for a determined attempt to deal with out-dated restrictive practices. The radical changes in outlook and methods that would be necessary might be brought about more easily if the G.A.T.T. negotiations which were then taking place were to result in a reduction of tariffs.

The essential purpose of the long-term measures is to improve the competitive position of U.K. industry and enable exports to be increased. Unless this is achieved it is hard to see how the aims of more rapid economic growth and rising living standards can be reconciled with the need to achieve and maintain external solvency.

Foreign exchange and gold markets The general uncertainty and lack of confidence in the exchange markets, which had been precipitated by the revaluation of the deutschemark and the guilder in March, persisted throughout the quarter. It diminished after a speech by the Managing Director of the International Monetary Fund on the 12th June in which he stated that in all the major financial centres the monetary authorities were determined to maintain existing exchange parities. On the 20th June the Canadian authorities announced that they intended to facilitate a reduction in the exchange value of the Canadian dollar, which subsequently has been quoted at a discount of around 3% on the U.S. dollar.[a] Although the Canadian dollar has not had an official exchange parity for several years the Canadian action caused rumours of changes in the parities of currencies to start circulating once again.

Large sums of overseas money had been moved away from London in March. Once this movement had started, overseas holders of sterling immediately began to look much more closely at the United Kingdom's prospects and their implications for sterling and to contrast them with the improved outlook for the U.S. dollar. The full seriousness of the United Kingdom's position became more generally realised when at the end of March revised figures for the balance of payments were published which showed that the U.K. current account had been in continuous and heavy deficit since September 1959. Subsequent items of news that could be interpreted as having adverse implications for the United Kingdom's position, such as a labour dispute or unfavourable visible trade figures, resulted in heavy selling of sterling.

The pressure on sterling was much less in April and May than it had been in March, but became very heavy again in June. Notwithstanding continuous and, at times, very substantial support provided through the Exchange Equalisation Account, the rate against the U.S. dollar fell from $\$2{\cdot}79\frac{3}{4}$ to $\$2{\cdot}78\frac{13}{16}$ over the period. Selling tended to be particularly heavy before week-ends, a time when important announcements affecting exchange rates have normally been made, but was seldom fully offset by buying at the beginning of the following week. Sterling continued under pressure until the Chancellor's measures were announced on the 25th July. It then recovered and the rate against the U.S. dollar rose from $\$2{\cdot}78\frac{17}{32}$ on the 24th July to $\$2{\cdot}79\frac{15}{32}$ on the 31st July; in August it rose further and stood at $\$2{\cdot}80\frac{9}{16}$ on the 31st August.

After the announcement of the Chancellor's measures the net withdrawal of funds from London ceased abruptly. The net demand for sterling seemed primarily due to purchases by those who had previously deliberately gone short by deferring payments due in sterling, by keeping sterling cash balances at an unusually low level or by selling sterling forward, rather than to the beginnings of any new net inflow; though the evidence available at this time was very scanty. In the first half of August continuing net purchases of sterling and a tendency for some U.K. short-term interest rates to fall suggested that some overseas funds might again be moving to London, but the amounts then involved were reported to be small. The uncertainties of the international situation and the demand for credit in the fast reviving U.S. economy make it unlikely that overseas funds

[a] See Table 18 of the Statistical Annex.

will now flow to London at a rate similar to that of the second half of 1960. A heavy inflow of short-term funds would not be welcome.

During the calendar quarter ended in June there was considerable forward selling of sterling in addition to selling for immediate delivery. As a result the discount on forward sterling against most currencies rose, and by the end of the quarter three months' sterling was being quoted at a discount equivalent to $3\frac{5}{8}$% per annum against the U.S. dollar and $5\frac{3}{4}$% per annum against the deutschemark. Rates for three months' Treasury Bills were little changed over the period in both London and New York. In consequence, the premium in favour of New York on the Treasury Bill comparison, allowing for the cost of forward cover, rose from $\frac{3}{16}$% per annum at the beginning of the quarter to $1\frac{1}{2}$% per annum at the end of the quarter. The widening of the discount on forward sterling made it unprofitable for banks in London to accept deposits denominated in U.S. dollars, switch them, covered forward, into sterling and employ the proceeds in three months' deposits with, for example, local authorities. This is illustrated by the graph on page 60. The outstanding amount of dollar deposits switched into sterling therefore fell during the period.

In July the discount on forward sterling widened further and on the 11th July three months' sterling was being quoted at a discount against the U.S. dollar equivalent to $4\frac{3}{8}$% per annum making the premium in favour of New York on the Treasury Bill comparison over 2% per annum. Then sentiment changed abruptly. It came to be felt that measures to restore the exchange position would be taken. In consequence the forward discount on sterling began to narrow rapidly so that by the 24th July it was equivalent to about 3% per annum making the premium in favour of New York around $\frac{1}{2}$% per annum. After the rise in Bank Rate on the 25th July the increase in the U.K. Treasury Bill rate had the effect of establishing a premium in favour of London of $\frac{1}{4}$% per annum by the end of the month, notwithstanding a renewed widening in the discount on forward sterling. If the forward risk were not covered, the margin in favour of London on the Treasury Bill comparison became $4\frac{3}{8}$% per annum. In August the Treasury Bill comparison allowing for the cost of forward cover showed little inducement to move funds on a covered basis either to or from London.[a]

During the quarter the price of gold was affected by sales by U.S. holders, who were required under a recent U.S. Treasury Order to dispose of their holdings before the 1st June, and also by sales, reported to be large, by the U.S.S.R. Furthermore the Bank of England, on behalf of the Exchange Equalisation Account, sold gold. These sales were necessary to replenish the Account's holdings of convertible currencies and, together with the Soviet sales and normal offerings by other gold producers, they enabled several West European central banks which were gaining reserves to increase their gold holdings without buying substantial amounts of gold from the United States and without causing any marked rise in the price of gold on the London market. Nevertheless, uncertainties over both the international situation and the stability of the reserve currencies meant that there was an underlying tendency for the price of gold to rise on the London market. This became obvious in July when, partly owing to the Berlin situation, the price of gold rose on most days and was quoted at U.S.\$35·14$\frac{1}{32}$ per fine ounce on the 31st July. In August the price rose further and was quoted at \$35·19$\frac{3}{16}$ per fine ounce on the 31st August. There was also, throughout July and August, a strong demand for gold coins, traditionally purchased by individuals fearful of currency or political instability.

U.K. drawing on the I.M.F.

During 1960 the United Kingdom had repaid the balance of the drawing of U.S.\$561 million made on the International Monetary Fund in 1956 and had also voluntarily repurchased sufficient sterling to reduce the I.M.F.'s holding at the end of the year to 75% of the U.K. quota. (The I.M.F. normally holds the equivalent of 75% of a member's quota in the member's currency if there are no transactions outstanding in that currency.) Subsequently the I.M.F.'s sterling holding was further reduced, as other members drew sterling, and

[a] See graph on page 60.

in July 1961 it represented some 73% of the U.K. quota.

On the 25th July 1961 the United Kingdom requested, and on the 4th August the I.M.F. agreed to make available, facilities totalling the equivalent of U.S.$2,000 million. Of this sum the equivalent of U.S.$1,500 million was made available immediately in the form of a drawing in nine different currencies, while, under a standby arrangement, the United Kingdom has the right to make additional drawings equivalent to U.S.$500 million. So far as possible, the drawing was made in the currencies of countries which at the time had a strong balance of payments position. Repayment of the drawing must be completed within five years. The standby is available for twelve months but, subject to negotiation, the facility could be renewed; amounts drawn under the standby fall due for repayment within three years. As a result of the drawing the I.M.F.'s holding of sterling amounts to approximately 150% of the United Kingdom's quota; full use of the standby would increase this percentage to a little over 175%. No member of the I.M.F. has yet drawn sufficient to cause the I.M.F.'s holding of its currency to exceed 200% of its quota.

The distribution of the drawing among the nine currencies was as follows: $450 million in U.S. dollars and the equivalent of $270 million in deutschemarks, $270 million in French francs, $120 million in lire, $120 million in guilders, $90 million in Belgian francs, $75 million in yen, $75 million in Canadian dollars and $30 million in Swedish kronor. Under an arrangement with the U.S. Treasury the U.S. dollar element of the drawing has been invested in special non-marketable Certificates of Indebtedness in order to avoid disturbing the New York money market.

Service charges of ½% (£2½ million) on the drawing and of ¼% (£½ million) on the standby have been paid. Interest charges will be determined by the level of the I.M.F.'s holding of sterling and the length of time for which the facilities are outstanding; they are likely to amount to some £5 million in the first year and could exceed £10 million in the third year. Whether charges are payable in gold or in sterling depends upon the level of the U.K. reserves[a] relative to the size of its quota at the time the charges are due. The service charges due in August were paid in sterling.

This was the largest amount ever drawn from the I.M.F. and to finance it the I.M.F.'s holdings of certain currencies, particularly deutschemarks and lire, were reduced to very low levels. To restore its holdings, the I.M.F. decided to use $500 million of its gold holding of some $2,500 million to purchase one-third of the amount drawn in each of the nine currencies.

The "Basle Agreement"

Superimposed on a basic balance of payments position which was anything but satisfactory, events in early March precipitated a speculative movement of funds of a magnitude which had not been seen in the post-war years.

During the first week of March the deutschemark was revalued by approximately 5%. This action was taken by the West German Government in the light of a large and continuing surplus on the balance of payments combined with very high domestic activity. The Dutch authorities found themselves in a position of almost immediately having to follow suit in view of the interdependence in many fields of the Dutch and West German economies.

The result of these actions was to set off an unintended and wholly unwelcome wave of speculation of whether the German and Dutch moves were in themselves merely interim moves and also whether they portended a general readjustment in exchange parities. As a result, some currencies, notably the Swiss franc, were heavily bought: London, which still retained the bulk of the inflow of short-term funds which took place during the second half of 1960, bore the brunt of the selling. At this stage sales of sterling were as much due to the wish to acquire currencies which might be revalued upward as to lack of confidence in sterling.

It was in these circumstances that a week later, on the 13th March, the normal monthly meeting of the Bank for International Settlements was held in Basle. The central bank

[a] As defined by Article XIX of the Articles of Agreement of the International Monetary Fund.

governors concerned discussed the problem which faced them, which was that unless they took early and effective action the whole stability of the foreign exchange structure, which had stood with certain modifications broadly steady since 1949, would be undermined. This led to what subsequently came to be known as the " Basle Agreement " or the " Basle arrangements ".

The first action that the governors took was to state formally that the central banks represented, namely those of Belgium, France, Italy, the Netherlands, Sweden, Switzerland, the United Kingdom and Western Germany, were satisfied that rumours about further currency adjustments had no foundation: and as a practical earnest of this belief they announced that the central banks concerned were co-operating closely in the foreign exchange markets.

Details of the various techniques to be employed were left for agreement and in practice they varied widely but the purpose was never in doubt. This was to ensure that, despite such pressures as might be generated in the foreign exchange markets during the heat of the day, no party to the so-called " Basle Agreement " should be forced by speculative movement of funds to deviate from the declared policy.

Whilst no one could estimate for how long or in what volume these movements would continue, it was clear in the minds of all concerned that this was essentially an essay in short-term banking accommodation which would be reversed in a reasonably short space of time, either by a reflux of short-term funds or recourse in due time, if this reflux did not occur, to one of the international sources of longer-term financial accommodation. It was agreed that to reveal at the time the amount of assistance given or received might well add to the magnitude of the speculative problem which the central banks were attempting to contain.

In practice, the operation achieved its objective and is perhaps an example significant for the future of the power and size of the resources which can be deployed by the leading monetary authorities when, as was the case on this occasion, they are in agreement about the aim to be pursued.

The pressures on sterling varied from month to month between the beginning of March and the end of July. The largest amount outstanding at any one time under the " Basle Agreement ", which included help provided by institutions other than those mentioned in the communiqué of the 13th March, was approximately £325 million.

Assistance was received in several forms and the transactions have therefore affected a number of published statistics. Assistance provided in sterling was reflected in the figures of overseas sterling holdings; sterling retained in the name of a central bank was included under official sterling holdings but where, for example, a central bank in effect held the sterling indirectly through a commercial bank in its country, the amounts were included under non-official sterling holdings. Assistance was also provided in the form of currencies other than sterling. This was included in the balance of payments statistics under the heading of " Miscellaneous capital (net) ". The total assistance outstanding at the 30th June under these headings was as follows:

	£ millions
Overseas official sterling holdings ...	112
Overseas non-official sterling holdings ...	85
Miscellaneous capital (net)	126

The sterling held by the institutions which provided assistance, including the sterling equivalent of assistance denominated in other currencies, was in the main invested in U.K. Treasury Bills. In so far as these Bills were the counterpart of assistance given by central banks directly, they have been included in " Overseas official " holdings of marketable government debt in the Quarterly Analysis of Banking and Exchequer Statistics in this Bulletin. The remainder have been included in the " Other home and overseas non-official " category. The figures for this split on the 21st June which, of course, include assistance received in both sterling and foreign currencies and therefore shown under separate headings in the balance of payments statistics, were:

	£ millions
Assistance included in holdings of " Overseas official " category	167
Assistance included in holdings of " Other home and overseas non-official " category	40

The great bulk of the assistance provided had been repaid by the end of September. There was a small repayment in July, £200 million was repaid in August, after £518 million of the £536 million drawing from the International Monetary Fund had been received, and a further amount in September.

During the whole period under review the United Kingdom was additionally running a deficit on current and long-term capital account and it was this state of affairs which made necessary the various measures taken in July, referred to on page 5.

Capital and money markets

During the first part of the quarter prices of gilt-edged stocks mostly rose, partly because the market considered that the budget proposals were likely to lead to a lower level of interest rates. In the middle of May a sharp fall in prices began which more than offset the previous rise and the Issue Department became a net buyer in order to steady the market. This turn-round was in part due to a more general awareness, stimulated by Ministerial speeches, of the extent of the United Kingdom's economic difficulties. During the period the other main influences on interest rates were the outflow of overseas funds, a continuing demand for equities, the expected enactment of the Trustee Investments Bill, an unusually large volume of new issues both fixed interest and equity, an apparent increase in the public's desire for liquidity and, towards the end of the period, institutional switching from short-term bonds to Treasury Bills as higher interest rates came to be expected and liquidity ratios came under pressure.

Between mid-March and mid-June the total outflow of funds abroad, excluding official funds and long-term investment, may have exceeded £200 million. It seems probable that the largest component of this outflow was a withdrawal of funds invested in Treasury Bills. Gilt-edged rates were affected indirectly by some withdrawal of funds deposited with banks and hire purchase finance companies or lent to local authorities.

The outflow of overseas funds had a marked effect on the local authority market, where the rate for three months' money rose from 5½% to 6% during the period and rates for longer-term money from about 6¼% to 6½%. Hire purchase finance companies were also affected by the outflow and some of them raised their deposit rates.

Although local authorities do not regard themselves as borrowers of overseas money on any important scale, a significant and fairly volatile part of their short-term deposits does in fact come from abroad. This is not necessarily apparent, because overseas money may be lent to U.K. borrowers not only directly but also indirectly. Where the transaction is direct the money is lent in the name of the overseas lender, but where money is lent indirectly it is usually deposited with a financial intermediary in London who then employs the funds with local authorities. This may be an overseas or foreign bank (see article on page 18), an accepting house or a U.K. bank. Much the greater part of the overseas funds employed with local authorities and hire purchase finance companies is invested indirectly; and Table 11C of the Statistical Annex shows that loans to local authorities by "Other Foreign Banks" fell by £28 million in the quarter ended the 30th June. The analysis of advances by the members of the British Bankers' Association showed that both local authorities and hire purchase finance companies had increased their borrowing in the quarter ended mid-May, probably a further indication that these borrowers were replacing overseas funds with money from home sources.

The continuing preference for equities did not prevent a sharp fall in their prices in the latter half of the period. In addition to the change in sentiment about the economic outlook, the exceptionally large volume of new issues, both made and pending, and calls on the prior charges of the steel companies were probably important influences.

Towards the end of the period, when it became clear that the next move in interest rates was more likely to be upwards than downwards, the discount market began to protect its position by switching out of bonds into Treasury Bills. At the time this switching was an important factor in the weakness of short-dated gilt-edged stocks.

Net deposits with the clearing banks rose during the early part of the second quarter substantially more than has been usual at that time of the year. Most of this rise occurred when $2\frac{1}{2}\%$ Funding Loan 1956/61 was redeemed in April; it was not subsequently reversed during the quarter, although the outward flow of overseas funds, some of which had been invested in debt other than marketable government debt, could have been expected to cause some fall in bank deposits. It appeared that there was not only a desire by the public to maintain the level of deposits relative to rising expenditure but also, later in the quarter, a specific wish to increase liquid balances at a time when there was a threat that the balance of payments position and the weakness of sterling might cause new restraints to be imposed on the economy.

The rise in deposits with the clearing banks was accompanied by an expansion of their advances. In order to raise their liquidity ratios to a level more usual for this time of the year and to provide for future commitments the banks reduced their holdings of government stocks by £102 million during the period.

The Exchequer's cash requirement during the quarter amounted to no more than £57 million.[a] Receipts from non-marketable government debt, from the rise in the note circulation and from a small increase in indebtedness to the Banking Department enabled the Exchequer to repay £117 million net of marketable debt, compared with only £3 million in the same quarter of the previous year. Net purchases by the authorities of £260 million of stocks over the quarter as a whole were heavily concentrated at the short end of the market; they included the redemption of $2\frac{1}{2}\%$ Funding Loan 1956/61 in April. As a result of these purchases there was a net increase in borrowing on Treasury Bills of £143 million.

As a result of the measures announced by the Chancellor of the Exchequer on the 25th July, and in anticipation of the Trustee Investments Bill which received the Royal Assent on the 3rd August, prices in the gilt-edged market fell sharply. On the 2nd August rumours began to circulate to the effect that the authorities intended to withdraw their support. The Bank therefore reminded the market that it was not the practice of the authorities to support the gilt-edged market in the sense of pegging it at any particular price level; that the authorities would continue to be concerned to ensure orderly market conditions so that dealings at a price could continue; and that prices would continue to depend upon general market conditions.

There were over the period only small movements in the tender rate for Treasury Bills which fell shortly after the Budget but then rose slowly from $4\frac{5}{16}\%$ on the 12th May to $4\frac{17}{32}\%$ at the end of June. The Treasury Bill rate is more directly affected by official operations in the money market than are most other short-term rates; up to the end of June official operations were designed to moderate the rise in Treasury Bill rates. After the rise in Bank Rate on the 25th July the Treasury Bill tender rate rose to $6\frac{11}{16}\%$.

Special Deposits

During the banking quarter ended mid-June advances by the clearing banks rose by £143 million. Nevertheless the rise in deposits and net Exchequer borrowing on Treasury Bills, together with the substantial reduction of the banks' investments, enabled the clearing banks to increase their combined liquidity ratio from 30·4% to 32·2% over the same period.

Until the July banking figures became available the underlying growth in advances seemed to have continued during 1961 at its earlier rate averaging about £35 million a month, but it then appeared that the underlying rate of growth had risen to some £50 million a month in June and July. Furthermore, the analysis of advances by all members of the British Bankers' Association, which became available in June, showed a relatively sharp rise in the rate of borrowing by groups associated with consumer finance in the quarter ended mid-May.

The clearing banks' holdings of commercial bills also increased. Over the banking quarter to mid-June the rise amounted to £14 million, and in the following month it was £28 million. These increases made some contribution to the rise in the clearing banks' liquidity ratio. A large part of the total growth in commercial bill holdings was probably due to further

[a] See Table 1 of the Statistical Annex.

recourse to bill finance in place of bank advances. The total commercial bill holding of the clearing banks, the Scottish banks, the overseas banks, the accepting houses and the discount market at the end of June was £526 million, over £100 million more than at the end of December 1960.

Advances by the Scottish banks increased by £14 million during the banking quarter to mid-June and more substantially, by a further £19 million, in the next month. Total advances by the overseas and foreign banks also rose during the quarter and there was a very sharp rise of £83 million (50%) in advances by the accepting houses. Advances denominated in foreign currencies to residents overseas form a much higher proportion of total advances for the overseas and foreign banks and the accepting houses than for the clearing banks and Scottish banks.

It was against this background that the decision was taken to make further calls for Special Deposits, the call on the Scottish banks being at half the rate of that on the clearing banks because pressures on the Scottish economy were again less pronounced, and all banks were informed of the authorities' views on bank advances and bill finance. Banking figures are analysed further below.

QUARTERLY ANALYSIS OF BANKING AND EXCHEQUER STATISTICS

16th March—21st June 1961

Banking The upward trend in net deposits with the clearing banks, which had been resumed in the first quarter of 1961, continued in the first part of the second quarter but then levelled off. An increase in this quarter of £216 million brought the total rise in net deposits in the first half of 1961 to £98 million, equivalent to an annual rate of around £600 million (about 10%), if allowance is made for seasonal factors. Allowing for these adjustments there had been a rise in the first quarter which had probably been associated with the disbursement of the purchase money for Ford shares; the further rise in the second quarter was associated with the redemption of 2½% Funding Loan 1956/61 in April. In May and June net deposits rose no more than seasonally. The fact that an expansion of deposits which originated from two special factors was not later reversed suggested a rising demand for deposits, especially as the outflow of funds, some part of which had not been invested in marketable government debt, would normally have caused some fall in deposits. This demand for deposits was not unexpected in view both of the prevailing financial uncertainty and of a continuing rise in national income and expenditure.

The clearing banks' advances (excluding those to the nationalised industries) rose by £144 million during the second quarter, a figure which was somewhat inflated by the debiting of half-yearly interest because the make-up day fell nearer than usual to the end of June. Between the middle of 1960 and mid-May, after making some allowance for seasonal and special factors, advances appear to have been rising at an underlying rate which has averaged £35 million a month, but from mid-May to mid-July the rate of increase seems to have risen to about £50 million a month. These figures need to be treated with caution as there are grounds for believing that changes may be occurring in the seasonal pattern which could make the existing seasonal adjustments misleading. Some acceleration would not have been surprising, in view of the rise in consumer demand, the need for industrial companies to finance a high rate of investment at a time of reduced profit margins and the withdrawal of overseas money lent to the banks' customers.

Some significant changes in the composition of the growth of bank advances were indicated in the analysis of advances by all members of the British Bankers' Association at mid-May. Of the total rise of £179 million (excluding the nationalised industries) in the three months ended in May, advances to the three groups most closely concerned with consumer financing (retail trade, hire purchase finance companies, and personal and professional) accounted for £41 million, or 23%, a much larger proportion than in the previous quarter. Loans to "Other Financial" borrowers also rose sharply, while an unusual rise for the time of year in lending to local authorities can be partly explained by their loss of overseas funds; the same cause may also have contributed to the rise in lending to the hire purchase finance companies. Advances to many industries continued to grow, those to the chemical industry rising markedly.

The strong rise in deposits would have enabled the clearing banks to achieve their expansion of advances and still maintain, in aggregate, a liquidity ratio above 30% without reducing their investments. In fact their holdings of gilt-edged stocks fell by £102 million during the quarter, partly because some individual banks were protecting their liquidity ratios, partly because liquidity ratios were comparatively low for the time of year and partly, it seems, in anticipation of known or expected future commitments; some of the fall in investments was directly associated with the April redemption. The combined ratio of investments to gross deposits fell from 16·5% to 14·6% and the combined liquidity ratio rose from 30·4% to 32·2%. Of the increase of £207 million in liquid assets, £191 million was in Treasury Bills, Bank of England notes and coin; commercial bill holdings rose by £14 million.

The experience of the Scottish banks was similar, with deposits and advances rising; but whereas with the clearing banks gross deposits rose proportionately less than advances, with the Scottish banks the rise in gross deposits was in about the same proportion as advances. There was little change in their total of investments.

The higher level of deposits with the clearing banks and Scottish banks resulted in a substantial net acquisition of marketable government debt and Bank of England notes, despite the sales of gilt-edged stocks. Holdings of the banking system,[a] including a rise of £10 million in direct holdings of the Banking Department, were £108 million higher, compared with an increase of only £5 million in the corresponding quarter last year.

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

16th MARCH - 21st JUNE 1961

£ millions

Bank of England, Banking Department:		
Direct holdings ...	+ 10	
Indirect holdings[c] ...	—	+ 10
Clearing banks and Scottish banks:		
Treasury Bills ...	+177	
Gilt-edged Stocks ...	−103	
Indirect holdings[c] ...	+ 3	+ 77
Bank of England Notes		+ 21[d]
		+108

Exchequer The pattern of Exchequer financing in the fourteen-week quarter was strongly influenced by the large outflow of funds from the United Kingdom. The overall budget deficit, at £218 million, was much the same as in the comparable quarter of each of the two previous years; the effect of the extra week in June this year was roughly offset by the advance repayment of post-war debt by Western Germany in April. The West German debt repayment totalled £67½ million of which £22½ million was financed by the redemption of a Treasury Bond, not reflected in official overseas sterling holdings, and £45 million by drawing on these holdings. The lower budget deficit forecast by the Chancellor (now expected to be further reduced by the July measures) will not be fully apparent in the Exchequer figures until the main revenue quarter ending in March 1962.

The fall in the exchange reserves brought in sterling receipts of £131 million; there was a net payment of £38 million on account of other external items and a net receipt from extra-budgetary funds of £68 million. The last item

(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) This table is derived from Table 2 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 (net).

(d) Including some coin.

was swollen by the receipt of money both from the sale of the steel prior charges and from the new Post Office Fund; prior to the 1st April 1961 funds on the Post Office account were taken into the Budget.

The Exchequer's cash requirement therefore was only £57 million, much less than has been usual in this quarter. Holders outside the banking system reduced their holdings of government debt and Bank of England notes by £51 million so that the banking system financed total requirements of £108 million.

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

16th MARCH - 21st JUNE 1961

£ millions

Government debt		
Overseas official holders:		
Treasury Bills ...	+151	
Gilt-edged Stocks ...	− 28	+123
Other home and overseas non-official holders:		
National Savings ...	+ 53	
Tax Reserve Certificates	+ 33	
Treasury Bills ...	−202	
Gilt-edged Stocks ...	− 96	
Indirect holdings[c] ...	− 19	−231
Bank of England Notes		+ 57
		− 51

Overseas funds In spite of the advance debt repayment of £45 million by Western Germany,[d] there was an unusually large increase of £123 million in "Overseas official" holdings of marketable government debt during the banking quarter. This reflected both assistance received under the Basle arrangements and an unusually large rise, amounting to £117 million in the second calendar quarter, in the official sterling holdings of overseas sterling area countries,[e] for which a drawing equivalent to some £63 million from the I.M.F. by Australia was mainly responsible.

In sharp contrast, marketable debt held (directly and indirectly) by "Other home and overseas non-official" holders fell by £317 million, or £357 million if allowance is made for the effect of the Basle arrangements, following a decrease of £96 million[f] in the previous quarter. The total reduction of some £410 million[f] (or £450 million[f] allowing for Basle) in the first half of 1961 was about the same as the increase of just under £450 million[f] which had occurred in the second half of 1960. Holdings of Treasury Bills fell by £202 million during the quarter and it seems likely that the withdrawal of non-official overseas funds was responsible for the greater part of this amount, either directly, or at one remove, for example as a result of the withdrawal of deposits from overseas banks in London.

Other evidence of the withdrawal of overseas funds during the second quarter is to be found in a further fall, of £96 million, in non-official overseas sterling holdings:[g] these would have fallen further had it not been for the Basle arrangements. In addition acceptances outstanding for account of overseas residents rose by £12 million. These figures imply a substantial outflow in the second calendar quarter. For comparison with the fall in holdings of marketable government debt in the quarter 16th March—21st June, it is necessary to make some allowance for the difference in dates. Because of the heavy outflow which must have been taking place in the second half of March the total outflow of funds abroad, excluding

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

(b) This table is derived from Tables 1 and 2 of the Statistical Annex.

(c) Including some overseas official.

(d) The Treasury Bond held by Western Germany, which was redeemed during the period, is not included in marketable government debt.

(e) See Table 17 of the Statistical Annex.

(f) These figures exclude the temporary investment of £131 million in Treasury Bills on account of the Ford purchase.

(g) "Other funds" in Table 17 of the Statistical Annex.

official funds and long-term investment, between mid-March and mid-June was probably greater than in the calendar quarter and may have exceeded £200 million. Some of this, however, did not involve sales by overseas residents of marketable government debt. For example, although deposits of overseas residents with the overseas banks and the accepting houses[a] were little changed during the quarter, deposits denominated in currencies other than sterling increased and there was thus a net withdrawal of sterling deposits from these institutions. They in turn withdrew £33 million from local authorities and also reduced their holdings of Treasury Bills and other sterling bills.

Sales of government debt by non-official overseas holders made directly, and indirectly in the sense of funds withdrawn from the discount market, may together have accounted for around a third of the total reduction of £317 million in holdings of marketable government debt by the " Other home and overseas non-official " group. Withdrawals of non-official overseas money from other forms of employment, such as local authority debt or deposits with hire purchase finance companies or overseas banks, affect either bank advances or bank deposits, or are responsible at one or more removes for selling of government debt by " other home " holders; and if these secondary effects are taken into account, the outflow of overseas funds must be regarded as responsible for more than half of the above total of £317 million.

The private sector

The private sector's financial surplus in the second quarter of 1961 was probably slightly greater than it had been in the same quarter of 1960, the increase reflecting both a reduced deficit on current account in the balance of payments and a moderate increase in the financial deficit of the public sector. Between the first and second quarters of 1961, however, the private sector's surplus probably remained about the same, if allowance is made for seasonal factors, of which the most important is the uneven flow of revenue into the Exchequer.

Within the sector there are indications that the financial surplus of persons may have fallen slightly, with a compensating rise for companies. During the quarter personal savings may have been tending to fall, or at least to stop increasing, for there was a renewed rise in hire purchase expenditure; outstanding hire purchase debt increased, after falling in each of the three previous quarters. There was also a renewed increase in personal bank advances. While identified borrowing by persons was thus rising, net subscriptions to National Savings fell fairly sharply. The decline was particularly marked in National Savings Certificates, for which subscriptions were lower than usual and repayments higher, so that there was a net repayment in the quarter. This may have reflected a fall in the financial surplus of persons. It may also be that the yield on National Savings Certificates (allowing for tax exemption) no longer compared favourably with that offered by some other comparable forms of investment. Persons may therefore have been switching into local authority debt, hire purchase finance company deposits, equities or bank deposits. Personal subscriptions for Tax Reserve Certificates were maintained, in spite of the surtax concessions announced in the Budget, and there was little decline in net lending to building societies; net borrowing from them showed a small increase over the low level of the preceding quarter.

Companies' savings are unlikely to have risen during the quarter, as profits remained under pressure, but their financial surplus may have been increased slightly through a continued fall in the rate of stock accumulation. Bank advances to ' non-financial ' companies showed no signs of falling off and, as in the first quarter, these advances were supplemented by a considerable amount of bill finance. Capital issues continued to bring in funds at a high rate. With the recovery in hire purchase business and the outflow of overseas funds, hire purchase finance companies increased their borrowing from banks, and members of the Finance Houses Association also continued to add to their deposit liabilities. Some other financial institutions also borrowed more, both on capital issues (particularly investment trusts) and on bank advances. Subscriptions by companies for Tax Reserve Certificates were a

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

little below a year before, perhaps because of continuing pressure on their liquid reserves and possibly also because, in spite of the increase in profits tax, it may have been expected that lower profits would in many cases give rise to reduced tax liabilities.

There was thus some falling off in net sales of non-marketable government debt; this had been foreseen. In view of the pressures on liquidity generated by the Budget and reinforced by the changes in indirect taxation and the other measures announced on the 25th July, a continued decline in net receipts compared with the previous financial year may be expected.

The analysis above of the outflow of funds abroad, excluding official funds and long-term investment, led to the tentative conclusion that sales of marketable government debt by " other home " holders accounted for a substantial part, perhaps around two-thirds, of the total fall of £317 million in the holdings of the " Other home and overseas non-official " group. To some extent the sales by " other home " holders were no doubt indirectly due to withdrawals of overseas funds from them. But if the evidence is taken in conjunction with the more than seasonal rise in deposits with the clearing banks, it suggests that the private sector as a whole was switching during the second quarter out of gilt-edged stocks into bank deposits; the redemption of 2½% Funding Loan 1956/61 was an important factor. There is no direct evidence of such a switch, or of the relative importance of the part which may have been played in it by either companies or persons; but in the prevailing economic uncertainty some attempt by the private sector to increase its liquidity could be expected.

The fall of £19 million in indirect holdings of government debt by the " Other home and overseas non-official " group (and by some " Overseas official " holders) reflected an increase of £51 million in borrowing from the discount market on commercial bills less a rise of £28 million in lending to the discount market; the further £4 million reflected changes over the quarter in the discount market's other assets and liabilities. The market's holdings of government debt fell by £16 million despite an increase of £3 million in its borrowing from the banking system. The market's holdings of commercial bills rose by £94 million in the first six months of the year, an increase of 87%. This increase was due mainly to an increase in the total supply of bills but also, to some extent, to selling by the overseas banks. Towards the end of the period, when it became clear that interest rates were likely to move upwards rather than downwards, the discount market began to switch out of bonds into Treasury Bills, so that in the quarter as a whole its holdings of gilt-edged stocks fell by £33 million and its Treasury Bills rose by £17 million.

Most building society interest rates had last been changed in July 1960. During the following twelve months rates for competing forms of savings such as loans to local authorities and deposits with finance houses had risen, and building societies had consequently experienced a slower inflow of funds and a rise in the rate of withdrawals. Their desire to attract further funds, the increase in profits tax announced in the Budget and higher management expenses caused the Building Societies Association to recommend, on the 2nd June, that from the 1st October the rate of interest paid on ordinary shares should be raised from 3½% to 3¾% (income tax paid) and that charged on mortgages from 6% to 6½%. Most societies announced that they accepted this recommendation and many have already brought the new rates into effect.

In August the Finance Houses Association raised its maximum permitted charges by 1% and members have raised their actual charges by 1-1½%. In addition it was recommended that down-payments required for most vehicles less than three years old should be raised from 20% to 25%, and for vehicles over three years old from 25% to 33⅓%. These measures, recommended for commercial reasons, will reinforce the Government's restrictions on consumer spending and will help to prevent a rise in total outstanding debt during the second half of the year.