COMMENTARY

OCTOBER—DECEMBER 1961

During the fourth quarter of 1961 there was little further change in the total of output. Allowing for seasonal factors consumers' expenditure remained much the same. The volume of retail sales rose slightly in October, fell in November but rose again in December, the contrast between November and December seemingly being due to Christmas buying starting later than in earlier years. The fall in sales of new cars on the home market stopped about November and the long decline in second-hand car prices ended. On the other hand, there was an appreciable fall in consumers' hire purchase debt outstanding, as less new credit was taken.

Public authorities' current expenditure on goods and services probably continued to rise; earlier in 1961 this had been considerably higher in volume than a year before. Provisional figures indicate a fall in total fixed investment. Exports were unchanged. Retailers' stocks continued to fall more than is usual for the time of year though the effect of this, and of the fall in investment, on manufacturing output may have been offset by additions to manufacturers' stocks of finished goods. Allowing for seasonal factors, industrial production was a little below the level to which it had fallen at the end of the third quarter. There was a further gradual easing in the pressure of demand for labour although reports of shortages of skilled workers persisted.

Though the current level of output was unaltered, there is some evidence of a change about this time in the financing of industrial companies. Table 10 of the Statistical Annex shows that manufacturing industry was borrowing rather less from the banks in mid-November than in mid-August and Table 15C shows that net capital issues by quoted companies in manufacturing industry fell sharply between the third and fourth calendar quarters. Moreover, during the third quarter as a whole, industry must have obtained finance from overseas as a previous adverse leads and lags position was unwound, but this source may have been of less importance during the fourth quarter. Thus industry's total borrowing may have fallen between the two quarters.

This conclusion is somewhat conjectural. The argument is referred to in a little more detail on page 14 but it is subject to many reservations. For instance the comparisons made in the preceding paragraph cover different periods and refer to rather different categories of industry. Moreover, industrial companies might have increased their borrowing in other ways about which no information is available, for example from financial institutions (other than banks) or from individuals. Nevertheless, there is a presumption that industry did considerably reduce its net borrowing towards the end of last year; and it is pertinent to consider why this should have been so.

Three reasons, in practice interlocking, are suggested. First, it may be that during the fourth quarter the absence of any further fall in profits combined with largely unchanged dividend payments to reduce industry's total borrowing requirements. But it must be remembered that seasonal factors are likely to have reduced these requirements in this quarter and the underlying change may therefore have been small.

Secondly, it may be that industrial companies decided, or were obliged, to run down their liquid assets as pressure on bank advances made bank borrowing more difficult and as hopes of a fall in interest rates, combined with some uncertainty in the capital market made capital issues, temporarily at least, unattractive and difficult. Industry may have been the more content to follow this course if holdings of liquid assets had been enlarged by the considerable sums raised through new issues earlier in the year.

Thirdly, realisation of liquid assets and reduced borrowing may have reflected industry's views concerning 1962. If higher retained profits, reduced capital expenditure and little change in stocks were being expected by some sections then borrowing requirements would be less. Moreover, if a higher turnover were also being expected, any necessary borrowing might take the form of bank advances rather than capital issues. If this were so, existing credit restraint might lead companies to cover their requirements by running down liquid assets in the hope that bank advances would subsequently become more easily available. This is very uncertain and the general pattern could be upset either by the large-scale funding of bank advances by particular companies or by the building-up of depleted holdings of liquid assets. Nevertheless, there remains the possibility that this year there may be a markedly smaller volume of industrial new issues than there was last year.

Financial institutions

The publication in December of the analysis of advances by members of the British Bankers' Association showed which borrowers had most reduced their advances during the three months ended mid-November. Advances, other than to the nationalised industries, had fallen in this period by £223 million, the largest absolute quarterly reduction recorded since this series of statistics was begun in 1946. Of this total, some £120 million seems to have been due both to seasonal influences and to a reclassification of assets by the clearing banks and Scottish banks, whereby loans to some financial borrowers were transferred to the item " Money at call and short notice ". The underlying fall of about £100 million contrasted sharply with an average underlying increase of about £100 million in the three preceding quarters.

In line with official requests, much of the reduction in advances affected borrowers concerned with the financing of personal consumption; in contrast there was only a moderate fall in the level of advances to manufacturing industry. Proportionately the largest significant reductions were in advances to local authorities, which fell to their lowest level for almost four years, and to hire purchase finance companies. Both were able to finance some part of their repayments by increased short-term borrowing from the public and from overseas; up to the end of November the relationship of interest and forward exchange rates made it profitable for holders of foreign currency deposits to switch into sterling and lend the proceeds to these two groups of borrowers.[a] Advances to the personal and professional category also fell sharply and, in contrast with the usual seasonal increase, there was a reduction in advances to the retail trade whose stocks, partly in consequence, increased less than usual during this period.

The underlying fall in advances by the clearing banks was reduced in the month ended mid-November and then ceased. In the month ended mid-January there was an underlying increase. Within that month, advances rose sharply up to the end of December and then fell during the next fortnight; this may reflect the usual end-year withdrawal of funds by overseas holders for balance sheet purposes and their subsequent return, though this year the movement in advances within this month was larger than in 1960-61. This complication made it difficult in early February to tell whether the trend in clearing bank advances had changed and turned upwards. The decline in advances by the Scottish banks ceased after mid-October but during the fourth calendar quarter the overseas and foreign banks and the accepting houses, taken together, continued to contract their advances to U.K. residents and to increase their loans to local authorities and the money market.

The fact that advances fell sharply in the months immediately after July but, seasonal factors apart, were running level towards the end of the year, reinforces the earlier impression that many repayments were financed both through the reversal of the previous unfavourable leads and lags position, and through the high level of new issues. Nevertheless, the pressure exerted by the banks, and the high cost of bank accommodation, had the effect of substantially reducing advances to several categories of borrower unaffected by the above factors; and this was, in particular, one of the influences behind the reduction in stocks held by the distributive trades.

During the three months mid-October to mid-January net deposits with the clearing

[a] See graph on page 71.

banks, after seasonal adjustment, seem to have stopped falling and may even have begun to rise. Over the first four months of 1961 they rose (as adjusted) by over £300 million; during May and June remained level; and during the third quarter fell by over £150 million. The underlying fall in deposits during the second half of 1961 was greater than the underlying fall in advances. The clearing banks made some further purchases of gilt-edged stocks between mid-October and mid-January but on a declining scale. The seasonal increase in liquid assets was invested mainly in Treasury Bills and in increased money at call; and their combined liquidity ratio was 36·1% in mid-January, three points higher than a year earlier. Some sluggishness in tax payments, possibly aggravated by postal delays, may have swollen this figure. But taking into account the redemption in February of their holdings of $4\frac{1}{2}$% Conversion Stock 1962, it seemed that the clearing banks as a whole would have little difficulty in maintaining their combined liquidity ratio above 30%, without sales of gilt-edged stocks, during the main revenue quarter; although the position of individual banks could be less comfortable.

The hire purchase finance companies repaid bank advances partly by attracting additional deposits and partly through a reduction in the total debt owed to them.[a] Deposits with members of the Finance Houses Association rose by £38 million between the end of July and the end of September, but then changed little until the end of November. In December they fell sharply, probably mainly because of end-year withdrawals of overseas funds for they rose again by a similar amount in January. Nevertheless, the decline in the debt owed to these companies reduced their need to borrow; and in November several reduced the rates of interest offered on deposits by rather more than the $\frac{1}{2}$% by which Bank Rate was reduced on the 2nd November.[b]

Money and capital markets

At the tender, the average rate of discount for three-month Treasury Bills fell slowly, from $5\frac{7}{16}$% on the 3rd November to $5\frac{5}{16}$% in the middle of December, despite heavy market borrowing from the Bank. There was a widespread opinion that a further reduction in Bank Rate would be made early in 1962, which maintained the demand for Treasury Bills. The discount houses, particularly those companies which were due to publish an annual balance sheet early in the new year, were concerned to meet this demand without a drastic fall in their own Bill holdings, and wished to show a holding of Bills approximately equal to, or rather greater than, holdings of bonds. A falling Treasury Bill rate, a normal effect of the discount market's efforts to increase its total Bill portfolio, can often raise the prices of short bonds and thus increase the market value of the discount market's bond holdings. This did not occur at the end of 1961 when the general uncertainties, which are referred to below, prevented any upward movement in bond prices.

Balance sheet influences became less important towards the end of December and the discount market's desire to obtain a particularly high proportion of the Bills on offer at the weekly tender became less noticeable. The Treasury Bill rate then rose slightly, as continued borrowing from the Bank began to have a significant effect on the average cost of the funds borrowed by the discount market and so reduced the margin between the cost of money and earnings on Bills. Between mid-October and mid-December the Bank made advances to the market on twenty-five days, the gross amount advanced being nearly £170 million.[c]

(a) Changes shown by the statistics for debt owed to members of the Finance Houses Association and their deposit liabilities may not match changes in bank advances to hire purchase finance companies as shown by the analysis of advances by members of the British Bankers' Association. Discrepancies may arise from several causes the more important of which are:

(i) Differences in timing: the quarterly figures for advances are mid-month whereas the deposit and debt figures are end-month.

(ii) Differences in coverage: the advances figures cover some hire purchase finance companies which are not members of the Finance Houses Association.

(iii) Figures for block discounts are not included in the figures for debt owed to the members of the F.H.A.; but in those for debt owed to retailers.

(iv) Hire purchase finance companies obtain a varying proportion of their funds from bill finance.

(b) See Table 13 of the Statistical Annex.

(c) See Table 6 of the Statistical Annex.

Up to the 2nd November demand for gilt-edged stocks had been encouraged by expectations of a reduction in Bank Rate and by the inflow of overseas funds which had developed during October. After the change in Bank Rate, prices remained firm for a time but then, despite a sharp decline in the amounts being raised on the capital market by industrial and commercial companies, tended to fall. This seems to have been due to renewed uncertainties about economic prospects and to the events in the exchange markets at the end of November which are discussed below. In the second half of November the authorities became significant net purchasers of gilt-edged stocks for the first time since July, mainly owing to their heavy buying of $4\frac{1}{2}\%$ Conversion Stock 1962, which was to mature in February. Nevertheless, during the quarter to mid-December net official sales of stocks totalled £183 million, of which two thirds were short bonds. Over three quarters of the total net sales had been made by mid-October.

Terms for the conversion of £758 million $4\frac{1}{2}\%$ Conversion Stock 1962 were announced early in December. They caused a revival of interest in short and medium-dated gilt-edged stocks, whose prices then rose. In replacement of the maturing stock, £300 million 6% Conversion Stock 1972 and a further £200 million of $5\frac{1}{2}\%$ Funding Stock 1982/84 were issued. The decision to offer a conversion for only part of the maturing stock was interpreted in some quarters as implying that the authorities might absorb or redeem government stock and, in consequence, that any rise in gilt-edged prices might not meet resistance from official sales. But the effect of this interpretation was short-lived and during the second half of December the fall in prices was resumed until, at about the end of January, there was a sharp recovery. Yields on most stocks fell between mid-October and mid-January but those on undated stocks rose slightly. Demand for long-dated stocks was concentrated on $5\frac{1}{2}\%$ Treasury Stock 2008/12, then the most recently issued of these, which was being sold at a yield somewhat above those of the nearest comparable stocks; departmental selling of this stock ceased in the middle of January.

The foreign exchange market

Sterling continued in steady demand during the greater part of the three months November to January, although the rate against the U.S. dollar fell slightly over the period. The inflow of funds which was taking place in October seems to have declined sharply in November. At the time of the change in Bank Rate on the 2nd November there was a sharp fall from $5\frac{21}{32}\%$ to $5\frac{11}{32}\%$ in the market selling rate for U.K. Treasury Bills; rates offered by U.K. local authorities for three months' deposits fell by $\frac{1}{4}\%$ and rates on deposits with finance companies were also reduced.[a] During November the rate for Treasury Bills in New York rose steadily and there was little change in the discount on three months' forward sterling; so the margin in favour of investment in London, both covered and uncovered, was reduced.

Sterling came under brief but strong pressure at the end of November and the beginning of December partly owing to rumours, soon proved wholly groundless, that the Italian lira would be revalued. For a short time turnover in the exchange markets was very heavy. Sterling was supported by large official sales of dollars; but the exchange rate against the U.S. dollar fell sharply from $\$2{\cdot}81\frac{15}{32}$ on the 29th November to $\$2{\cdot}80\frac{15}{16}$ on the 1st December. By the 4th December, following second thoughts in the market, the selling of sterling had largely stopped. This episode was a significant illustration of the doubts and uncertainties that still existed in the exchange markets as a result of the upheavals of March 1961.

Much of the selling of sterling which took place at the beginning of December seems to have been undertaken by professional operators abroad. It partly took the form of outright forward sales and, in consequence, the discount on forward sterling rose, and the rate for spot sterling fell as the counterparties protected their positions. It also took the form of swap operations whereby the operators in effect borrow sterling and sell it spot, leaving themselves with a holding of another currency against their forward liability to repay in sterling. In these cases the rate for spot sterling is depressed by the original speculative sale

(a) See Table 13 of the Statistical Annex.

and the 'swap margin' (the rate charged for a spot sale of sterling against a forward repurchase) is affected by the borrowing transaction.

The improvement in sterling, after the flurry at the beginning of December, was interrupted by end-year movements of funds in the week immediately preceding Christmas. The rate against the U.S. dollar then fell again and some small-scale support was provided by the authorities. These end-year movements, which appeared to be heavier in 1961 than in previous years, mainly consisted of the withdrawal of foreign currency deposits from London.[a] The spot rate for sterling was immediately affected by the reversal of switches of foreign currency deposits into sterling which had not been precisely matched by forward purchases, and also, within the limits permitted, by purchases of spot dollars needed to repay dollar deposits in cases where the deposit-taking bank had been unable to match precisely the period of deposit with the period of an on-lending in foreign currency. The withdrawal of funds from London, and the simultaneous and seemingly much larger withdrawals of dollar balances from the "Euro-dollar" market, contributed to fluctuations in the reserves of some West European countries. For instance the West German official reserves rose during December by some £130 million as funds were repatriated by the West German commercial banks for balance sheet purposes; once this purpose had been served the banks again increased their investments abroad. Seasonal movements helped them to do this by more than the amounts previously withdrawn; and in the first three weeks of January the West German official reserves fell by some £275 million.

The withdrawal of foreign currency deposits from London in December for end-year reasons caused the rate offered for such deposits to rise sharply[b] and it ceased to be profitable to switch them into sterling and employ the proceeds in loans to U.K. local authorities, all the more so as the latter had earlier reduced their own borrowing rates. This may, in turn, have led to a larger unwinding of previously-switched foreign currency deposits than would have been required by the withdrawal of currency deposits alone. Certainly the proportion of foreign currency assets held by banks in London to their foreign currency liabilities increased during December which helped to confirm that the previous switching of some foreign currency deposits into sterling was reversed.

By contrast during December there may have been some inflow of longer-term investment funds associated with American buying of British equities, in particular the shares of Unilever Limited which were dealt in on the New York stock exchange for the first time in December. The rate for security sterling rose into line with external sterling and some buying of the latter for investment purposes was reported. But this inflow was less than the end-year withdrawal of short-term funds.

In the first few days of January demand for sterling revived, as some of the money withdrawn before the end of 1961 was re-deposited in London, and there was some switching into sterling. Some mid-week sales of sterling then developed in anticipation of a reduction in Bank Rate but otherwise sterling remained in demand; the demand increased markedly in February and the rate reached \$2·81$\frac{19}{32}$ on the 19th February.

The impression gained from the foreign exchange market that the inflow of funds slackened during November is strengthened by the fact that the amount of sterling held by non-official holders outside the sterling area increased only very slightly during that month. In December there was again very little change; West European holdings fell, but not by as much as might have been expected over the turn of the year. This small end-year fall in non-official holdings was in general not matched by a corresponding increase in the balances of official holders.

[a] It seems that deposits denominated in U.S. dollars were not much affected at this time by U.S. proposals to amend Regulation Q. This Regulation sets maximum limits to the rates of interest that may be paid by U.S. domestic banks for time and savings deposits. So far as time deposits are concerned the limits between 1957 and the end of 1961 had been 1% on deposits for less than ninety days, 2½% on deposits between ninety days and six months and 3% on longer-term deposits. On the 1st January 1962 the limits for longer-term time deposits were raised so that up to 3½% could be paid on deposits for between six months and one year and 4% on deposits for one year or more.

[b] See page 70 of the Statistical Annex.

Gold market Demand for gold on the London market, which had risen steadily during the third quarter, fell away after the middle of November. Nevertheless, while there were few purchases by central banks on the London market during the fourth quarter, private demand was enough to absorb not only all new production and some other selling but also sales made by the U.K. authorities to prevent the price rising sharply. The price of gold coins is in normal circumstances a sensitive indicator of private demand for gold and in January gold coins, other than the sovereign, were being dealt in at the highest premiums over the value of their gold content that have been recorded in recent years.

Private buying of gold was briefly stimulated by the announcement at the end of November of the suspension of sales of silver by the U.S. Treasury at a fixed price. At the same time it was proposed that the silver backing to a part of the U.S. note circulation should be withdrawn, and this reduced, though by a smaller amount,[a] the U.S. stock of gold currently available for settling international transactions; but these changes had no more than a transient effect on the gold price. The disturbances in the exchange markets at the beginning of December had no noticeable effect on the gold market but there was some rise in demand at the end of the month associated with international tension in the Middle and Far East. It was only on the occasion of these temporary disturbances that official intervention in the market was required on any significant scale; the price fell from the equivalent of \$35·19$\frac{19}{32}$ per fine ounce at the end of October to \$35·15 at the end of December. In January demand became stronger and there was a steady rise in the price, associated with the Algerian situation, to \$35·16$\frac{3}{4}$ on the 19th January. In February the price fell as private demand slackened, largely it seems because of less anxiety about Algeria. Later there was some active selling; the source of which was not known although Soviet offering was suspected in the market and at the end of February the price had fallen to \$35·08$\frac{1}{2}$ and the prices of gold coins were also sharply lower.

International Monetary Fund By the end of December 1961 the large movements of short-term capital which had been a feature of the international payments situation since the summer of 1960 had diminished, at least temporarily. In the summer and autumn of 1960 they had been met primarily by movements in gold and exchange reserves. In 1961, borrowing, first under the Basle arrangements and later from the International Monetary Fund, enabled the United Kingdom to meet a large capital outflow without a corresponding fall in the published reserves.

The I.M.F. had been established, and for some years had operated, in a period when an outstanding feature of the international payments scene was a relative scarcity of U.S. dollars. In this situation members were able to overcome temporary difficulties in their balances of payments by drawing U.S. dollars from the Fund without adversely affecting the strength of that currency. The events of 1960 and 1961 made it clear that the Fund's resources needed reinforcement if it were to function adequately in a period when there was no scarcity of U.S. dollars and if it were to help the present international payments system to withstand strains in the future. For although its resources were adequate to finance the type of transactions it had undertaken in the past, they were insufficient to meet large-scale international movements of short-term funds adversely affecting both sterling and the U.S. dollar simultaneously, or even, in some circumstances, the U.S. dollar alone.

On the 5th January 1962 the I.M.F. announced that arrangements, which have now to be ratified by all the countries concerned, had been made for it to obtain additional resources in certain circumstances. Ten countries are expected to participate in the arrangements, the total of their maximum commitments being the equivalent of \$6,000 million. The commitments of the United States and the United Kingdom together total \$3,000 million. Thus, in the event of a drawing by one or other of these two countries in conditions where it would be undesirable that the currency of the other should be drawn, there would still be

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(a) 100% cover is required for silver certificates, whereas the gold cover for Federal Reserve notes is 25%. Silver certificates totalling \$1,494 million are to be withdrawn. The maximum amount of gold that may have to be set aside for this purpose is therefore no more than \$373 million.

$3,000 million of the extra resources available. The countries concerned and the maximum amounts of their own currencies which they might be called upon to lend are:

	Equivalent in U.S. $ millions
United States	2,000
United Kingdom	1,000
Western Germany	1,000
France	550
Italy	550
Japan	250
Canada	200
Netherlands	200
Belgium	150
Sweden	100

If the Fund receives from one of these countries an application for a drawing or a standby facility, made necessary by a threat to the international payments system, which requires resources additional to those already available to the Fund, it will seek to borrow under these arrangements. Loans will be made to the Fund if after consultation the participating countries agree on the need for them, but only to the extent that these countries' reserves and balance of payments positions permit.

These important additional resources will enable the Fund to fulfil more effectively its role in promoting the stability of the international payments system, with benefit to all countries. The new arrangements do not preclude the possibility that any future major disturbance in the exchange markets may be met initially by co-operation between central banks.

Balance of payments

In the fourth quarter there was probably a small surplus on the visible trade balance (as recorded on a balance of payments basis[a]) but the improvement was less than might have been expected at the time of year. As recorded in the trade accounts, seasonally adjusted, imports rose in the fourth quarter by some $1\frac{1}{2}$% in value and exports fell by about $1\frac{1}{2}$%. The fall in imports of industrial materials ceased. Unexpectedly, imports of finished manufactures were also little changed but those of fuels and food rose. The fall in the value of exports was mainly due to lower deliveries of ships which had been exceptionally large in the third quarter. Exports of engineering capital goods failed to increase; and though revised figures showed that outstanding export orders for these goods had increased, the trend of new orders has yet to give any convincing sign that a large and sustained increase in exports is imminent. Exports of this type will be helped by the new arrangements for the provision of medium-term finance for exports of capital goods, at fixed rates lower than those previously prevailing. These arrangements, which are described on page 23, and the facilities announced by the Bank of England in February 1961 and by the Export Credits Guarantee Department in April 1961 and February 1962 should put British exporters at least on a comparable footing with their main overseas competitors.

The January trade figures showed that the trade gap, seasonally adjusted, had increased during that month by some £20 million compared with the average for the fourth quarter of 1961. Most main categories of imports rose, and imports of machinery resumed their earlier rise. There was no sign of an overall improvement in exports, though those of cars rose.

The deficit on visible trade may have been about one third the figure for 1960; the improvement was due rather more to higher exports than to lower imports. The rise in exports came in the first quarter and thereafter the trend was about level. The principal fall in imports was in industrial materials, partly a consequence of a much reduced rate of stockbuilding.

Conditions abroad still favour a growth in exports during 1962. In the past growth of production in the main industrial countries seems to have been accompanied by a similar increase in the volume of world trade, and the

[a] The main differences between the balance of payments and trade figures are that (i) imports are valued c.i.f. in the trade accounts but converted to an f.o.b. basis in the balance of payments estimates as these show insurance and freight payments to overseas countries under the separate heading of invisibles and payments to U.K. companies are excluded; (ii) some items are excluded from both imports and exports in the trade accounts whereas the balance of payments estimates attempt a complete coverage. For further details see page 17 of this Bulletin and " United Kingdom Balance of Payments 1958 to 1961 ", Cmnd. 1506, page 27.

volume of U.K. exports has tended to expand with world trade, though less rapidly. In 1961 the volume of world trade was 5% higher than in 1960 and U.K. exports went up by 3%. The decline in the United Kingdom's share of world trade was considerably smaller than in 1960.

It seems that the increase in world trade during 1962, as a whole, may be larger than it was in 1961. The reduction during the third quarter of 1961 in the rate of growth of output in the United States proved to be only temporary. Output there grew appreciably during the next three months and seems likely to continue to grow during the first half of 1962, although the rate of expansion may slow down towards the end of the year. Over the turn of the year there were also signs of increased production in Western Germany, France and Italy; in Western Germany this was partly due to a renewal of stockbuilding. Earlier the rate of expansion in Western Europe had been checked by labour shortages and, in Western Germany, by a reluctance to maintain stocks. In general a further growth of output in Western Europe is likely in 1962.

During the fourth quarter the faster growth of output in the United States helped to check the fall in world prices of industrial raw materials which had proceeded in the third quarter. The prospect of increased output in the United States and Western Europe suggests that the volume of exports of these materials by primary producing countries will grow and that no further fall in prices will take place. Incomes of primary producing countries as a whole may therefore grow sufficiently to allow them to expand their imports again after the fall during 1961. This could be particularly important for the United Kingdom.

Success for the Government's policy on incomes would make it possible for changes in costs to favour U.K. exporters against their main competitors in Western Europe. Even so a continuation, and perhaps intensification, of the efforts being made by manufacturers to devote more attention to export markets will still be required.

The domestic economy

Looking forward in February it seems that some increase in consumers' expenditure has to be expected before long. In the third and fourth quarters total personal incomes were growing only slowly, because there were few rises in wage and salary rates, employment was no longer rising so fast and there was a fall in average weekly hours worked. By January, however, pay claims were outstanding for a large proportion of the working population. Some limited increase in personal incomes has therefore to be expected by the summer. In addition an unusually large number of outstanding hire purchase contracts are due to run off in 1962. Income previously committed to repayments on hire purchase contracts will therefore be released for new commitments which, within the limits of the total credit available, may help to revive demand for cars and other durable goods or else may lead to increased spending on other goods.

The upward trend of total public expenditure seemed to have continued during the fourth quarter and further growth is expected. Supplementary estimates for the current year now total £248 million. The estimates for 1962/63 total £5,611 million, an increase of £384 million on a comparable basis over the budget estimates for 1961/62. In October it was announced that public investment would grow over the same period by 5% at constant prices.

A survey published by the Board of Trade during January suggested that private industry as a whole had made little change since July 1961 in the value of its investment planned for 1962, despite the greater uncertainty about the economic outlook which had developed during the autumn. The survey indicated that manufacturing industry expected to invest much the same in 1962 as in 1961. But as investment in this sector had been rising during most of 1961, this implied that there might well be a falling trend in 1962, primarily due to reduced investment by the steel and motor industries. In so far as this change in trend affects investment in machinery the supply of capital goods available for export should increase. This survey, taken together with the flow of orders for new building, suggested that a continued rise would occur in investment in distribution and other services. Indications are that the number of houses on which private builders begin construction in 1962 will be much the same as in 1961 though as between the two years the number of houses completed may rise.

The course of output in the months immediately ahead will depend to an important extent on the rate of stockbuilding. Retailers' stocks continued to fall more than usual during the fourth quarter but it seems that manufacturers' stocks of finished goods are still growing. The effect on output of rises in private consumption, public expenditure and exports, and any rebuilding of stocks by wholesalers and retailers, may therefore be delayed by a reduction in manufacturers' stocks of finished goods. Nevertheless, a revival in total stockbuilding can most likely be expected later this year or, at least, early in 1963.

Looking a little further forward it is clear that the resumption of economic growth will only be securely based if it is led by an increase in exports, both because of the continuing need to strengthen the balance of payments, and because renewed expansion will lead to a rise in imports. Growth based on faster expansion of public expenditure or private consumption alone will be likely to impair the progress so far made in restoring external balance.

QUARTERLY ANALYSIS OF FINANCIAL STATISTICS

21st September—13th December 1961

Exchequer The overall budget deficit was £274 million in this period, £25 million less than in the corresponding quarter of 1960. Up to mid-December there was little sign of the large reduction in the budget deficit forecast for 1961/62 last April. The increase in revenue expected from the fiscal measures of last July was less than the total of supplementary estimates published in July, in December and in February. Nevertheless, the budget surplus in the current revenue quarter is still expected to be larger than that in either of the last two years.

Net expenditure at home out of extra-budgetary funds (£7 million) and net sterling expenditure, outside the Budget, on external account (£132 million) raised the Exchequer's total cash requirement to £413 million. This total was not affected by the repayments of £150 million to the International Monetary Fund which took place during the period.

Of the total cash requirement of £413 million, £260 million was met by Exchequer borrowing outside the banking system.[a] This was in sharp contrast with the previous two quarters, when there had been moderate net repayments of debt held outside the banking system. The change was probably largely due to an inflow of overseas funds (considered in more detail below). This inflow, by provoking official purchases of foreign exchange, in contrast with net sales in the previous quarter, increased the Exchequer's cash requirement. At the same time the sterling proceeds of foreign currency sold in London tended to increase the demand for government debt, so that the inflow itself helped to finance the enlarged Exchequer deficit.

Estimates of the net acquisition of government debt and Bank of England notes outside the banking system are given below:

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

21st SEPTEMBER - 13th DECEMBER 1961

£ millions		
Government debt		
Overseas official holders:		
Treasury Bills ...	− 38	
Stocks	− 47	− 85
Other home and overseas non-official holders:		
National Savings ...	− 7	
Tax Reserve Certificates	+ 96	
Treasury Bills ...	− 46	
Stocks	+126	
Indirect holdings[d] ...	+103	+272
Bank of England notes		+ 73
		+260

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

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

(d) 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). This figure includes some overseas official holdings.

As in the previous quarter, there was a net repayment of National Savings; this cost the Exchequer £7 million whereas in the corresponding quarter of 1960 National Savings had contributed £43 million. Results for all forms of National Savings compared unfavourably with those for a year earlier, but the decline was again most marked in Defence Bonds and National Savings Certificates. Although the yields on some competing outlets for personal savings fell during the quarter, those on some medium-dated gilt-edged stocks, on local authority mortgages and on deposits with hire purchase finance companies still appeared high enough to be effective counter-attractions. There was a marked increase in net subscriptions to Tax Reserve Certificates which began after the rate of interest on them was raised from 3% to 3½% (tax free) on the 12th August and continued until it was reduced to 3¼% on the 25th November.

Overseas funds

"Overseas official" holdings of marketable government debt (Treasury Bills and stocks) fell by £85 million. This was partly due to repayments of Basle support in late September and early October; excluding these repayments the fall in "Overseas official" holdings of government debt was £53 million.[a]

Excluding repayments of Basle support (£15 million), "Other home and overseas non-official" holders directly or indirectly acquired £198 million of marketable government debt, compared with £28 million in the previous quarter. There is little doubt that an inflow of non-official funds from overseas was the main factor making these net purchases possible. Recorded non-official overseas holdings of sterling rose during the fourth calendar quarter by £42 million. Most of this increase occurred in October; in that month there was also some switching of foreign currency deposits into sterling, but this was reversed before the end of December. In addition, it seems likely that during the quarter there was some inflow of capital in other forms, not all of it necessarily short-term. The inflow of non-official overseas funds appears to have been heavy in the early part of the period and to have diminished towards the end. The total amount coming in between mid-September and mid-December was therefore greater than in the calendar quarter and may be very roughly estimated as about £150 million.[b] Not all of this affected the market for government debt, but probably most of it had some effect, if only by enabling home holders to acquire, or retain, more government debt than they otherwise would have done. Thus, "other home" holdings of marketable government debt may have risen a little, apart from increases which may be attributed to the receipt of funds from overseas.

The strength of the rate for security sterling, and market reports as well, suggest that there were overseas purchases of long-term securities, some of which may have been gilt-edged stocks. In addition, the expectation of falling yields, particularly in October (between the two changes in Bank Rate), seems to have caused a general improvement in demand; and it is likely that both overseas and home purchasers contributed to the total of £126 million of stocks acquired by the "Other home and overseas non-official" group. On the other hand, some part of the inflow of overseas funds may be supposed to have gone into Treasury Bills. The decrease of £31 million (excluding Basle support) in the Treasury Bill holdings of the "Other home and overseas non-official" group may therefore conceal some increase in the overseas component, offset by a larger reduction in "other home" holdings. This tentative conclusion fits well with the suggestion put forward below that 'non-financial' companies may have been running down their liquid assets in this period (see page 14).

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[a] The repayment at the end of December of £17½ million to Switzerland on account of Basle assistance fell outside the period under consideration.

[b] This calculation covers the total inflow on private account, including not only funds for investment purposes, but also the reversal of leads and lags, unidentified movements on inter-company accounts, etc. It will be clear from the article on page 16 that this calculation, where it entails interpreting the "Balancing item" in the balance of payments estimates, must be liable to considerable error.

Exchequer borrowing from the banking system The remaining £153 million of the Exchequer's cash requirement was met by borrowing from the banking system as follows:

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

21st SEPTEMBER - 13th DECEMBER 1961

£ millions

Bank of England, Banking Department:		
Direct holdings ...	− 65	
Indirect holdings ...	+ 38	− 27
Clearing banks and Scottish banks:		
Treasury Bills	+ 28	
Stocks	+ 58	
Indirect holdings ...	+ 36	+122
Bank of England notes[b]		+ 58
		+153

The Banking Department's direct lending to the Exchequer fell by £65 million, of which £38 million was the counterpart of the rise in the Department's lending to the discount market. The remaining decrease of £27 million was associated with a seasonal reduction in the clearing banks' balances with the Bank of England as holdings of notes were built up in preparation for the Christmas demand. The counterpart was a rise in the clearing banks' holdings of notes and coin. The clearing banks' and Scottish banks' direct and indirect holdings of government debt rose by £122 million.

Net deposits at the clearing banks rose during the quarter by £24 million, probably only a little less than seasonally. Their advances to the private sector fell by £115 million, but it seems that all but about £20 million of this was due to seasonal factors and to a reclassification of certain assets. The clearing banks' holdings of commercial bills fell by £4 million, against a probable seasonal tendency for them to rise in this quarter. The moderate increase in deposits combined with a fall in advances helped the clearing banks to add £128 million to their direct and indirect holdings of marketable government debt. This increase, like the changes in deposits and advances, was probably mainly seasonal, and for the first quarter since 1958, it included a net purchase of gilt-edged stocks (£71 million). The combined liquidity ratio nevertheless rose from 34·3% to 35·3%, partly because of the reclassification as liquid assets of certain items previously included in advances.

Both net deposits at and advances by the Scottish banks fell during the quarter. Unlike the clearing banks, the Scottish banks sold gilt-edged stocks (£13 million) and their total holdings of marketable government debt fell by £6 million.[c]

Part of the net increase in the banks' holdings of government debt was attributable to an increase of £36 million in loans to the discount market. The discount houses also borrowed an additional £61 million from other sources outside the banking system, mainly overseas banks, and at the same time reduced their holdings of commercial bills by £38 million. So, allowing for minor changes in their other assets and liabilities, their net borrowing outside the banking system (as defined) rose by £103 million, and their total net borrowing both inside and outside the banking system rose by £177 million. The counterpart of this was a rise of the same amount in their holdings of government debt (a large increase is usual in this quarter of the year). This consisted of £46 million of short-term gilt-edged stocks, all acquired in the earlier part of the period, when short-term interest rates were expected to fall, and £131 million of Treasury Bills.

Private sector If some allowance is made for seasonal factors, the financial surplus of the private sector as a whole in the third quarter of 1961 was probably about the same as in the second quarter. In both quarters the private sector's surplus was substantially greater than a year before. The main reasons for this were a higher rate of personal saving and a lower rate of stock accumulation; these were together more than enough to offset a rise in expenditure on fixed capital.

[a] This table is derived from Table 2 of the Statistical Annex.
[b] Including some coin.
[c] Recent banking statistics are discussed more fully earlier in this Commentary. See page 4.

Within the private sector, there are indications that the financial surplus of persons fell rather more than seasonally in the third quarter. Estimated personal savings fell from the unusually high level of £695 million in the second quarter to £454 million in the third. This decline was about £75 million greater than the estimated seasonal movement and therefore implies some underlying fall in personal savings, and probably also in the financial surplus of persons. It is possible that the financial surplus of companies, which had for some time been at a low level, began to rise a little in the third quarter; if so, the change must be attributed mainly, if not wholly, to reductions in the level of stocks by companies in the distributive trades.

Preliminary estimates of the private sector's financial transactions in the fourth quarter of 1961 suggest that the total financial surplus in that quarter was again higher than a year before. Part of the rise was absorbed by a slightly greater increase in net claims on the banking system (because of the changed trend of advances). The remainder may have been absorbed either by an increase in net lending to the public sector compared with a year before, or by reduced net private borrowing from overseas, or both; it is not possible to be more specific, because of the uncertainty about the size and composition of the inflow of overseas funds.

Among the financial transactions of persons in the fourth quarter, the main identifiable change was a reduction of £18 million in their hire purchase and other instalment debt, which in the previous quarter had been little changed. Bank advances to persons also probably fell in the fourth quarter; and there was a further reduction in net borrowing from building societies. Total borrowing by persons during the fourth quarter may thus have been less than in the third; and it is probable that persons also added less to their financial assets. There was a net reduction of £7 million in the amount invested in National Savings (about the same reduction as in the third quarter, but contrasting with an increase of £43 million in the fourth quarter of 1960). Net lending to building societies on shares and deposits rose seasonally and was probably about the same as in the corresponding quarter a year earlier. Finally it must be presumed, in view of the fall in new capital issues, that persons spent less than in the previous quarter on equities and other company securities.

The rate of identified new borrowing by 'non-financial' companies was again reduced in the fourth quarter, when there was probably an absolute fall in bank advances to companies and also in their use of commercial bill and hire purchase finance. New capital issues by 'non-financial' companies fell sharply (from £163 million in the third calendar quarter to £45 million in the fourth, but the contrast between the quarters ended mid-September and mid-December was less marked). The lower rate of identified borrowing may have been accompanied by a reduction in companies' liquid assets. Although companies took up more Tax Reserve Certificates, because of the favourable rate of interest offered for most of the period, this could have been offset by reductions in other liquid assets, for example Treasury Bills, temporary loans to local authorities, or deposits with hire purchase finance companies.

Another possibility is that the fall in borrowing by 'non-financial' companies was due to a fall in their total need for credit. This could be due to a temporary, and perhaps merely seasonal variation in the level of retained profits. On the other hand there is reason to believe that in 1962 stockbuilding may be low for a time and that expenditure on fixed capital will be falling. Profits may also recover from recent low levels, if total demand and output begin to expand in 1962, as seems likely. In such circumstances the financing requirements of companies might continue for some time to be less than they were in 1961 and new capital issues in particular would continue to be on a smaller scale. Such statistics as there are for the fourth quarter of 1961 could be regarded as consistent with the beginning of such a phase.

In contrast with 'non-financial' companies, the new capital issues of financial institutions (excluding the banking system[a]) rose further

[a] "Banking system" in this analysis means only the London clearing banks, the Scottish banks and the Banking Department of the Bank of England.

in the fourth quarter, when they exceeded £50 million, of which the greater part was for insurance companies. Hire purchase finance companies raised no new capital, but on the contrary reduced their indebtedness both to banks and depositors. The finance companies' assets, *i.e.*, the hire purchase debt due to them, fell at the same time by £32 million.

The overseas and foreign banks and the accepting houses, as in the previous quarter, increased their holdings of short-term assets in London. Although their holdings of Treasury Bills fell by £23 million, their balances with other banks rose by £62 million, perhaps for end-year balance sheet reasons, and their loans to local authorities by £40 million; the latter may help to explain the fall between mid-August and mid-November in advances to local authorities by members of the British Bankers' Association. The overseas and foreign banks and the accepting houses also bought £13 million of gilt-edged stocks. The resources for these additions to their assets were found through a reduction in advances and an increase in deposits. As a group they reduced their advances to overseas residents by £30 million in the fourth calendar quarter. Deposits of overseas residents rose by £6 million (a fall in foreign currency deposits being offset by a rise in sterling deposits). These institutions' net overseas lending thus fell by £36 million. Advances to U.K. residents which had fallen by £12 million in the third quarter, fell by £35 million, while U.K. residents' deposits rose by £24 million.