COMMENTARY

JANUARY—MARCH 1962

Throughout the quarter, with little interruption, sterling was in good demand. Commercial demand from abroad is seasonally high at this time, and a strong revival in the inflow of funds, which began during February, had become well established by the end of the month. Gold and convertible currencies amounting to £80 million were added to the reserves during February, out of which a further repayment to the International Monetary Fund, costing £75 million, was made at the end of the month. Accruals to the reserves continued in March and April; Australia, whose reserves are mainly held in sterling, repaid the equivalent of £63 million in March to the I.M.F., and a further repayment by the United Kingdom, costing £25 million, was made at the end of April.

After Bank Rate had been reduced to 6% in November, it was important not to move too far before opinion abroad could be confident that the short-term measures of July 1961 would be followed by the pursuit of long-term policies directed to ensuring a more lasting external recovery. Over the winter, uncertainties at home and abroad about developments during 1962 were focused largely on the pay pause, the establishment of the National Economic Development Council, and the forthcoming Budget. Signs of improvement in the long-term trends could not appear quickly; but by March it could be seen that confidence in the currency and in the policies being pursued in the United Kingdom was firm enough to allow further reductions in Bank Rate, and the rate was lowered progressively to 4½% by the 26th April.

Foreign exchange and gold

A reduction in Bank Rate from 6% to 5½% on the 8th March had no appreciable effect on the demand for sterling. After a brief hesitation, the rate against the U.S. dollar rose again; and further purchases of foreign currency for the reserves were possible. In part, the continued strength of sterling reflected strong expectations of another early reduction in Bank Rate. By contrast, when Bank Rate was reduced from 5½% to 5% on the 22nd March, there was some foreign selling of sterling.

By early April demand was again strong, although the rate against the U.S. dollar remained below the level reached in mid-March. When Bank Rate was reduced from 5% to 4½% on the 26th April the reaction was not as sharp as the reaction to the change on the 22nd March; but the demand for sterling was moderated and became generally a little less strong in May.

Private demand for gold on the London market, which weakened during February, remained weak throughout the rest of the period under review. By early May the dollar price had fallen to \$35·07 from \$35·08½ per fine ounce at the end of February. Only occasionally was there any intervention in the market by the Bank of England specifically to prevent excessive movements in the price; and the scale of these interventions was small. The demand for gold coins was also weak, with a continuing tendency for their price to fall.

The repayment to the I.M.F. at the end of February was made in six currencies: £27 million in U.S. dollars, £20 million in deutschemarks, £12 million in Netherlands guilders, £7 million in French francs, £5 million in Belgian francs, and £4 million in Italian lire. Half the repayment at the end of April was in deutschemarks and the remainder in Canadian dollars and Belgian francs.

Inflow of funds

The strength of sterling during the first four months of 1962 was in part a normal seasonal feature; it was also helped by some inflow of funds from abroad, but the evidence as to how these were invested is indecisive.

In each month from January to March there was a substantial rise in sterling assets held by London banks against deposits in foreign currencies. This increase reflected both a rise in the total of these deposits and an increase in the proportion of the deposits switched by the banks into sterling. The growth in January, which was particularly large, was mainly a return of deposits withdrawn over the end of the year; but there was some further growth in subsequent months. This reflux of foreign currency deposits led to a fall in the rate of interest paid on them by London banks, so that a margin of profit, lying between $\frac{1}{4}$% and $\frac{1}{2}$% for most of the time, re-emerged in favour of covered investment in certain short-term sterling assets such as three-months' deposits with local authorities (see graph on page 151). In early April a sharp and partly seasonal fall in rates offered by local authorities eliminated this margin, and during the month as a whole no further switching of currency deposits took place.

The market rate for U.S. Treasury Bills remained steady at around $2\frac{3}{4}$% per annum throughout the period January-April. The market rate for U.K. Treasury Bills fell from $5\frac{5}{16}$% per annum in early January to 4% per annum one week after the reduction in Bank Rate on the 26th April. In early January the discount on three months' forward sterling was sufficient to give a margin of just over $\frac{1}{8}$% per annum in favour of covered investment in New York. Except for short periods, this margin was maintained until the middle of March; after that it increased, because, as Bank Rate came down, the discount on forward sterling did not fall as much as the margin between the rates of interest on U.S. and U.K. Treasury Bills.

Although there was no margin in favour of covered investment in London on the Treasury Bill comparison during these months, there was a margin for uncovered investment in U.K. Treasury Bills. Reported overseas sterling holdings (which include holdings of Treasury Bills) by non-official holders in Western Europe rose by £21 million during the quarter; but non-official holdings by North America fell by £24 million, and in total the official and non-official holdings by countries outside the sterling area were reduced by £51 million.

New information becoming available in March indicated that during the last six months of 1961 there had been large private overseas purchases of government stocks and other U.K. securities on the London market. Preliminary information suggested that overseas purchases of U.K. securities were continuing in the first quarter. There were large sales of government stocks by the Issue Department, larger than could be explained by reference to the likely scale of purchases, at that time, by home holders. These indications were not confirmed by direct reports from the market. But such transactions are not abnormal in the financial centre of a country with a currency widely held abroad; even purchases on the scale of the last half of 1961 are small in relation to the total turnover in the markets and may attract little attention.

Balance of payments

The substantial improvement in the U.K. balance of payments on current account in the first nine months of 1961 did not continue in the last quarter of the year. By April 1962 it could be seen that a better trend in exports had begun in January; but imports rose as well, and the trade balance in the balance of payments accounts, which had shown a small surplus in the fourth quarter of 1961, probably reverted to a deficit in the first quarter of 1962.

Exports, seasonally adjusted, rose in each of the first four months of 1962. The decline in exports to other sterling area countries, which had persisted since the beginning of 1961, appeared to have come to an end; and exports to Western Europe continued to rise. The change in the trend of exports came largely from increased shipments of cars. There was little sign of a beginning of the substantial rise in exports of machinery which must eventually play a large part in the desired increase in total exports.

The rising trend of exports during the first quarter reversed the fall which had taken place during the last quarter of 1961, so that between the two periods there was little change in the total. Imports, on the other hand, again rose a little, resulting in a further small deterioration in the trade balance, as recorded in the trade accounts and adjusted for seasonal variations. Imports of industrial materials, especially semi-manufactures, were smaller, but imports of all other classes were larger. Among these, food and petroleum showed the largest increases; but finished manufactures also contributed. The fall in manufacturers' spending on fixed investment in the United Kingdom which began in the fourth quarter of 1961 suggests that still higher imports of machinery are unlikely.

Conditions overseas The U.S. balance of payments deficit appears, on the basis of preliminary information, to have decreased substantially in the first quarter of 1962. This deficit, by American definition, is measured by changes in holdings of gold and convertible currencies and in U.S. liquid liabilities; and most of the improvement probably represented a reduction in the unusually large short-term lending by U.S. banks which took place at the end of 1961. U.S. exports were maintained and the rise in imports was slight. The recent slackening in the growth of U.S. imports may reflect the pause in the expansion of domestic demand which occurred early in 1962, and may prove to be only temporary. The volume of the gross domestic product, seasonally adjusted, rose only just over 1% between the last quarter of 1961 and the first quarter of this year. By March it was clear that consumers' expenditure in the United States was once again rising and that fixed investment was likely to continue to grow. The prospect is that activity there will continue to rise during 1962, although probably at a somewhat slower pace than seemed likely at the start of the year.

There are now some signs that Western Germany's balance of payments surplus on current account may be smaller than in recent years. The revaluation of the deutschemark in March 1961, and rising costs following a more rapid increase in wages than in productivity, have faced some sectors of West German industry with new choices between profitability and competitiveness in international markets. But whether the current account surplus, though smaller, will be covered by the outflow of long-term capital is problematical.

The overall surpluses of France and Italy have been increasing recently and seem likely to continue to do so. In both countries it is expected that domestic demand will continue to expand, but that exports will rise faster than imports, at least in the immediate future. In France, as in Germany although not so markedly, wages have recently been rising rather faster than productivity. Prices have been rising slowly, but not enough to suggest that France's competitive position in world markets will yet be appreciably affected.

Domestic economy During the quarter there was a prospect that total demand and output would rise in the course of the year; and the outlook overseas indicated that this should include a substantial increase in demand from abroad. At home, public expenditure would continue to grow; and to this expansionary force would, it seemed, be added a rise in private consumption as personal incomes in real terms began to rise again, supplemented by a probable increase in buying on hire purchase. In private capital expenditure, some further fall was evidently in prospect in manufacturing industry; but investment in housing, and in distribution and other services, seemed likely to rise. Later in the year more stock accumulation could be expected. The pace of the growth in exports, of the rise in consumer spending, and of the fall in manufacturing investment were matters round which the main uncertainties centred; but the probability as it appeared then was that the prospective rise in total demand during the year was as great as could safely be accommodated, and therefore that relaxation of restrictions on home demand was as yet inappropriate.

The margin of unused capacity in some industries appeared to be appreciable at that time; and, although the shortage of skilled labour continued, the general labour position was easier. Unfilled vacancies, seasonally adjusted, had fallen steadily since the middle of 1961; and the total of registered unemployed had risen, not wholly for seasonal reasons, from a low point of 1·2% of all employees in June and July 1961 to 1·7% in November and 2·0% by January, February and March 1962.

A fall in the second half of last year in the engineering industries' order books for the home market seemed to be levelling out, while those for export continued fairly flat. Home and export deliveries, after some allowance for seasonality, were not rising; but the flow of new export orders, although not yet indicating higher exports later in the year, was large enough to maintain the considerable total of orders on hand. Manufacturers' forecasts of their capital spending indicated a fall, largely concentrated in the steel and motor vehicle industries, in 1962; indeed, the figures for the last quarter of 1961 showed that it had already begun. Deliveries of plant and equipment by the engineering industries to manufacturers therefore seemed likely to fall in 1962, while their deliveries to the distributive and service industries and to the public sector were expected to increase. The home market did not appear to be attracting, nor likely during the year to attract, so much of the output of the engineering industries as to leave them insufficient capacity to meet any increase in overseas demand that might occur in the course of 1962.

Consumers' purchases of durable goods and registrations of new cars which, under the influence of restraint in incomes and credit, had been falling, both showed signs of recovery. Consumer credit outstanding continued to fall; although many three-year contracts initiated early in 1959 must have been expiring and providing the occasion for entering into new purchases on credit, the amount of new credit extended by finance houses was low, and was exceeded by repayments.

Stocks of goods held by wholesalers and retailers had been falling in the last quarter of 1961. No substantial rebuilding of these stocks was likely until the signs of reviving consumer and export demand became more convincing; but an end to the fall seemed probable early in 1962. Manufacturers' stocks of materials and fuel, and of work in progress, did not appear unduly high; but towards the end of 1961 there had been a large, and probably for the most part unintended, increase in their stocks of finished goods. With bank credit under restriction, this was probably unwelcome to the manufacturers; and some reaction, in the form of deferring any increase in production until these extra stocks had been cleared, seemed likely for the first few months of 1962. The net movement of manufacturers' and distributors' stocks was therefore difficult to forecast for the immediate future; though, as demand and activity revived during the year, a renewed upturn in stocks could be expected.

Capital market

For business opinion in many industries the first quarter of the year was a time of uncertainty; and a cautious attitude prevailed toward future sales and to official forecasts of an increase in demand. With a few exceptions, company reports showed that profits were still falling and did not suggest that an early recovery was to be expected. Retail sales continued level; the success of the interim policy for limiting incomes was unconfirmed, and the Budget lay ahead. The market for equity shares was weak. The volume of new capital issues continued to fall from the peak reached in the third quarter of 1961; and many of the issues that did come to the market were directly associated with the repayment of bank advances. With the equity market offering little prospect of an early recovery, institutional funds were more likely to be invested in fixed interest, including gilt-edged, securities. The conversion and redemption of £758 million 4½% Conversion Stock 1962 was due in February; and in preparation for this the stock was being bought heavily for the official portfolio. Despite this there were, on balance, substantial net official sales from the start of the year; but official policy at this time was not to oppose some slow rise in prices. By the end of January the gilt-edged market was very firm. Yields on long-dated and undated government stocks fell from about 6½% to about 6¼% by the end of February, and some continued to fall a little after that. A yield of 6% or more on long-dated gilt-edged stocks became attractive to many investors, at home and abroad, who, in choosing government stocks, showed a marked preference for the longer dates. The market in medium-dated government stocks was also very firm, and substantial official sales were made in that range. But there were some large new issues of medium-dated stocks by corporations, and several new industrial debentures, which absorbed some of the demand.

Bank Rate and Special Deposits

By February confidence in the maintenance of existing exchange parities had recovered enough for short-term funds to move into sterling probably without forward cover; the danger that a reduction in Bank Rate would result in an outflow of funds was diminishing. Much of the inflow at this time was in forms that were unrecorded, and concerning which only circumstantial evidence is yet available, such as the high level of official sales of government stocks; but the fact that so little of it was recorded in overseas sterling holdings supported the belief that it was not particularly volatile money, likely to move out again at the first sign of U.K. rates falling. A reduction in Bank Rate was therefore appropriate as soon as domestic conditions permitted.

During March information becoming available suggested that the expansion in exports had in fact begun; exports of cars were now rising and were expected to rise further. With unused manufacturing capacity available and an easier labour situation, lower short-term interest rates did not seem likely to lead to any revival of inflationary features in the economy. Bank Rate was lowered from 6% to $5\frac{1}{2}$% on the 8th March; in the exchange markets this was regarded as suggesting that a further reduction to 5% was likely before long, and the inflow of funds continued strongly.

A further reduction in Bank Rate therefore became possible; and it was brought down to 5% on the 22nd March. The prices of medium-dated and long-dated government stocks moved very little in response to these changes, the yields remaining around $6\frac{3}{8}$% and $6\frac{1}{4}$% respectively.

The Chancellor of the Exchequer, in his budget statement on the 9th April, said that he would add no budgetary stimulant to demand. For some weeks before the Budget, the stock markets had been affected by profit-taking, especially in short-dated securities, in advance of legislation to tax speculative gains; prices of most securities were steady or falling. Once the contents of the Budget and the Finance Bill were known, this technical weakness disappeared; and the markets both for gilt-edged stocks and for company securities became firmer. The Budget was taken in the markets to be fully as restrictive of demand, in its total effect, as was required by the current situation, and to suggest that some further relaxations in monetary policy might become possible during the year.

In April demand for sterling became strong again, and, with the publication of the figures for March, evidence of a rise in exports became a little firmer, exports both to the sterling area and to other countries reaching higher levels. Imports, seasonally adjusted, were lower. Bank Rate was reduced by a further $\frac{1}{2}$% to $4\frac{1}{2}$% on the 26th April. The rate on Treasury Bills fell by less than $\frac{1}{4}$% and medium-dated and long-dated gilt-edged stocks showed little change. The performance of sterling in the exchange markets remained satisfactory in May and at home it became clear that the growth of expenditure on some consumer durable goods was slower than had been expected. Without in any way departing from the general policies outlined in the Budget, it was now possible to undertake some limited easing of credit restrictions. It was announced on the 31st May that 1% of Special Deposits would be repaid during June to the London clearing banks and $\frac{1}{2}$% to the Scottish banks; and the banks and other financial institutions to whom requests for restraint in lending had been made in July 1961 were asked to continue to pay primary regard in their advances policy to the requirements of exports and of production which would aid exports. They were also asked to continue to exercise restraint in lending for speculative purposes, especially for building and property development, and to keep within modest limits any relaxation in lending connected with consumption at home. On the 4th June the minimum initial deposit of 20% on hire purchase contracts was reduced to 10% on all goods except cars.

The reductions in Bank Rate have been made against a background of increasing exchange reserves, and with recognition of the fact that high financing costs impede exports as well as home trade and investment. It is as well to remember, however, what the circumstances were that led last July to the raising of Bank Rate to 7% and other restrictive measures; so that in the process of relaxing restraint the seeds of similar trouble are not sown. A higher level of spending at home cannot be sustained for long without a higher level of overseas earnings than the United Kingdom now has. Stimulation of home demand without the secure prospect of a sufficient increase in overseas earnings would only jeopardise the attainment of steady economic growth. The delayed impact on demand of capital investment programmes drawn up in the second half of 1958 and in 1959, in the public sector as well as the private sector, superimposed on consumer demand which had risen to a high level in the intervening period, helped to create an excessive total of home demand in 1960. Imports rose in response, and exports stopped rising; only a heavy inflow of short-term funds prevented the reserves from falling. When the dangers of this situation, and of the rise in U.K. costs which ensued, were perceived abroad, the resulting withdrawal of foreign money led to the exchange crisis of last summer; such money might be withdrawn again if the situation were allowed to recur. In considering further relaxation, and the increases it might engender in consumption and investment, the phasing of the incidence of long-term capital projects, particularly in the public sector, upon total demand requires special consideration if there is to be no repetition of home demand building up to an excessive concentration in certain periods, to the detriment of the overseas trade balance.

Many yields in the United Kingdom, on loans of all maturities, other than bank overdrafts, and the average dividend yield on company shares, are still high by comparison with yields prevailing in many other industrial countries. A further gradual fall in the cost of finance for industrial investment might assist expenditure by British industry that would improve its competitive position; but it might have to be accompanied for a time by a continuation of some selective restrictions on the availability of credit.

At the end of May the recovery of output still seemed to be largely a prospect rather than a reality, but a prospect that could quickly be realised if a definite increase were seen in new orders. To maintain sterling on a firm foundation, a sufficient proportion of these orders must be in the export trade: nor without this can the level of outflow of long-term capital from the United Kingdom in recent years be safely maintained. Such a development implies a faster growth in exports of manufactures and perhaps also slower growth in imports of manufactures. While this presupposes restraint in costs and a high level of initiative in this country, it also implies elsewhere a somewhat slower growth of exports and a somewhat faster growth of imports. In the end industrial growth both here and abroad could be retarded if all industrialised countries took measures that arrested this process of adjustment by restraining domestic demand and stimulating exports, whatever their current external position.

The indications that costs have been and may still be rising faster in other European industrial countries, and the better recent trend of costs in the United Kingdom, are both encouraging for U.K. export prospects. Unless there are difficulties ahead for other countries leading them soon to adopt restrictive policies, these prospects should remain good during 1962. And so far as the cost and availability of credit in the United Kingdom are concerned, the finance of exports should be easier than in the past.

QUARTERLY ANALYSIS OF FINANCIAL STATISTICS

14th December 1961—21st March 1962

Exchequer The overall budget surplus in this revenue quarter (of 14 weeks) was £637 million. Though less than had been expected, this was some £100 million greater than in the corresponding quarter (of 13 weeks) in 1960/61. Internal extra-budgetary funds brought in £57 million, also more than a year before. In spite of this, the cash surplus of the Exchequer was over £100 million less than a year before, because there was a change on external items from a large receipt last year to a substantial sterling expenditure (£118 million) this year. The inflow of overseas funds led in the first instance to accruals to the reserves, which increased the Exchequer Group's sterling payments.[a] From the increase in the reserves a repayment of £75 million was made to the International Monetary Fund at the end of February, but this did not affect the Exchequer's cash surplus.

Of the total cash surplus of £576 million, £194 million was used to repay debt held outside the banking system,[b] as follows:

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[a] The Exchequer Group comprises the Exchequer, the Paymaster General, the National Debt Commissioners, the Exchange Equalisation Account and the Issue Department of the Bank of England.

[b] " 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.

GOVERNMENT DEBT AND BANK OF ENGLAND NOTES

Holdings of the public, other than the banking system

£ millions		
Government debt		
Overseas official holders:		
Treasury Bills ...	− 8	
Stocks	− 5	− 13
Other home and overseas non-official holders:		
National Savings ...	+ 44	
Tax Reserve Certificates	−177	
Treasury Bills ...	− 46	
Stocks	+120	
Indirect holdings[a] ...	− 42	−101
Bank of England notes		− 80
		−194

This net reduction of £194 million includes changes both in overseas holdings and in those of the private sector at home. Three items, which together fell by £213 million, can be taken to relate almost wholly to home holders —National Savings, Tax Reserve Certificates and Bank of England notes.

National Savings yielded £44 million, approximately in line with the underlying trend of the two previous quarters. Rates of interest offered on some competing outlets for personal savings were reduced during the quarter; and by mid-March the yield on National Savings Certificates (which is free of tax), but not that on Defence Bonds, compared favourably with those offered by hire purchase finance houses and local authorities. Nevertheless all forms of National Savings brought in less than a year before, especially National Savings Certificates and Defence Bonds, of which there were small net repayments, perhaps because better returns were still obtainable on some gilt-edged stocks of similar maturity.

Net repayments of Tax Reserve Certificates were £177 million, much as expected seasonally, both issues and repayments being a little greater than in the previous year. The fall in the note circulation was larger than usual during the quarter; this was partly because the Easter demand came too late to affect the quarter's figures, and partly because some of the proceeds of the £1 notes in the old series, paid in to banks following the announcement that they would not be legal tender after the 28th May, were held as bank balances rather than in new notes.

Overseas funds

Marketable government debt (Treasury Bills and government stocks) in overseas official hands fell by £13 million; there was a repayment to the Swiss National Bank, out of the proceeds of a loan from the Swiss Government, of the last remaining £18 million of Basle credits.

Direct and indirect holdings of marketable government debt by " Other home and overseas non-official " holders rose by £32 million, compared with an increase of £198 million in the previous quarter (excluding repayments of Basle credits). Foreign currency deposits switched into sterling by banks in London rose by some £80 million in the calendar quarter. On the other hand, known holdings of sterling by private overseas residents (including banks) actually fell by £21 million. Yet the total inflow of private overseas funds can hardly have been less than £200 million, the greater part of which was in forms, not necessarily short-dated, that are at present unidentified. The inflow was certainly much greater than the net increase of £32 million in " Other home and overseas non-official " holdings of marketable government debt, stocks and Treasury Bills together, and there would probably have been no net increase in the absence of the inflow. The fall in reported overseas sterling holdings suggests that if there was any increase in overseas holdings of Treasury Bills it was probably small. But overseas residents may well have taken up part of the large total of £120 million of government stocks, mainly long-dated, sold to " Other home and overseas non-official " buyers. Overseas money was probably also invested in company securities, and placed with local authorities, hire purchase finance houses, and perhaps other borrowers. An article on page 93 discusses

(a) Changes in the discount market's holdings of government debt are treated as changes in the " indirect holdings " of those from whom the market has borrowed (net). This figure includes some overseas official holdings.

the ways in which such inflows can affect the total of borrowing by these institutions from home investors. In the quarter under review the effect of the inflow could have been that gilt-edged stocks were bought and taxes paid without as large a reduction in total bank deposits, or as large an increase in overdrafts, as would otherwise have occurred.

The banking system The greater part of the Exchequer's cash surplus had its counterpart in a reduction in the banking system's holdings of government debt and Bank of England notes, as follows:

Holdings of the banking system

£ millions

Bank of England, Banking Department:		
Direct holdings ...	+ 82	
Indirect holdings ...	− 42	+ 40
Clearing banks and Scottish banks:		
Treasury Bills	−313	
Stocks	− 31	
Indirect holdings ...	− 17	−361
Bank of England notes (including coin) ...		− 61
		−382

Holdings of government debt and bank notes by the Banking Department of the Bank of England, including indirect holdings through the discount market, rose by £40 million. This matched the seasonal increase in Bankers' Deposits at the Bank of England which is the normal consequence of a reduction in the banks' holdings of notes and coin after Christmas. The clearing banks' and Scottish banks' holdings of marketable government debt fell by £361 million.

The trend of net deposits with the London clearing banks had been downward since mid-1961; but by the end of that year it seemed to be levelling out, and in the first quarter of 1962 the recorded decrease of £90 million was some £130 million smaller than expected on seasonal grounds.[a] There are, however, reasons for thinking that this smaller seasonal decrease for the clearing banks does not necessarily mark the beginning of a new upward trend. The effect on deposits of calling in £1 notes of the old series has already been mentioned. Secondly, there is a possibility that more tax payments than usual were met by increases in bank advances, and therefore less were debited to deposits, and that more were still outstanding at the end of the period to which the figures relate. Thirdly, although there is no evidence that the incoming overseas funds remained on deposit with the clearing banks, it is possible that some "Other home" holders were at this time selling securities, directly or indirectly to overseas buyers, and holding the proceeds on deposit because of uncertainties about the Budget and the speculative gains tax. Part of the proceeds of the redemption of a government stock in February may also have been kept on deposit for a time. Finally, the clearing banks' figures for April, seasonally adjusted, show a fall rather than a rise in net deposits.

The clearing banks' advances (excluding advances to the nationalised industries) rose by £169 million during the three months. This was rather more than the usual seasonal increase, probably because heavy tax payments on profits mainly earned in 1960 had to be made at a time when current earnings had fallen. The lower level of new capital issues may also have been a factor. At mid-March the ratio of total advances to gross deposits was 45·5%, 1% lower than a year before; but part of this fall came from the reclassification of assets which took place in October. The advances of the Scottish banks rose by £23 million; and this, too, was rather greater than the usual seasonal movement.

Advances by members of the British Bankers' Association other than to the nationalised industries, rose by £158 million between November 1961 and February 1962, about double the estimated seasonal increase; if some allowance is made for seasonal factors, it appears that virtually the whole of this was in lending to industry. The largest increases were to borrowers in the engineering, chemicals, iron and steel and building industries and in "unclassifiable industry and trade". There was also a sharp increase in

(a) It is not yet possible to calculate a seasonal adjustment for net deposits with the Scottish banks; but, at an estimate, the seasonally adjusted figures would show little change.

advances to retail trade, which had fallen in the previous quarter; but hire purchase finance companies made further repayments of advances, at the request of the banks; and the moderate increases in lending to personal, professional, and " other financial " borrowers were probably no more than seasonal. These trends reflect the restrictions applied by the banks, in accordance with the official request, to advances for personal consumption and for speculative building, property development and other speculative purposes.

The clearing banks, in addition to the rise in their advances, increased their holdings of commercial bills (including re-financeable export credits) by £21 million in the March quarter; but the total remained below the peak of £280 million reached last August. The total of their call money with institutions outside the discount market rose by £47 million, probably to finance larger holdings of Treasury Bills. The clearing banks' total liquid assets fell by £250 million, rather less than usual in the revenue quarter. Their combined liquidity ratio fell from 35·3% to 32·6%, leaving most banks comfortably clear of the 30% minimum without recourse to any substantial sales of government stocks.

Figures for the accepting houses and the overseas banks in London in the first quarter illustrate their importance in facilitating the movement of overseas funds. Overseas residents' deposits with these institutions rose by £133 million, of which about half represented deposits in foreign currencies. Advances to overseas residents, both in sterling and other currencies, and balances held abroad increased by £50 million; so that through these banks there was a net inflow into the United Kingdom, in sterling and other currencies, of some £80 million from overseas. U.K. residents' deposits rose by £25 million, making a total of over £100 million available to increase advances and other assets within the United Kingdom. Advances to U.K. residents rose by £27 million—probably for seasonal reasons similar to those that caused a rise in the clearing banks' advances in this quarter; and the overseas banks and accepting houses increased their holdings of gilt-edged stocks by £13 million. Most of the remaining £60 million was invested in short-term assets. Balances with other banks and with the discount market fell by some £40 million, following a substantial increase in the December quarter; but this was more than offset by a large rise (£86 million) in temporary loans to U.K. local authorities and a smaller one (£20 million) in holdings of Treasury Bills. In the six months since September lending to local authorities, mainly by the accepting houses and the " other foreign banks " group, has increased by £126 million.

Private sector

Seasonal factors apart, there was probably little change in the rate of saving by the private sector as a whole (persons and all companies outside the banking system[a]) in the **fourth quarter of 1961**. Expenditure on fixed capital fell; but the rate of stockbuilding increased, and on balance the financial surplus of the whole private sector seems to have continued at about the same level as before. Within the total, some independent estimates can be made for the personal sector. Personal savings showed some increase, if allowance is made for seasonal factors. As expenditure by persons on fixed capital (mainly houses) and on stockbuilding (mainly by unincorporated shopkeepers) was probably little changed, the financial surplus of persons rose. Allowing for seasonal factors, therefore, it appears that the savings, and the financial surplus, of companies fell. This is an indirect inference, for which there is little firm evidence; but it seems reasonable in view of the downward trend of profits at the time.

In the **first quarter of 1962**, the private sector was, as usual in the revenue quarter, in financial deficit; but the evidence so far shows that, with the budget surplus about £100 million greater than in the corresponding quarter a year before, the private sector's deficit was also about £100 million greater. The seasonal fluctuation in this quarter is so great that comparison with other recent quarters is difficult. Compared, however, with the first quarter of 1961, the private sector's total net claims on the banking system fell slightly less, mainly because of a smaller fall

[a] The London clearing banks, the Scottish banks and the Banking Department of the Bank of England.

in deposits. The reduction in net private lending to the public sector was also smaller than last year, excluding from the comparison the maturing Treasury Bills held last year for the Ford Motor Company of America. But the figures for private sector holdings of public sector debt also include indistinguishably non-official overseas holdings, and the relatively small fall in the first quarter of 1962 probably conceals a larger fall in private home holdings offset by an increase in overseas holdings.

The increase in the private sector's financial deficit therefore appears to have been financed in part by a reduction in its holdings of public sector debt, but perhaps to a considerable extent through an increase in its liabilities to overseas. As suggested above, the inflow of overseas money probably exceeded £200 million, whereas a year before there had been a small outward movement. But this total probably includes some overseas investment in public sector debt, as well as in liabilities of the private sector, such as company securities and deposits with overseas and foreign banks and accepting houses.

Within the private sector, the decline in bank advances to persons which occurred in the fourth quarter of 1961 probably ceased in the first quarter of this year. The fall in consumers' hire purchase debt, however, accelerated from £18 million in the fourth quarter to £41 million in the first. Borrowing from building societies was little changed. There was, however, a marked increase in the rate of lending to building societies on shares and deposits. Other identifiable changes in the financial assets of persons include a seasonal recovery in subscriptions to National Savings, and a reduction, also seasonal, in personal holdings of Tax Reserve Certificates. Purchases of units from unit trusts, which had risen in the fourth quarter, maintained the higher level in the first quarter of this year. On the whole, the available figures for the first quarter suggest some increase in total lending by persons, but no great change in their total borrowing; if their desire for more credit was still strong, its satisfaction was limited by the credit restrictions in force.

Attention was drawn in the March issue of this Bulletin to a marked fall in borrowing by ' non-financial ' companies towards the end of last year. This fall does not appear to have been due to any rise in the financial surplus of these companies, which is rather more likely to have fallen a little. It may therefore have been achieved, one way or another, by a reduction in their liquid assets, for example Treasury Bills and temporary loans to local authorities, or trade credit. In the first quarter of 1962 by contrast identified borrowing by ' non-financial ' companies increased by rather more than the usual seasonal rise. This seems to have been because tax payments were high in relation to current earnings; and the rate of borrowing has probably since fallen back again. The increase was almost wholly in bank advances. Bill finance outstanding probably continued to fall. Capital issues in the first calendar quarter did indeed recover from the exceptionally low rate of the previous quarter but were still below the average for 1961. Liquid assets may have fallen for seasonal reasons, but there is no evidence to suggest any unusual movement.

Financial institutions (other than banks) taken as a whole borrowed less in the first quarter of 1962 than in the previous quarter. The proceeds of new capital issues fell from the unusually high total of £53 million to £22 million; insurance companies, which had raised large amounts in the previous quarter, made no new issues, but there was an increase in those by investment trusts.