COMMENTARY

In some important respects the situation in July 1962 was much better than it had been a year earlier. Confidence in sterling had been restored, the outflow of funds reversed, and the reserves were considerably higher. Exports had been rising for six months, but imports had been steady and the current balance had moved from deficit to surplus. The " pay pause " had helped to make the United Kingdom more competitive abroad. Bank Rate, which had been raised from 5% to 7% in July 1961, had since been reduced by stages to 4½%. During the year too a start had been made with the long-term remedies which the weakness of 1961 had shown to be necessary; an incomes policy was being formulated and the National Economic Development Council had been set up. All these achievements had, however, not been without cost. Industrial output had grown very little over the year as a whole and, more serious for the future, there were now some indications that the long-term upward trend in fixed investment by manufacturing industry might not be maintained.

Repayments to the I.M.F. The substantial improvement in the strength of sterling since July 1961 enabled the United Kingdom to repay within a year the drawing of £536 million obtained from the International Monetary Fund in August and September 1961. It is the policy of the I.M.F. that use of its resources should be regarded essentially as short-term and that countries should repay drawings as soon as the difficulties which they were intended to meet have been overcome. In accordance with this principle the United Kingdom began to repay its drawing from the Fund in October 1961, and repaid further instalments during the winter, as accruals to the reserves permitted; at the end of April and May further amounts, each the equivalent of £25 million, were repaid. By July 1962 the improvement in the external position was well established, but the exchange markets were disturbed and the risk of further large and sudden movements of short-term funds remained. The United Kingdom therefore offered to repay the outstanding balance of the drawing from the I.M.F., amounting to £183 million,[a] and at the same time applied for standby facilities for another year. The repayment was made at the end of July; and new standby facilities, amounting to the equivalent of £357 million, were made available for a year from the 8th August 1962. During this period the United Kingdom can draw foreign currencies up to this amount from the I.M.F. Standby facilities for the equivalent of £179 million had previously been obtained for one year at the time of the U.K. drawing in August 1961, but not used.

Exchange control In July 1961, as part of the short-term measures to relieve the strain on sterling, a more stringent examination of new private investment outside the sterling area had been instituted; thereafter only investment which promised a clear short-term benefit to the balance of payments was permitted. At the same time U.K. firms operating overseas had been asked to remit home a higher proportion of their earnings. In May of this year the restrictions on new investment were relaxed; but larger remittances of earnings are still being encouraged. New investment outside the sterling area, which would have been allowed before July 1961, but did not satisfy the stricter criterion then introduced, is now allowed again provided that it is financed either with the proceeds of sales of U.K.-owned foreign currency securities (that is, through the so-called switch dollar market)

[a] Formally a member who has drawn from the I.M.F. is obliged to reduce the Fund's holding of its currency to its original level (though not below 75% of its quota). At the beginning of August 1961, however, because of drawings by other members, the Fund's holding of sterling amounted to some 73% of quota. The United Kingdom's original repayment obligation was thus less than the £536 million actually drawn and amounted to £521 million. The United Kingdom's obligation to repay this sum, together with some £3 million in charges, was discharged by £275 million repayments between October 1961 and May 1962, by £66 million sales of sterling by the I.M.F. to other countries, and by this final repayment of £183 million.

or by approved long-term borrowing abroad. In May also the restrictions which had prevented U.K. residents from switching from dollar securities to other foreign currency securities were removed.

The reserves The repayments to the I.M.F. in April, May and July were the principal reason for a fall of £192 million in the reserves of gold and convertible currencies between the end of March and the end of July. The reserves were also affected by other special transactions, with the United States and Canada.

In May the Exchange Equalisation Account acquired under a swap arrangement U.S.$50 million against the deposit of £18 million to the account of the Federal Reserve Bank of New York at the Bank of England; the reserves benefited accordingly. This transaction, which was reversed at maturity after three months, was one of a series by the U.S. authorities designed to give them resources for conducting limited and exploratory operations in European exchange markets, and to provide an immediate source of funds to meet any speculative outflow from the United States. Transactions with similar objectives have been undertaken by the U.S. authorities with the central banks of Belgium, France, Western Germany, Italy, the Netherlands and Switzerland and with the Bank for International Settlements.

In June, international help, totalling U.S.$1,050 million, was made available to Canada in cash and standby credits. This total included U.S.$100 million made available by the Bank of England to the Bank of Canada. It also included a drawing of various currencies from the I.M.F.; £36 million was drawn in sterling. The cost to the reserves of U.K. help to Canada was £36 million over the month.

The special transactions affecting the reserves can be summarised as follows:

	£ millions
U.K. repurchases from the I.M.F.	
April	− 25
May	− 25
July	−183
	−233
U.S. swap arrangements	
May	+ 18
Assistance to Canada	
June	− 36
	−251

Because the actual fall in the reserves during the four months April—July was £192 million, all other transactions augmented them to the extent of £59 million. Nearly all this gain occurred during April and May when the flow of funds to London for investment, although considerably reduced, may have been continuing. This flow probably stopped at the end of May when there was a renewal of uncertainties in the gold and foreign exchange markets.

Gold and foreign exchange markets In the last two weeks of May prices of industrial shares in the United States fell sharply, partly because prices had come to be regarded as unduly high in relation to earnings. This fall strengthened doubts about the future course of the U.S. economy and balance of payments; and revived speculation about the dollar price of gold, which was not checked until the 23rd July when President Kennedy, in a "Telstar" broadcast, took the opportunity to confirm that the U.S. authorities would not devalue the dollar. Doubts also arose in May about the Canadian exchange position and added to the general uncertainty until help was made available to Canada in the last week of June.

These uncertainties affected the gold market. Private demand again became strong and there was substantial intervention by the Bank of England. Thus restrained, the price rose at the fixing from the equivalent of $35·07\frac{1}{4}$ on the 22nd May to $35·14\frac{3}{4}$ on the 23rd July. The demand for gold then dropped abruptly and the fixing price fell to the equivalent of $35·11 by the end of the month.

Throughout June and most of July rates for the U.S. dollar in continental markets were at or near the lower points at which the respective authorities customarily intervene. A large part of the flow of funds out of U.S. dollars appears to have been directed to Switzerland. Official Swiss reserves of gold and foreign exchange, which had been falling almost continuously since last autumn, rose by the equivalent of some £75 million between the beginning of June and the end of the second week of July.

For a short while at the end of May and the beginning of June there was some selling of sterling as doubts about the price of gold led to some distrust of both the reserve currencies. The rate for sterling against the U.S. dollar fell[a] from $2·81¼ on the 22nd May to $2·80$\frac{9}{16}$ on the 5th June despite some support by the authorities. Thereafter the demand for sterling was erratic, but only on one occasion was substantial intervention by the authorities required and the rate remained between $2·80½ and $2·81 until the middle of August.

At the beginning of June some foreign sales of U.K. securities caused the rate for security sterling, which had earlier been close to parity with the official rate, to fall to $2·79. This movement proved short-lived and the rate recovered, although not fully; it has been steady around $2·80 since the middle of July.

Flow of funds to London

The apparent change from a modest flow of funds to London during April and May, to an absence of flow thereafter, can in part be explained by reference to changes in the pattern of relative interest and exchange rates. There was a sharp fall during May in the discount on three months' forward sterling in part the result of increased commercial demand for forward sterling and the decline in confidence in the U.S. dollar. It again became profitable for London banks to hold covered short-term investments with local authorities against foreign currency deposits. But the margin in favour of such investment did not persist. Rates paid on dollar deposits rose sharply at the end of May, fell back a little in June and then rose again in the middle of July as a result of some withdrawals of deposits thought to arise from the financing of gold purchases. Rates offered by local authorities were falling until the end of June. Over the three months May—July the amount of foreign currency deposits switched into sterling by London banks fell slightly.

There was a margin in favour of *uncovered* investment in U.K., rather than U.S., Treasury Bills throughout the four months April—July. At the beginning of the period it was about 1½% per annum. Rates for U.K. Treasury Bills fell between the end of April and the middle of June, while rates for U.S. Treasury Bills were little changed, so that the margin in favour of uncovered investment was reduced to about 1% per annum where it remained until the end of July. On the other hand there was a small margin in favour of *covered* investment in U.S., rather than U.K., Treasury Bills in April and early May. Subsequently a small margin in favour of covered investment in U.K. Treasury Bills emerged as a sharp fall in the discount on three months' forward sterling more than offset the reduction in the margin between interest rates in London and New York. But this margin in favour of London was of little significance as it rarely exceeded ¼% per annum.

During the three months to the 30th June holdings of sterling by official holders in countries outside the sterling area fell by £48 million.[b] This fall was probably largely due to ordinary trading transactions. Non-official holdings of these countries were virtually unchanged.

Balance of payments

Even though the net inflow of funds from abroad had halted, sterling remained fairly strong. This was partly due to a continuing improvement in the balance of payments on current account. At the same time the balance of payments of overseas sterling area countries has improved, largely for seasonal reasons: their holdings of sterling rose by £116 million during the second quarter.

The improvement in the U.K. current balance has probably been largely due to a favourable trend in the balance of trade, although invisible transactions improved more than seasonally in the first quarter. Investment income of U.K. companies increased and U.K. payments of interest, profits and dividends decreased.

The steady rise in exports (seasonally adjusted) which had become apparent by April, continued up to June, and they remained high in July. On the other hand

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(a) The drop in the sterling/dollar rate at a time when both reserve currencies were being sold by European holders does not indicate that the main pressure fell upon the pound. It arose because the U.S. dollar was then at support level against the main continental currencies and could not weaken further. The pound being above support point was free to decline against the U.S. dollar at the same time as it moved lower against European currencies.

(b) Before taking account of the acquisition of £18 million by the Federal Reserve Bank of New York.

imports (seasonally adjusted) remained stable during the second quarter: an unusual rise caused by the shortage of home supplies of fruit and vegetables was offset by a reduction in other classes of goods. Imports of industrial materials fell slightly. In July, however, these imports, and imports of fuel, rose abruptly; and they may grow further if industrial production continues to rise. There was no sign in July of any increase in imports of finished manufactures.

The satisfactory trend in exports derives from a continued vigorous growth in sales to Western Europe and a revival of sales to Australia and New Zealand. Exports to the United States have risen a little since the fourth quarter of last year but in the last few months shipments to Canada have been falling.

The growth of exports during the second quarter was more widely spread than during the first. Most of the increase arose from a general growth in sales of manufactures, but there was also an exceptional rise in sales of iron and steel scrap. Among the main groups, only shipments of cars failed to show a more than seasonal increase during the second quarter, but they were already high. In particular, exports of machinery and scientific instruments rose significantly in June for the first time this year. The flow of new export orders to the engineering industries rose during the first six months, and totalled 6% more than during the corresponding months of 1961. In spite of higher deliveries during the second quarter of 1962, outstanding export orders were 4% greater at the end of June than a year earlier.

Conditions abroad

The growth in exports so far this year reflects a continued expansion of world trade, and some strengthening of the United Kingdom's competitive position. The prospects for world trade turn largely on the future course of economic activity in North America and in Western Europe. In the middle of August the immediate prospects appeared to be satisfactory in Western Europe, but somewhat less so in the United States. The longer-run outlook seemed to be generally less assured.

In the United States the gross national product, seasonally adjusted, increased in the second quarter by just over 1%, the same rate of growth as had taken place in the first quarter of the year. There were nevertheless signs that the pace of expansion slackened during the period, although economic indicators have been substantially affected by a decline in steel output and a paucity of new orders in that industry after the wage settlement in March. Industrial production increased in April, despite the fall in steel output, but thereafter changed little until July when the index rose by a whole point. Total new orders reached a peak in May, but fell by 2% in June. Manufacturers' new orders for durable goods improved in July. These trends were accompanied by a fall in unemployment except during June. By the end of July it was lower than for two years (though still just over 5% of the labour force).

The volume of retail sales, seasonally adjusted, rose rapidly during the spring, helped by consumers' willingness to make use of the ample funds available for purchases of durable goods, especially cars, on credit. More new buildings were started and funds were readily available for house mortgages. Thereafter retail sales changed little, but spending on new construction rose slightly.

Federal and state government expenditures continued to rise during the second quarter. On the other hand the growth of private investment in plant and machinery has disappointed some commentators, and successive surveys of investment intentions have shown no improvement. The fall in security prices at the end of May could strengthen the reluctance to invest which actual and prospective reductions in profit margins have created. The economic outlook has led the U.S. administration to propose a change in company taxation to encourage expenditure on new plant and equipment, and a general reduction in taxation from the 1st January 1963.

During the spring, activity in Canada rose more than seasonally, partly because exports rose sharply. Production was substantially higher, and unemployment lower, than in 1961. But growth may be curtailed by the fiscal and monetary measures adopted towards the end of June, and demand for imports is likely to be restricted by the lower exchange rate and the imposition of tariff surcharges of 5%-15% on more than half of all imports.

The renewed rise in output in continental Western Europe which started about the turn of the year seems to have been maintained, although in most countries the upward trend is not so clearly discernible as it is in France and Italy. Growth of personal consumption generally continues to play a larger part than hitherto, and private investment a smaller part, in stimulating activity.

The expansion of consumption reflects higher incomes following increases in earnings. In many countries indices of wage rates for the first quarter of the year were between 5% and 10% higher than during the same period of 1961. Labour remains fully employed almost everywhere in Europe and the shortage of skilled workers has recently become more acute. Consumer prices have also been rising, by 4%-5% over the year in most countries. This increase has been partly due to temporarily high food prices but prices of manufactured goods have also been rising.

In general, wholesale prices have risen less, but higher wages have eroded profit margins; this has been one reason for the slackening of investment. At the same time the shortage of labour has shifted the emphasis of investment from expansion of capacity to improvement of productivity. It seems possible that the incentive to invest may continue to weaken.

Despite the continued expansion in continental Western Europe, the slower rate of growth in North America and some restraints on activity in other industrial countries have limited total demand for primary commodities; and at the end of July prices of these commodities were still falling. Thus, although the volume of trade in them may have risen, the producing countries' incomes are unlikely to have benefited much. Among overseas sterling area countries, Australia and South Africa continue to have a strong balance of payments but some others, notably India, still experience difficulties.

The future course of world trade quite largely depends, as always, upon the policies pursued by the main countries. At present there prevails some contrast between the situations in North America on the one hand and in continental Western Europe and Japan on the other; in the former, policy is having to meet problems of under-employment, while in the latter it is increasingly concerned with problems of rising costs. The very existence of this contrast suggests that the main disequilibrium in trade and payments is on the way to solution; but at the same time, and bearing in mind the weakness of primary commodity prices, it suggests some approaching restraint upon the growth of world trade, at a peculiarly inopportune time for the United Kingdom. Speedy solutions to problems of under-employment, consistent with maintaining external strength, may not be easy to obtain if treatment elsewhere of rising costs were to prove very difficult without some restriction of home demand. It is the task of international economic co-operation, highly developed as it is, to minimise any adverse change in the growth of world trade; and if this task were made too difficult by doubts about the adequacy of exchange reserves and international credit facilities, it would be for international discussions to resolve them.

Domestic economy

Industrial production, seasonally adjusted, rose during the second quarter, and for the three months as a whole was about 2% higher than during January-March. This increase occurred even though there seems to have been little or no revival in personal consumption.

Output during April—June was sustained by the rise in exports described above, by movements in stocks and probably by increases in public sector expenditure. Expenditure by local authorities on education, for example, seems to have been higher. Capital investment in the public sector had risen between the fourth quarter of 1961 and the first quarter of 1962, and probably rose further; greater expenditure on electricity and water supply, roads, telecommunications, schools and hospitals had been planned for 1962/63 as a whole.

The volume of personal consumption on the other hand probably changed little between the first and second quarters of 1962. The many pay awards which became effective from April onwards helped to increase incomes, but prices, particularly of food, rose. Meanwhile, cold weather in April and May discouraged buying of summer clothes. On the 4th June the minimum initial deposit required for a hire purchase contract was fixed at 10% for all household goods; hitherto only furniture, cookers and a few other articles could be obtained with a 10% down-payment, and for other goods a 20% deposit had been needed. This relaxation gave some help to hire purchase sales of refrigerators and a few other goods, but retail sales of household durables as a whole were little higher in June than in May and rose no further in July.

Registrations of new cars rose more than seasonally between the first and second quarters, but monthly movements in the figures were erratic. Registrations were low in April, but reached a new peak in May, when sales benefited from the reduction of purchase tax in the Budget and from the approach of Whitsun. May was also the first month in which a large number of hire purchase contracts entered into in both 1959 and 1960 reached final maturity: in May 1959 most contracts were for three years (though there was no maximum period); in May 1960 the maximum period had just become two years. Some users of hire purchase may have been quick to enter into new commitments once they had discharged their old ones: contracts for new and used cars rose sharply in May. In June, however, they fell away, and were in fact 8,000 fewer than in June 1961. It seemed that potential purchasers might have been holding back because of uncertainties in the economic situation.

Taken as a whole, movements in stocks probably contributed towards the rise in output between the first and second quarters of 1962. The destocking which hindered output in the first quarter is thought to have slowed down. Manufacturers' stocks, which had fallen bv £60 million (1%) at 1958 prices, probably fell much less in the second quarter.

The course of private fixed investment as a whole during the second quarter was difficult to judge. In the first quarter the volume of fixed investment by both manufacturing and distributive industries, seasonally adjusted, had been lower than in the fourth quarter of 1961. But building may have been hindered to an unusual extent by bad weather and there may have been a postponement to the second quarter of purchases of cars by businesses in the expectation of tax cuts in the Budget. During April—July there were reports that some manufacturers were spreading their investment programmes over a longer period than they had planned earlier. Some companies appear to have decided to re-equip on their existing sites rather than to carry through more expensive programmes of expansion. Deliveries to the home market (including the public sector) of engineering goods (mainly capital equipment) in the second quarter were no higher than a year earlier, whereas in the first quarter they had been 5% higher. The number of private houses under construction, seasonally adjusted, was lower in the second quarter than in the first.

While industrial output generally rose during the second quarter, the number of registered unemployed fell less than usual at this time of year, and at mid-July totalled 400,000, or 1·8% of all employees. Outstanding vacancies also fell between mid-April and mid-July, although a rise is usual during this period.

Looking ahead in late summer, it seemed that a further, if modest, rise in industrial production was likely during the next few months. Conditions abroad suggested that export prospects were still promising, in the short term at any rate. Personal consumption was also expected to increase. Food prices, which had gone up by 6½% between January and June, mainly because of dearer vegetables, had fallen appreciably, leaving room for more buying of other goods; credit was also easier and cheaper than it had been earlier in the year. Fixed investment on the other hand seemed likely to change little in aggregate. Public investment was expected to go on rising and private investment in manufacturing industry to continue falling. The fall in factory building might be distinctly sharp, judging from the statistics of the value of new orders received by contractors and of applications to the Board of Trade for industrial development certificates. Outstanding home orders for engineering goods were 10% lower at the end of June than a year earlier. The fall in security prices during the summer may have influenced some manufacturers' plans. Orders for new offices and shops had not fallen much and it seemed possible that total investment in distributive and other services might rise. The number of private houses being started showed signs of increasing and, with a greater flow of funds to the building societies, the rate of expenditure should be maintained. It also seemed likely in August that, with a rise in final sales and easier credit conditions, stocks might be built up during the next few months, so providing a spur to output.

If, contrary to present expectations, output failed to rise further, the case for some stimulation of the economy would be strengthened. This is because the first effects of a sustained rise would probably be healthy. Higher output would mean a better use of plant capacity, which has increased as a result of the substantial fixed investment of recent years. A rise in output would also strengthen business confidence, thereby tending to check the fall in fixed capital formation by manufacturing industry. On the other hand, stimulation of home demand would do more harm than good if it led to an excessive rise in personal incomes, a fresh weakness in the balance of payments, and an ebbing of foreign confidence in sterling.

Capital market

The main features of the period April—July in the security markets were a sharp fall in ordinary share prices and a further rise in gilt-edged prices. These changes brought the average dividend yield on a representative group of industrial shares[a] into line with the yield on undated gilt-edged stocks. A year earlier there had been a margin in favour of gilt-edged (or 'reverse yield gap') of about 1½%.

Prices of industrial ordinary shares rose a little during April, but fell by as much as 18% over the next eight weeks. There was some recovery in the last week of June, but prices tended to fluctuate in the following weeks and at the end of July they were still 15% lower than at the end of April. Throughout this period prices were affected not only by movements on Wall Street and continental exchanges, but also by the subdued tone of a number of company reports, by the slowness of the revival in industrial output with its discouraging implications for profits, and by announcements of a considerable number of new capital issues. Most of this new money was required by financial institutions and property companies; the demands of manufacturing industry were not particularly heavy.

Apart from a pause before the Budget, when there were sales in anticipation of the speculative gains tax, the gilt-edged market was firm for most of the four months, and prices rose sharply early in July. During the whole period yields on medium-dated and long-dated stocks fell from about 6¼% to about 5¾%. This fall was not opposed by the authorities. On the other hand to have encouraged a faster fall in yields than in fact occurred seemed inappropriate. Uncertainties remained both at home and abroad, and a too rapid fall, which could not be sustained and might indeed have been reversed, would have damaged the market.

There were probably fewer overseas purchases of gilt-edged securities during April—June than during the winter, but home demand was strong, partly to take advantage of high yields while they were still available, and partly because the prospect for equities remained uncertain. There was also considerable buying by the banks, and total net sales of stock by the authorities were substantial. Departmental holdings of 5½% Funding Stock 1982/84 were virtually exhausted early in May, and a further tranche of 5% Treasury Stock 1986/89 was then issued. The new tranche was issued at a price slightly above the market price for the existing stock; in the circumstances prevailing this could be, and was regarded as an indication that some continuing fall in long-term rates would not be opposed. Departmental selling of 6% Conversion Stock 1972 ceased in June, and a new stock, 5% Exchequer Stock 1967, was issued. Sales of these stocks were partly offset by purchases of 5½% Treasury Bonds 1962; the authorities are normally ready buyers of the next maturing stock, so as to reduce the dislocation in the money market when the redemption day arrives.

The banks

Purchases by the London clearing banks and Scottish banks accounted for about half of the total of net purchases of gilt-edged stocks by the market during the three months ending in mid-June. The banks' purchases were largely concentrated between mid-May and mid-June, when Special Deposits equal to 1% of the clearing banks' total gross deposits (½% for the Scottish banks) were being released. In fact the total purchases by the London clearing banks during that period corresponded almost exactly to the total Special Deposits released to them, although purchases by particular

[a] See Table 14 of the Statistical Annex.

banks did not. The banks were informed, at the time Special Deposits were being released, that they need no longer adopt quite so severe an attitude towards applications for finance, though they were still asked to be selective in their lending. Advances by the London clearing banks, after seasonal adjustment, increased substantially between mid-May and mid-July and again in the four weeks to mid-August; even so the combined liquidity ratio of these banks at mid-August was above 33%.

Short-term money rates The reduction in Bank Rate from 5% to $4\frac{1}{2}$% on the 26th April had largely been anticipated by the discount market which tendered for Treasury Bills at a rate of $4\frac{1}{8}$% at the next tender, a fall of only $\frac{5}{32}$%. Between early May and mid-June the discount market raised its bid in six successive weeks in the face of strong competition at the tender, and its tender rate fell by $\frac{13}{32}$% to $3\frac{23}{32}$%. There were some expectations of a further reduction in Bank Rate, but the main factor was the discount market's desire to increase its Bill portfolio, which was then low in relation to its bond holdings. In particular the market wanted more Bills because it expected a higher demand from the banks when Special Deposits were released. The authorities wished to prevent too large a fall in short-term rates during these six weeks and there was borrowing from the Bank on eleven days for a total of £82 million. This borrowing raised the average cost of money to the discount market, and at mid-June, when its Treasury Bill tender rate was $\frac{25}{32}$% below Bank Rate, the margin between the average cost of funds and the rate of earnings on Bills was very small. Special Deposits had now been released and a reduction in Bank Rate was considered unlikely; the market therefore lowered its bid at two successive tenders, and its tender rate rose by $\frac{7}{32}$%, to $3\frac{15}{16}$%, at the end of June. Late in July and early in August the discount houses were again suffering from a shortage of Treasury Bills, because they had been receiving small allotments at the tenders and because they had had a persistent demand for Bills from their customers. Accordingly, they raised their bid at three successive tenders and their tender rate fell back to $3\frac{13}{16}$%.

Rates on local authority temporary money fell by $\frac{1}{2}$% at the end of April, after the reduction in Bank Rate. During the next two months borrowing needs were lower, as there was a seasonal inflow of revenue, the Treasury Bill rate was falling, and enough overseas funds were still obtainable. Thus local authority rates were lowered by a further $\frac{1}{2}$%. Some lenders withdrew funds at the end of June, because they make up their balance sheets at that date and wished to increase their holding of cash, and the rates rose by up to $\frac{3}{8}$%. They fell back again early in July, but by the end of that month had returned to end-June levels; demand had risen and overseas funds were probably less readily available.

Rates on deposits with finance houses, like other short-term rates, fell by $\frac{1}{2}$% at the end of April; but they were unchanged during May and June. The decline in hire purchase debt owed to these companies had slowed down in March and April, and, with higher sales of cars, debt rose slightly in May. In June less new credit was extended, and there was no change in debt. Bank advances to hire purchase finance companies were at much the same level in mid-May as in mid-February, acceptance facilities were not fully used, and there was no need to attract additional deposits. Indeed, it was reported that the finance houses were reluctant to accept them, and at the end of June deposits with members of the Finance Houses Association were no higher than in January. During July the finance houses generally lowered their rates by another $\frac{1}{4}$%.

QUARTERLY ANALYSIS OF FINANCIAL STATISTICS

22nd March—20th June 1962

Exchequer The overall budget deficit in this quarter was £282 million. This was roughly the same as in the corresponding quarter of last year, if allowance is made for special factors (last year the quarter contained an extra week, and Western Germany made a debt repayment). Revenue in this quarter was at about the same rate as a year before; expenditure above the line was rather higher but net expenditure below the line a little lower. The sterling cost of external items not included in the Budget was smaller than in each of the two preceding quarters and was exceeded by receipts from internal extra-budgetary funds, so that the cash deficit was less than the overall budget deficit:

	£ millions
Budget: above the line	−218
below the line	− 64
overall	−282
Internal extra-budgetary funds ...	+ 78
Exchange Equalisation Account ...	+ 18
Repayments to the I.M.F., etc. ...	− 52
Cash deficit	−238

Of the Exchequer's total cash deficit of £238 million, £97 million was financed by borrowing from sources outside the banking system:[a]

GOVERNMENT DEBT AND BANK OF ENGLAND NOTES

Holdings of the public, other than the banking system

£ millions		
Government debt		
Overseas official holders:		
Treasury Bills ...	+ 12	
Stocks	+ 10	+ 22
Other home and overseas non-official holders:		
National Savings ...	+ 40	
Tax Reserve Certificates	+ 46	
Treasury Bills ...	− 54	
Stocks	+ 67	
Indirect holdings[b] ...	− 4	+ 95
Bank of England notes		− 20
		+ 97

Overseas funds Overseas official holdings of marketable government debt rose by £22 million. Of this rise, £18 million was the counterpart of the sterling received under the swap arrangement with the Federal Reserve Bank of New York mentioned on page 164, this counterpart being treated for statistical purposes as an overseas official holding of government debt. The holdings of Australia were, however, drawn down when that country repaid the equivalent of £63 million to the International Monetary Fund at the end of March. Others in the overseas official group thus added substantially to their holdings. This reflects a net increase in the official sterling balances of overseas countries: during the second calendar quarter holdings of sterling area countries rose by £73 million, largely for seasonal reasons, but those of other countries, excluding the £18 million acquired by the Federal Reserve Bank, fell by £48 million.

The inflow of private overseas funds seems to have stopped after May, and any inflow during the quarter as a whole was probably small. Reported non-official overseas sterling holdings rose during the second calendar quarter by £45 million. On the other hand there was a slight fall in the outstanding total of foreign currency deposits switched into sterling (a sharp increase in such switching had been an important element in the previous quarter's inflow), and bank acceptances for account of overseas residents increased by £14 million. Net overseas purchases of long-term securities had apparently ceased during the quarter—the exchange rate for security sterling fell to a significant discount at the end of May—and there were no indications of any substantial unidentified inflow during the quarter. Thus the influence of overseas funds on the demand for marketable government debt was probably small.

" Other home " holdings Net purchases of marketable government debt by home holders outside the banking system were apparently also small, because the total rise in " Other home and overseas non-official " direct and indirect holdings in the quarter ending in mid-June was no more than £9 million. Within this total, there may well have been some outright switching from Treasury Bills, holdings of which fell by £54 million in total,

(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) 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.

into stocks, holdings of which rose by £67 million. There must also have been some outright purchases of gilt-edged, including a high proportion of longer-dated issues.

New investment in National Savings totalled £40 million during the quarter. In the first month most forms of National Savings, and in particular deposits with the Post Office and Trustee Savings Banks, showed some improvement on recent months. But it was transitory and may have been due—at least in part—to the recall of the old series of £1 notes described below. Rates of interest on other outlets for personal savings which compete with National Savings were mostly unchanged during the quarter, the recommended rates for building societies, for example, being maintained; but the rates offered by leading hire purchase finance houses generally fell by about 1%, following the reductions in Bank Rate, to comparatively unattractive levels.

The yield on Tax Reserve Certificates was also reduced during the quarter, from 3¼% to 2¾% tax-free, but this seems to have had only a slight effect on total issues, and, with repayments lower, net issues (£46 million) in the quarter as a whole were rather more than in the same quarter last year.

As the table above shows, Bank of England notes in circulation outside the banking system fell by £20 million. This was contrary to the seasonal pattern, which might have been expected to produce an increase of over £50 million. It was a result of the recall of the old series of £1 notes, which ceased to be legal tender on the 28th May.[a] Over the whole period from the announcement of the recall at the end of February up to mid-June some £210 million of the old series of notes were paid; but only about £120 million of these were exchanged for new notes. Some £50 million of the difference may have been held as deposits with the clearing banks, and a further £40 million invested in various other ways, in particular in National Savings.

One result of the fall in the note circulation was that the share of the Exchequer deficit financed from sources outside the banking system was some £50 million lower, and the share from the banking system £50 million higher, than they would otherwise have been.

The banking system Borrowing from the banking system totalled £141 million during the quarter, made up in the following way:

GOVERNMENT DEBT AND BANK OF ENGLAND NOTES

Holdings of the banking system

£ millions		
Bank of England, Banking Department:		
Direct holdings ...	−110	
Indirect holdings ...	+ 15	− 95
Clearing banks and Scottish banks:		
Treasury Bills ...	+126	
Stocks	+ 93	
Indirect holdings ...	− 26	+193
Bank of England notes (including coin) ...		+ 43
		+141

The Banking Department's direct and indirect holdings fell by £95 million. This was due mainly to the release of Special Deposits, which fell by £75 million, and partly to a reduction of £22 million in the clearing banks' ordinary deposits with the Bank of England. This reduction was associated with a seasonal increase in these banks' holdings of notes and coin. A seasonal rise in the clearing banks' and Scottish banks' direct and indirect holdings of marketable government debt was in any case to be expected, but, because of the release of Special Deposits and also because of the exceptional fall in the note circulation, the actual increase of £193 million was especially large.

As mentioned above, one consequence of the withdrawal of the old series of £1 notes is thought to have been an increase of about £50 million in net deposits with the clearing banks. This increase, together with a rise of around £90 million to be expected on seasonal grounds, is sufficient to account for the recorded increase of £142 million in net deposits. The underlying trend was therefore about level. At the end of the quarter net deposits were only £32 million (½%) higher than a year before; and this small difference can be attributed to the recall of the old series of notes. Net deposits with the Scottish banks were unchanged over the quarter.

[a] The recall of the old series of £1 notes is also discussed in an article on page 186.

The clearing banks' advances (excluding advances to the nationalised industries) rose by £54 million during the three months. Seasonal factors are unlikely to account for more than a small part of this rise. Advances changed little in the first two months of the quarter, but appear to have turned up sharply in June. The change of trend, which was confirmed by a further increase of £46 million in July, was evidently an immediate reaction to the announcement on the 31st May of the partial release of Special Deposits and to the accompanying intimation to the banks that the restriction of lending for consumption (but not for speculative purposes) might now be somewhat relaxed, and was sharper than had been expected, especially as some reports had suggested that the demand for advances was not very strong.

The Scottish banks' advances, other than to the nationalised industries, also rose during the quarter, by £10 million, but most of this increase occurred early in the period. Advances rose further in July.

The latest available analysis of advances by members of the British Bankers' Association sheds no light on the latest trend in advances, since it relates to the middle of May, before the release of Special Deposits had been announced. During the three months from mid-February to mid-May total advances (other than to the nationalised industries) rose by £82 million. After allowing for seasonal factors, this was equivalent to an underlying increase of around £25 million—a smaller rise than in the previous quarter. Still allowing, so far as possible, for seasonal variations, it appears that there was some continued expansion of advances to private industry, but it was not widely spread: the engineering industry and some sections of the textile industry (but neither cotton nor wool) were the main borrowers. There were also some sizeable increases in two of the categories associated with personal consumption—retail trade (perhaps to finance higher stocks), and personal and professional. On the other hand advances to hire purchase finance houses, which had been severely reduced in the two previous quarters, fell again, though only very slightly; and advances to "other financial" borrowers also fell, no doubt reflecting the continued restraint on advances for speculative purposes.

The London clearing banks' advances to the nationalised industries fell during the quarter ended mid-June by £29 million, so that the increase in their total advances was only £26 million and the ratio of advances to gross deposits declined slightly, from 45·5% to 44·9%. The banks judged that their liquidity ratios, fortified by the release of Special Deposits, were high enough to allow them to add to their holdings of gilt-edged stocks, on which yields still looked high but were expected to fall. Despite these purchases, which totalled £91 million, the combined liquidity ratio rose from 32·6% to 33·4%.

The Scottish banks did not add to their gilt-edged portfolios until June, and in the quarter as a whole their purchases were very small.

The London discount houses reduced their Treasury Bill holdings by £32 million during the quarter, but added £17 million to their bond holdings. The net decrease of £15 million in their holdings of marketable government debt has been included above as a fall in the "indirect" holdings of various other holders.

Accepting houses and overseas banks Some evidence of the smaller scale of movements of overseas funds in the second quarter is provided by the figures for the accepting houses and overseas banks in London.[(a)] Deposits held for overseas residents in sterling and other currencies rose by £72 million (compared with £133 million in the previous quarter); and because advances to overseas residents also increased, by £65 million, the amount of overseas funds available for lending within the United Kingdom rose only by £7 million. U.K. residents' deposits rose by £55 million and advances to U.K. residents by £58 million—in each case a greater increase than in the previous quarter. Purchases of gilt-edged stocks (£23 million) were higher than for some time past, but short-term assets in London fell. Money with the discount market and holdings of Treasury Bills declined by £21 million and

(a) These figures relate to the calendar quarter. These banks are not included in the "banking system" as defined in this analysis.

£22 million respectively. Temporary loans to local authorities rose by £24 million, but this was a much smaller increase than in the previous quarter. The additional funds for local authorities were provided by the accepting houses and the British overseas banks, while " other foreign banks " withdrew some money from this market, apparently to repay overseas depositors.

Private sector The financial surplus[a] of the whole private sector (including both persons and companies but not the banking system) in the quarter under review was probably at about the same level (after allowing roughly for seasonal factors) as in the two preceding quarters.

Companies Among the components of the private sector, the financial surplus of companies had begun to fall during 1960, and by 1961 had become a deficit, but there are signs that by the beginning of 1962 this decline had ceased. National income figures show that, seasonal factors apart, there was some recovery in company profits in the first quarter of 1962 (though not too much significance should be attached to one quarter's figures), while expenditure on fixed investment and stocks was lower than it had been during most of 1961. It may therefore be inferred that there was some underlying decrease in the financial deficit of companies in the first quarter of 1962, though this was temporarily overlaid by the discharge of tax liabilities incurred on a higher level of earnings in the past.[b] It is too soon to say whether this improvement has continued.

The available evidence about the second quarter points to some increase in borrowing by ' non-financial ' companies. Bank advances to them rose for the first time since the second quarter a year before (excluding the seasonal increase in the first quarter of this year, associated with heavy tax payments); and capital issues rose from £72 million in the first (calendar) quarter to £98 million in the second. This increase in borrowing may have been matched by an increase in total liquid assets; but there is as yet no firm evidence of such an increase except in the figures of Tax Reserve Certificates:[c] " other holdings " of the certificates, mainly company holdings, rose more than in the corresponding quarter of last year. Judging from the figures, already quoted, of " Other home and overseas non-official " holdings of Treasury Bills and gilt-edged stocks, it is unlikely that ' non-financial ' companies were replenishing their holdings of these assets.

Capital issues by financial institutions[d] other than banks were slightly less than in the previous quarter. There was probably some fall in bank advances to " other financial " borrowers and little change in advances to hire purchase finance houses.

Persons The quarterly estimates of national income show that personal savings in the first quarter of 1962 were, for the first time since 1959, no higher than a year earlier. Seasonal factors apart, consumers' expenditure rose between the last quarter of 1961 and the first of 1962 by more than personal disposable incomes (much of the increase being due to higher prices), and personal savings therefore fell. Despite a slight fall in personal capital expenditure, mainly on new houses, this implies some fall, but perhaps only a temporary one, in the financial surplus of persons.

It is not easy to identify such a fall in the changes in the financial assets and liabilities of persons. There was little change in the rate of net personal borrowing in the first quarter but apparently some increase in the second quarter. Bank advances in the personal and professional category rose by £14 million in the quarter ending in mid-May, and building society mortgages were reported to be more freely available. The reduction in personal hire purchase debt came to an end. On the other hand identifiable assets held by persons appear to have risen during the second quarter (seasonal variations apart) at much the same rate, in aggregate, as in recent quarters, though

(a) Excess of saving over expenditure at home on fixed assets and stocks.

(b) Income and profits tax paid by companies in this quarter totalled about £1,020 million, compared with £890 million a year before.

(c) See the article on page 176.

(d) Not including property companies, which are classified as ' non-financial '.

the composition of these assets was changed in an unusual way. As already explained, the withdrawal of £1 notes in the old series led to a 'once-for-all' decrease of some £90 million in the note circulation. This decrease, which took place partly in the first quarter but mainly in the second, is presumed to relate to notes previously held by persons. Various other assets were apparently substituted for the withdrawn notes. Personal bank deposits, for example, probably rose for this reason, and the modest and short-lived improvement in National Savings may perhaps be attributed to the same cause. The growth of deposits with the Special Investment Departments of Trustee Savings Banks had accelerated in the first quarter, when they rose by £29 million, and these deposits probably continued to rise in the second quarter at much the same rate.[a] The net flow of funds into building society shares and deposits had also risen sharply in the first quarter to £83 million (compared with £61 million a year earlier). Most building societies raised their rates of interest during the third quarter of 1961 and have since maintained them despite successive reductions in Bank Rate. In the second quarter these rates were relatively attractive (compared, for example, with those offered by finance houses or with the return on Defence Bonds), and there was a continued high rate of inflow of funds to the societies. Other important outlets for personal savings are life assurance and pension funds and local authority mortgages; these probably continued to absorb a substantial part of the financial surplus of persons.

A general impression is that there was a moderate increase in borrowing both by companies and by persons during the first two quarters of this year, particularly in the second when some restrictions on borrowing were eased. The increase was not apparently associated with any considerable rise in current or capital expenditure, but seems to have been offset by an increase in the rate of accumulation of financial assets.

[a] The Special Investment Departments are excluded from National Savings in the analysis of Exchequer financing (see Table 1 of the Statistical Annex) because their funds are not wholly invested in government debt. The greater part of recent accruals has been lent to local authorities.