COMMENTARY

The external monetary situation has been broadly satisfactory during 1962, and the rate for sterling against the U.S. dollar has remained almost continuously above parity. At home, output has risen, though from a low starting point. In the financial sphere, an outstanding feature has been the strength of the gilt-edged market, and with it the market for other fixed interest securities: the yield on a twenty-year government stock fell from about 6¼% in June to below 5½% at the end of November, and on an industrial debenture of the same maturity from about 7% to about 6%.

Some important developments of policy have been announced during the last three months. At the end of September a release of Special Deposits was announced, the second this year, and early in October the various requests to the banks and other financial institutions to exercise restraint in lending were withdrawn. At the same time the Chancellor of the Exchequer stated that there was to be a further repayment of post-war credits, and further increases, beyond those forecast earlier, in public sector capital investment, particularly in Scotland and the North of England. Early in November the Chancellor told the House of Commons that he intended in his next Budget to propose tax concessions for investment in plant and machinery and industrial building; plant and buildings used for scientific research would be particularly favoured. The concessions would be retrospective to the date of the announcement. The Chancellor also reduced purchase tax on cars from 45% to 25%. At the end of November it was announced that the remaining Special Deposits would be released during December.

Some of these acts of policy represented the removal of restrictions which had been imposed in 1961 or earlier and which were no longer necessary, while others represented a moderate additional stimulus which the prospects for 1963 now suggested was appropriate. They also included changes in taxation to help the economy, and exports, to grow more rapidly. The rest of this Commentary sets the background for these policy measures and touches on their possible effects. Not all the information there discussed was known when the measures were announced.

Domestic economy

Industrial production, seasonally adjusted, was about 1% higher in the third quarter of 1962 than in the second quarter. This increase compared with one of about 2% between the first and second quarters.

Comprehensive figures for the various categories of expenditure during the third quarter were not available at the end of November, but it was nevertheless possible to form a fairly clear impression of the main trends. For example, the volume of personal consumption, seasonally adjusted, had almost certainly risen again. Wages in the engineering and shipbuilding industries had increased in July, and in a few smaller industries later in the quarter, and retail prices were lower. In particular, food prices, which had risen abruptly earlier in the year because of a shortage of vegetables, had fallen steadily, and were about 2½% lower on average in the third quarter than in the second. Retailers generally reported some improvements in trade in August and September, and the total volume of their sales, seasonally adjusted, rose by 1¾% between the two quarters. Sales of clothing, which had been sluggish earlier in the year, rose strongly, and sales of household durables also increased. New cars also seem to have sold well during the late summer; used car prices were steady at that time.

There was also probably a further increase between the second and third quarters in public authorities' current expenditure. Fixed investment, which had changed little in aggregate during the two previous quarters, was probably continuing to run level, though there will again have been divergent movements in the various components of the total. Public capital expenditure is on a rising trend, and some private capital formation has also been increasing. New private housing work by contractors, for example, rose in the third quarter, and there was a marked expansion in some other property development, such as the building of shops and offices. On the other hand, fixed investment by manufacturing industry, which has been declining since the third quarter of 1961, probably weakened further in the third quarter of 1962, when a number of large schemes were completed.

Exports, seasonally adjusted, changed little in total between the second and third quarters. At home, stocks, which had fallen a little in total in the first quarter and risen a little in the second, probably rose again in the third quarter, though hardly far enough to raise output significantly. Imports of industrial materials and fuels increased during July—September, and at least part of this increase must still have been held by industry in one form or another at the end of September. Retailers' stocks, which had fallen during the second quarter, were little changed in the third, in spite of larger sales.

The rise in output during recent months has not been accompanied by a fall in unemployment. Indeed between July and October unemployment rose by 100,000; only about half of this increase was due to seasonal factors. It seems that some employers, having less confidence in the future, were no longer content to have a labour force larger than their immediate needs, while others were using labour-saving equipment installed earlier and needed fewer workers. By mid-October the total number of unemployed exceeded 500,000. This total was equal to 2·2% of all employees, the highest percentage since the early months of 1959. Between mid-October and mid-November unemployment rose by a further 43,000, or more than double the usual seasonal increase. The percentage rate went up to 2·4.

The prospects at the end of November were for a further rise in output. Exports were expected to increase during the early part of 1963, if less rapidly than previously, and there would be further increases in public current and capital expenditure. The extra £70 million of public capital investment announced by the Chancellor in October was to be undertaken quickly. £15 million was expected to be spent before the end of March, and £40 million during 1963/64, bringing the rise in that year to nearly 7% in real terms. Other proposals were being considered for further investment in electricity, and this could bring the increase to over 10%. A rise in private house building was in progress (judging from the figures of houses started in recent months) and there was also likely to be a further increase in certain kinds of commercial building (judging from contractors' reports of new orders). Personal consumption was expected to grow moderately; car buying in particular would be encouraged by the reduction in purchase tax. Stocks and work in progress were also likely to rise, and at a rather higher rate, in the early part of 1963, as output increased and business confidence revived. All these forms of expenditure should benefit from the removal of credit restrictions. Credit was mostly cheaper than it had been earlier in 1962, and the banks, finance houses and building societies were all in a good position to provide it.

The prospects for fixed investment by manufacturing industry were harder to assess. The steel, motor, and chemical industries had been investing heavily in recent years, and a decline in their expenditure was expected. Forecasts of all manufacturers' investment expenditure suggested that, in aggregate, such fixed investment would be about one-tenth less in 1963 than in 1962, but these forecasts had been compiled before the Chancellor's tax concessions, designed to raise investment and keep it high, had been announced. Even without an upward revision in manufacturers' plans, no fall in fixed investment as a whole, public and private, was foreseen.

The release of Special Deposits The release of Special Deposits which was announced on the 27th September amounted to 1% (of gross deposits) for the London clearing banks and ½% for the Scottish banks. Half the release was made on the 8th October, and half on the 15th October. Thereafter the amounts still deposited with the Bank of England became 1% and ½% respectively. After the announcement of the release these banks were informed that previous requests to them—in July 1961 and May 1962—to exercise restraint and discrimination in the granting of credit had been withdrawn: and that the Bank of England were confident that the banks in deploying their resources would continue wherever possible both to foster exports, and to assist activity in areas where labour and plant were not fully employed.

The Bank also informed other banks in the United Kingdom, including the associations of the overseas and foreign banks and the Accepting Houses Committee, that similar requests made to them for restraint in lending had been withdrawn. Similar letters were sent by the Bank to the British Insurance Association, and to the Finance Houses Association and the Industrial Bankers Association.

The release of Special Deposits, and the withdrawal of earlier requests to the banks and other financial institutions, were intended to promote an increase in the total amount of credit granted and to encourage a raising of business activity. Applications for credit for personal consumption and for building and property development were expected to increase most, because these were the spheres where restrictions had been most rigorously applied. Some rise in demand by manufacturers also seemed likely; but it was doubtful whether total demand for bank advances would prove as strong as in the year following the removal of credit restrictions in July 1958, when advances by the London clearing banks rose by some £670 million and advances by the Scottish banks by some £55 million. The banks were well placed to meet likely demands for new credit in the short run—the London clearing banks' liquidity ratio was over 33% even before the release of Special Deposits—but they were not so well placed to meet a strong and sustained rise as they had been in 1958. Advances already amounted to 45% of the total deposits of the London clearing banks (compared with about 30% in 1958) and investments, though higher in September 1962 than a year earlier, still amounted to only about 16% of total deposits.

In the first complete month after the release, from mid-October to mid-November, advances by the London clearing banks rose by some £20 million; seasonal influences are usually neutral at this time of year.

In October it seemed that the hire purchase finance houses would both have the resources, and also experience the demand, to make some increase in business possible, but a rapid rise seemed unlikely. The houses were expected to be discriminating in their acceptance of proposals, so as to avoid any repetition of the losses sustained during recent years. The reduction in purchase tax in November will widen the potential market for cars, but the average value of a hire purchase contract will probably be lower.

The gilt-edged market

The gilt-edged market had been firm during the first half of the year; yields had fallen and the authorities had made substantial sales of stock. Early in July there was a further, and sharper, fall in yields, and during the whole third quarter the market was exceptionally strong. By mid-October most yields were between ½% and 1½% lower than at the end of June. There was some reaction in the second half of October, partly because of the international crisis over Cuba, but yields at the end of the month were still up to 1¼% lower. As the second graph on page 292 shows, the sharpest falls in yields between the end of June and the end of September were in the stocks with about ten years to run to maturity (the yield pattern in mid-October was broadly similar).

The general strength of the gilt-edged market between June and October was partly a result of a reassessment of the prospects for equities which had begun several months earlier, and partly a response to official indications that a fall in yields would not be opposed. Buying of gilt-edged spread from medium-dated stocks to long-dated and undated stocks as the disparity in yields increased. Few overseas purchases of gilt-edged stocks are believed to have been made, but there was heavy domestic demand; the banks, insurance companies and pension funds were reported to have made substantial purchases. Turnover increased towards the end of the period and the total number of transfers received in the Bank for registration during October was the highest for any month for many years.

Official policy in July and August allowed medium and long-dated yields to fall more rapidly than earlier in the year; nevertheless the demand for longer-dated stocks, once sharpened, became so strong that official holdings of 5% Treasury Stock 1986/89, a further tranche of which had been issued in May, were practically exhausted by the end of August. The authorities moderated the outflow of cash from the market by buying short-dated stocks. In September the authorities sought to steady the fall in yields: a further tranche of £500 million $5\frac{1}{2}$% Treasury Stock 2008/12 was issued early in the month, the price of which was allowed to rise only slowly, despite heavy official sales. In a strong market this policy kept the yield above that of other long-dated stocks, and investors were tempted to switch, that is to buy the new tranche against a sale of another long-dated stock. Although the authorities became less willing to provide the market with such switching opportunities, official holdings of the new tranche were exhausted by the middle of October. Thereafter the authorities had available a portfolio of other stocks, largely acquired through earlier switching, and augmented during the Cuban crisis, when the authorities gave some support to the market.

At the shorter end, official selling of 5% Exchequer Stock 1967, which had been issued in June, ceased in September, and early in October a new stock, 4% Treasury Stock 1965, was issued. £100 million was offered for cash subscription, and was oversubscribed by the market. In addition, some £290 million of the new stock was issued to those holders of a maturing stock, £300 million $5\frac{1}{2}$% Treasury Bonds 1962, who accepted an offer of conversion.

During the third quarter other fixed interest securities were made available to the market on an unusually large scale. A number of these issues were by local authorities and were of stocks with a life of some ten years. Official sales of gilt-edged stocks in this particular range were not heavy. Official operations at this time are also referred to in the Quarterly Analysis of Financial Statistics on page 246.

Short-term money rates

Short-term rates tended to decline during the three months ending in October. At the outset the Treasury Bill rate was already low in relation to Bank Rate; nevertheless it declined gradually but steadily right up to mid-October. The discount market was throughout particularly anxious to secure good allotments of Bills; its portfolio was still low in relation to bond holdings and it also wished to meet the demands of customers, particularly the banks, for Bills. The market expected these demands to be especially heavy while Special Deposits were being released. It was also facing strong competition at the tender, because there was a general belief that Bank Rate would soon be reduced. Over the two-and-a-half months to mid-October the market's tender rate fell from $3\frac{13}{16}$% to $3\frac{5}{8}$%, a rate which can have allowed little or no running profit. In the second half of October hopes of an early reduction in Bank Rate faded, and the Cuban situation added a new uncertainty. The discount market raised its tender rate sharply, and by the end of the month it had reached $3\frac{7}{8}$%.

Local authority borrowing has risen steadily in recent years, and the third calendar quarter is customarily a period of heavy borrowing because local authority income from rates is low. There was probably little increase this year in the supply of funds from overseas to meet these heavier needs. Nevertheless short-term interest rates declined slightly in August, and, after fluctuating in September, fell away further in October, when half-yearly rate payments became due. The decline was probably facilitated by a further movement away from temporary borrowing and towards longer forms of debt, that is mortgages and stock issues (such a movement was apparent in the second calendar quarter). Mortgage rates, influenced by the fall in gilt-edged yields, fell more steeply than short-term rates. Local authorities, expecting that the Government would in due course seek to restrict the amount of their temporary borrowing, were thus encouraged to lengthen their debt in good time; and they probably found ready lenders among those who were expecting rates to fall still further.

The hire purchase finance companies, which are other important borrowers of short-term money, were not particularly active seekers of such money during August—October. The total of deposits with the companies, and the rates offered, fell slightly, as did the total of debt owed to them.

The equity market

Prices of industrial ordinary shares had fallen by no less than 15% between the end of April and the end of July; half of this fall had been reversed by mid-August, but there was little further change before the end of October. There were some signs that profits had begun to rise again—gross trading profits in the second calendar quarter, seasonally adjusted, were higher than in the first—but the prospects for a further rise during the rest of 1962 and 1963 were considered to be far from assured. The gilt-edged market also provided a strong counter-attraction to the equity market during August—October.

The reserves; foreign exchange markets The reserves of gold and convertible currencies fell by £33 million during the three months August—October. Part of this reduction was due to the maturity of the swap arrangement under which the Exchange Equalisation Account had acquired $50 million in May against the deposit of £18 million to the account of the Federal Reserve Bank of New York at the Bank of England. This arrangement had been made to establish the machinery and the U.S. authorities did not spend the sterling thus obtained. The United Kingdom has undertaken to renew this swap arrangement if required.

Excluding this special transaction, the reserves fell by £15 million, a modest reduction for the time of year, and seasonal pressures in the exchange market were met without difficulty. The rate for sterling against the U.S. dollar fell from $2·80\frac{1}{2}$ early in August to $2·80\frac{1}{8}$ in early September despite some support by the authorities towards the end of August. In the third week of September the rate weakened a little further in spite of some fresh support. It then recovered quickly and the support was recouped. Early in October the underlying strength of sterling became more readily apparent and the rate rose to $2·80\frac{1}{4}$. The Cuban crisis towards the end of the month caused scarcely any selling of sterling and little movement in the exchange rate. Sterling remained strong during November.

The information at present available does not provide a full explanation for the strength of sterling during August—October. The trade balance had deteriorated, and some of the statistics suggested that an outflow of capital, or only a small inflow, had been occurring. For example, sterling holdings of overseas countries fell by £69 million during the third quarter. The margin in favour of uncovered investment in London rather than in New York, on the Treasury Bill comparison, was less than 1% per annum for almost all of August—October, and the margin in favour of covered investment on the same comparison was small. Moreover on only a few occasions was the interest obtainable on three months' deposits with local authorities, after allowing for the cost of forward cover, above the rate paid by London banks on U.S. dollar deposits.[a] The rate for security sterling in New York remained below that for external sterling. These two rates tend to be equal whenever there is substantial buying of U.K. securities by foreigners, so that it is unlikely that there was any such buying at this time.

It is possible, however, that the strength of sterling was partly due to undetected transactions of a capital nature. It may be that some U.K. importers had greater undischarged obligations to overseas exporters at the end of the third quarter than at the beginning. Another possible explanation is that some U.K. exporters were receiving payment during the third quarter for goods exported during the earlier months of the year when exports were rising strongly.

Conditions in continental exchange markets were quiet between the beginning of August and the middle of October and there were few signs of movements of capital. The rate for the U.S. dollar against the main continental currencies therefore reflected the course of underlying balances of payments. Rates against the deutschemark, and for a time against the Swiss franc, moved in favour of the dollar, but in Paris and Milan rates remained for almost the whole period at the levels at which the authorities there are accustomed to intervene.

The main impact of the international crisis at the end of October was felt in the gold market,

(a) In the second half of October Italian banks offered higher rates of interest on dollar deposits, and it became profitable for holders of sterling to switch into dollar deposits, covering their spot sales of sterling with three months' forward purchases. The discount on three months' forward sterling thus fell, and the margin in favour of covered investment in Treasury Bills in London rose, so that for a time investment funds may have moved both into, and out of, London; on balance there was perhaps a net outflow. Later the demand for dollar deposits fell, the forward margin widened again, and by the middle of November the margin in favour of covered investment in London, on the Treasury Bill comparison, had fallen to $\frac{1}{8}$% per annum.

but it also caused a sharp fall in rates for the U.S. dollar in some European centres, particularly Switzerland where the authorities intervened. The deutschemark, exceptionally, weakened, because of fears that the crisis might extend to Berlin; but on the whole the exchange markets were surprisingly little disturbed.

Gold market By the middle of August the gold market had become quiet and demand did not revive again appreciably until the middle of September. From then until the third week of October demand became sufficiently strong to require some intervention by the authorities. In the two days following President Kennedy's speech about the Cuban crisis, demand for gold was the heaviest experienced since the London market was re-opened in 1954; sales by the Bank of England were very large but the price rose from $35·14 to $35·20. Gold coins were also in heavy demand. The buying of both bar gold and coin appeared to come largely from the Continent. Demand then subsided and by the middle of November the price had fallen to about $35·09.

Conditions abroad Activity in the main industrial countries continues to rise, though there are still signs of some slackening in the rate of growth.

In the United States domestic demand seems to be continuing to grow but only slowly; unemployment is still over 5% of the labour force. In the third quarter the gross national product, seasonally adjusted, is estimated to have risen at about half the pace of the previous quarters of the year. The rate of stock accumulation continued to decline, but personal consumption continued to rise and government expenditure, private house building and other private fixed investment were slightly higher. Changes have recently been made in tax allowances for investment, and the Administration have promised to submit to Congress early next year fresh proposals for changes in taxation, including general reductions in personal and company taxes.

In the European Economic Community activity continues to grow faster than in the United States, but at a slower pace than earlier in the year. Personal consumption and expenditure on construction seem to have provided the main stimulus, exports to the rest of the world having almost ceased to rise. The rate of growth of private fixed investment in plant and machinery has probably continued to slow down; and narrower profit margins may further diminish the willingness to invest. Stockbuilding seems to have been small recently. Some increase may occur even if the growth of output continues to slow down, but personal consumption and public expenditure seem likely to provide the main expansionary force in the near future.

Elsewhere in Western Europe, although there are substantial differences in economic conditions between individual countries, some restraint on activity is evident. In Austria, Denmark, Norway, and Switzerland policy is being directed towards limiting the growth of domestic demand. In Sweden, where growth had almost ceased, steps taken to stimulate investment have resulted in some signs of increased activity.

In these circumstances little improvement has occurred nor can much be expected soon in prices of primary commodities, or, generally speaking, in the earnings of countries whose export income derives mainly from the sales of such commodities. Among overseas sterling area countries only Australia and South Africa have had the means in recent months to expand their imports appreciably.

The external accounts of some of the main industrial countries have moved towards a better balance during 1962, although the U.S. deficit seems to have grown again recently. In the first six months of 1962 the U.S. deficit, as measured by changes in gold and convertible currency holdings and in liquid liabilities to foreigners, was substantially smaller than in the second half of 1961. In the third quarter it seems to have widened, but the second quarter was favourably, and the third quarter unfavourably, affected by disturbances in transactions with Canada.

Canada's overall balance of payments improved rapidly after international help was made available at the end of June. The capital inflow, which has been an important feature of Canada's balance of payments in recent years, re-emerged, and reserves of gold and foreign exchange rose rapidly. At the end of October Canada repaid half the U.S.$250 million received in June, under a swap arrangement, from the United States; and the amount of the assistance extended in June by the Bank of England to the Bank of Canada was reduced from U.S.$100 million to U.S.$50 million.

Western Germany's imports have been rising more rapidly than its exports since early 1961; and its deficit on account of current invisible transactions has been growing. As a result Western Germany is now in current deficit for the first time since 1950. Long-term capital transactions have been roughly in balance so far this year. France remains in substantial surplus on current and long-term capital account; but Italy's earlier surplus has been much reduced by an outflow of capital.

The Japanese balance of payments on current account moved into substantial deficit during 1961 following a very rapid expansion of domestic demand. Restrictive measures have now brought about a small surplus, so that relaxation has become possible.

The United Kingdom's balance of payments on current account improved between July 1961 and the second quarter of 1962, as is shown below.

International payments thus seem to be approaching a better balance than for some time, and the strains upon the payments system seem to be easing. The recent ratification by the U.S. Congress, and thus the entry into force, of the arrangements agreed in December 1961 to augment, in certain circumstances, the resources of the International Monetary Fund will help to meet such strains in the future. Further measures to supplement international liquidity are now being discussed. The United Kingdom's tentative proposals were put forward by the Chancellor of the Exchequer at the I.M.F. meeting in September 1962.

U.K. balance of payments

There is usually a deterioration in the balance on current account during the third quarter. Holidays restrict exports more than imports and bring a net rise in travel payments. This year the deterioration seems to have been larger than usual, mainly because the trade balance worsened more than seasonally. The current account surpluses earned in the first two quarters were probably replaced by a deficit.

The steady rise in exports, seasonally adjusted, which had taken place during the first six months of the year, was interrupted in July. For the third quarter as a whole exports were little different from the total for the second quarter. Shipments of fuel rose sharply and those of metals, metal manufactures and road vehicles slightly. But most other classes of exports, and particularly ships and aircraft, declined. Western Europe continued to provide the fastest growing market for U.K. exports, but in the third quarter expansion in that market was offset by a reduction in shipments to sterling area countries, and to non-sterling countries in the Middle and Far East. Exports to Australia continued to recover with the rise in domestic demand there; but exports to other sterling area countries, notably India and New Zealand, suffered because of the balance of payments difficulties of those countries. Exports to Japan felt the effect of the restrictive measures taken earlier and mentioned above.

On the other hand imports, seasonally adjusted, rose appreciably in the third quarter. Imports of food still reflected the shortage of home supplies of vegetables; and although by September these imports were falling, total food imports for the quarter remained unchanged. But imports of fuels and industrial materials rose sharply. The increase in imports of fuels (mainly crude petroleum), which reflects rises both in exports of refined products and also in stockbuilding, may not continue for long. But it now seems that imports of industrial materials reached a low point during the first half of this year.

The development of the U.K. balance of payments between July 1961, when the restrictive measures were taken, and the middle of 1962 seems to fall into two stages. First, in the last five months of 1961, imports were curbed sharply and there was an inflow of capital—partly a reversal of the earlier outflow—which was large enough to ensure a small surplus on current and long-term capital account. Secondly, in the spring and early summer of 1962, the inflow of capital fell away, partly in response to lower interest rates; but there were improvements, partly seasonal, both in the trade balance and in current invisible transactions, and the surplus on current and long-term capital account increased. So far as the improvement in the trade balance was not seasonal it was due to a rise in exports, itself partly attributable to an improvement in the United Kingdom's competitive position.

The upward trend in exports was resumed in October; indeed there were increases in all the main classes of goods, and in shipments to all the main areas. Imports also increased sharply. Imports may continue to rise as home demand increases, but a relatively satisfactory balance of trade should be maintained. In the longer run, however, a faster growth of exports remains essential, and it is therefore most important to pursue vigorously all measures to improve the competitiveness and efficiency of British industry. Such improvement will be all the more necessary if the future growth of world trade should be slower than it has been in recent years.

QUARTERLY ANALYSIS OF FINANCIAL STATISTICS

21st June—19th September 1962

This quarterly analysis is in a somewhat different form from its predecessors. The first part describes the financial situation of the private sector (that is, private individuals, partnerships, unincorporated businesses and companies outside the banking system). In most recent quarters the private sector has saved enough out of its current income not only to invest in new fixed assets and to add to stocks and work in progress, but also to take up financial or overseas assets (or reduce financial or overseas liabilities). The amount so taken up is called its " financial surplus ". The financial assets acquired, such as deposits with banks, holdings of government securities or claims on overseas residents, are the liabilities of other sectors. These sectors are the banking system,[a] the public sector (Central Government, local authorities and public corporations), and overseas residents. The financial transactions of the private sector are affected both by the size of its surplus and also by the many factors which cause changes in the relative attractiveness of different assets (or liabilities).

Financial statistics have recently been improved considerably and there is hope of further progress soon. So far, however, it is possible to make only an incomplete analysis of changes in the private sector's financial assets and liabilities, and there are still important gaps in the information about sub-groups, such as persons or companies. A particular weakness in the figures is that it is not always possible to distinguish between the financial assets of overseas residents and those of the domestic private sector; for example, to tell how far a change in private holdings of Treasury Bills is due to overseas holders and how far to home holders. But a short section about overseas funds in the first part of this analysis gives some indication of the extent to which overseas movements may have affected the estimates for the private sector.

The analysis then considers the banks, and comments on the main changes in their assets and liabilities and on their transactions with the public sector. The last section considers the public sector—what has been its need for finance, and how its obligations to the various other sectors have changed. Because the public sector's liabilities are the financial assets of the other sectors, this section is a re-examination, from another standpoint, of what has been considered previously.

More important in the September quarter than any changes in the financial surpluses and deficits of the various sectors were the considerable changes in preference between different sorts of asset. The leading influence was the general expectation that interest rates, long-term as well as short-term, were likely to fall. This led to a greater demand for fixed interest securities, particularly long-dated loans and those with no final redemption date. At the same time ordinary shares remained under the influence of the uncertainties which caused and followed the sharp break in equity markets in May.

[a] " Banking system " is at present defined to cover only the London clearing banks, the Scottish banks and the Banking Department of the Bank of England.

In these circumstances, as investors sought to rearrange their assets, sharp variations in relative yields and interest rates occurred. These variations were moderated to the extent that debtors—whether the Exchequer Group, local authorities, or private borrowers—were willing and able to alter the structure of their debt. The fall in long-term rates also provided some incentive to companies in need of funds to choose fixed interest debt rather than equity financing.

Overseas funds Despite an apparent deterioration in the current balance of payments in the third calendar quarter, the balance of monetary movements seems to have been favourable to the United Kingdom. The official reserves fell by £229 million, but certain net short-term liabilities to overseas residents fell more. Overseas sterling holdings declined by £264 million in total: holdings of international organisations fell by £195 million; other overseas official holdings by £52 million; and non-official holdings by £17 million. There was also a reduction of some £40 million in the banks' net deposit liabilities in foreign currency. Acceptances by U.K. banks, on the other hand, fell by £16 million.

If the current account really deteriorated, while monetary movements remained favourable, then, unless there was a large fall in net direct investment overseas in the third quarter, there must have been a capital inflow of some kind, perhaps including a net extension of trade credit to the United Kingdom (as was suggested on page 239). The inflow may perhaps have exceeded £50 million. This possibility affects the discussion below of the financial transactions of the home private sector, in which some of the figures quoted may relate in part to changes in the direct employment of overseas-owned funds, or to the use of funds arising from an increase in private sector indebtedness to overseas.

Private sector Preliminary information suggests that in the third quarter the financial surplus of the private sector was somewhat below last year and, after allowing roughly for seasonal factors, probably lower than in the second quarter of 1962.

The private sector increased its holdings of public sector debt in the quarter ended mid-September, probably by more than £300 million, of which about half consisted of local authority debt. The total may include a small contribution by overseas lenders. A striking feature was the form taken by the lending: " Other home and overseas non-official " holdings of gilt-edged stocks rose by £185 million, by far the largest quarterly increase since 1960. The appetite for marketable stocks was further demonstrated in the subscription of £56 million net to new public issues by local authorities during the third calendar quarter, more than in the whole of 1961. Treasury Bill holdings were reduced by £51 million in the quarter ended mid-September, following similar decreases in each of the three preceding quarters. Some switching out of Treasury Bills into longer-term securities seems to have occurred.

£34 million net was invested in Tax Reserve Certificates, mostly by companies, making a total for the first two quarters of the financial year about the same as a year earlier. A net repayment of £15 million of National Savings in the September quarter can be explained by seasonal withdrawals from the savings banks; there was a small net subscription to other forms of National Savings. In the previous quarter net subscriptions to National Savings had amounted to £40 million, but this was probably partly due to the recall of the old series of £1 notes. About seven million of these notes were presented for payment in the third quarter, reducing the total outstanding to £32 million. It is not expected that the recall of the old series of 10s. notes, announced on the 26th September, will have any appreciable effect on the total circulation, because the value of these notes in circulation on that date was only £16 million.

Net claims by the private sector on the banking system normally rise in the September quarter, deposits rising while advances fall; the actual net rise of £130 million was less than might have been expected on seasonal grounds, so that there was an underlying fall (compared with little change in the previous quarter). The fall may have reflected the increased purchases of gilt-edged stocks already mentioned, and perhaps also a fall in the financial surplus of the private sector.

£36 million of the rise of £130 million in private sector net claims on the banks was due to large subscriptions during the quarter to new long-term capital issued by the banking system, and most—£84 million—of the remainder to movements in deposits and advances. Net deposits with the London clearing banks rose by £77 million and with the Scottish banks by £17 million; advances, other than to nationalised industries, rose by £9 million and £1 million respectively. The increase in net deposits was no more than might have been expected on seasonal grounds. On the other hand it seems that bank advances to the private sector, seasonal factors apart, rose by some £100 million during the quarter as a whole (a steeper underlying rise than in the earlier part of the year). Between mid-August and mid-September, however, advances by the clearing banks, seasonally adjusted, did not rise; the Scottish banks' advances, which had risen in July, were little changed thereafter.

Persons A substantial part of this borrowing from banks was by persons (a term which includes partnerships and unincorporated businesses as well as individuals). The analysis of advances by the British Bankers' Association relating to mid-August showed a total increase since mid-May of £86 million (excluding advances to the nationalised industries). Adjusted for seasonal factors, the total increase in B.B.A. advances between mid-May and mid-August was about £150 million, of which probably over a third was shared between the categories " personal and professional " and " agriculture ".

Identified personal borrowing from sources other than the banks also rose in the third quarter. Hire purchase debt on household goods rose, even though hire purchase business tends to be seasonally slack in the third quarter; and the increase in advances by building societies, which had been apparent in the previous quarter, continued.

This underlying increase in personal borrowing may have been matched by an equivalent increase in the rate of addition to financial assets, though there is no firm evidence of this yet. In National Savings, there was no more than a seasonal variation; and although funds were continuing to flow freely into the Special Investment Departments of the Trustee Savings Banks, deposits with them appear to have risen slightly less than in the previous quarter. Building societies (whose rates of interest remained generally at the levels to which they had been raised a year earlier) continued to attract funds on a considerable scale. Finally persons must be presumed to have contributed to the strong demand for gilt-edged and local authority stocks, either directly, or indirectly through life assurance companies and pension funds. Thus it would be premature to conclude from the rise in personal borrowing that there was necessarily a fall in the savings or financial surplus of persons, which, so far as can be judged from national income figures up to the **second** quarter, have changed little in recent quarters.

Companies Companies were in financial deficit in the year 1961 as a whole, for the first time for many years, but more recently have moved back towards surplus. In the **second** quarter of this year their surplus was higher than in the corresponding quarter a year before, mainly because of lower stockbuilding.

During the **third** quarter there was little change in the rate of identifiable borrowing by " non-financial " companies.[a] Bank advances to them may have risen rather more than in the previous quarter (seasonal factors apart): although advances to manufacturing industry by members of the B.B.A. increased only by £15 million between mid-May and mid-August, there is normally a seasonal fall and the underlying rate of increase was perhaps nearer £50 million. Advances to property companies probably also rose. On the other hand the amount raised through new issues of capital by non-financial companies fell slightly, from £98 million in the previous calendar quarter to £83 million. Market conditions have recently favoured a shift from equity to loan financing. Issues of ordinary shares by non-financial companies in the September quarter were less than half the high figure for the corresponding quarter of 1961, but the creation of new loan capital was well maintained at its recent higher level, and so far this year as much money has

[a] All companies excluding those engaged in insurance, banking, and finance. Property companies are regarded as non-financial.

been raised in this way as by ordinary shares. In the first three quarters of 1961, by contrast, new issues of ordinary shares raised nearly three times as much as those of new loan capital.

Accepting houses and overseas banks Because of a break in the statistical series for the accepting houses and the overseas and foreign banks, which are now compiled in a new form,[a] little can be inferred about movements in their assets and liabilities during the quarter. The only figures virtually unaffected by this discontinuity are those of loans to local authorities and holdings of government stocks, U.K. Treasury Bills, and other sterling bills. Government stocks increased by £53 million in the calendar quarter (mostly attributable to the British overseas banks) and these purchases must have contributed significantly to the increase in the holdings of the private sector in the quarter ended mid-September. Loans to local authorities fell by £27 million during the calendar quarter, and a small increase of £7 million in holdings of Treasury Bills matched a similar fall in commercial bills.

The banking system The movement of deposits and advances has already been described during the discussion of the financial transactions of the private sector, where it was shown that in the third quarter the banking system acquired from the private sector funds amounting to about £130 million net. This was mainly in the form of a seasonal increase in net deposits with the clearing banks and Scottish banks, supplemented by the proceeds of capital issues by the banks. Advances to the private sector rose slightly, though a seasonal fall might have been expected.

Most of the £130 million was matched by lending by the banks to the public sector. Advances to the nationalised industries rose by £20 million, after falling by £30 million during the previous quarter; and the banking system added £99 million to its direct and indirect[b] holdings of government debt and Bank of England notes (as shown in the table on page 246). Included in this increase of £99 million were net purchases of gilt-edged stocks totalling £46 million by the clearing banks and Scottish banks: the Scottish banks' holdings fell by £2 million, while the clearing banks' holdings rose by £48 million. This rise of £48 million was less than in the previous quarter, when Special Deposits were released, but was sufficient to raise the ratio of their investments to gross deposits to 16·3%, compared with a low point of 13·6% on the 30th June 1961. Despite these purchases, the clearing banks' combined liquidity ratio rose during the quarter from 33·4% to 33·7%, an adequate level for the time of year.

The banking system's lending to the Exchequer included a rise of £13 million in the amount lent indirectly through the discount market. The discount houses' borrowing from sources outside the banking system rose only slightly, the increase being offset by a small take-up of commercial bills. The discount market's net purchases of marketable government debt (£5 million of stocks and £8 million of Treasury Bills) were thus equal to its borrowing from the banking system.

Public sector The contributions made by the banking system and by the private sector to the financing of the public sector's deficit have now been described. The Exchequer Group's share of the public sector's deficit amounted to £202 million in the quarter ended mid-September, composed as follows:

	£ millions
Budget: above the line	−100
below the line	−105
overall	−205
Internal extra-budgetary funds ...	− 1
Exchange Equalisation Account ...	+254
Repayments to the I.M.F. etc. ...	−250
Cash deficit	−202

The overall budget deficit in the quarter was much smaller than last year, but the com-

(a) Described in an article on page 267.

(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).

parison may be misleading because of differences in the timing of payments to and from the Exchequer. In contrast, extra-budgetary funds, which last year contributed £75 million, this year cost £1 million. This again is partly due to a difference in timing. Most payments to and from the Exchequer are made through the various government departments, and temporary balances with departments are lent to the Exchequer. This lending appears in the statistics of Exchequer financing under the heading " extra-budgetary funds etc.". Departmental balances fell in the September quarter by nearly £40 million more than in the same quarter last year. There were also this year no substantial receipts from sales of securities by the Iron and Steel Holding and Realisation Agency, which last year raised over £20 million.

External items taken together had virtually no effect on Exchequer financing: the exchange reserves were drawn on, mainly to provide assistance of £36 million to Canada and to repay the final instalment of £183 million of the U.K. debt to the I.M.F.; but the receipts of sterling by the E.E.A. were offset by sterling expenditure, in particular to redeem interest-free notes held by the I.M.F.

The financing of the Exchequer's deficit was divided between the banking system and other lenders in the following way:

GOVERNMENT DEBT AND BANK OF ENGLAND NOTES

£ millions

Holdings of the banking system		
Bank of England, Banking Department:		
Direct holdings	+ 7	
Indirect holdings ...	+ 2	+ 9
Clearing banks and Scottish banks:		
Treasury Bills	+53	
Stocks	+46	
Indirect holdings ...	+11	+110
Bank of England notes (including coin) ...		− 20
		+ 99

£ millions

Holdings of the public, other than the banking system		
Government debt		
Overseas official holders:		
Treasury Bills ...	− 17	
Stocks	− 29	− 46
Other home and overseas non-official holders:		
National Savings ...	− 15	
Tax Reserve Certificates	+ 34	
Treasury Bills ...	− 51	
Stocks	+185	
Indirect holdings[a] ...	—	+153
Bank of England notes		− 4
		+103

Net official sales of stock were sufficient to meet the Exchequer's cash requirement of £202 million, but even this was not the full extent of funding operations. Official net purchases of stocks with less than five years to maturity, especially those due to mature later in 1962 or in 1963, amounted to nearly £200 million, so that net sales of other stocks were about £400 million, about half of these net sales being of stocks of more than fifteen years' life. This activity, followed by heavy official sales of 5½% Treasury Stock 2008/12 between mid-September and mid-October, had the effect of lengthening the average life of dated government stocks in the hands of the market from rather more than twelve years in mid-June to rather more than thirteen years in mid-October.

The public sector's deficit includes not only the Exchequer's cash requirement but also that of public corporations and local authorities. Public corporations obtain their finance through the Exchequer (with some exceptions, such as the increase of £20 million in borrowing from the banking system noted above). Local authorities' borrowing from sources other than the Exchequer is, however, substantial; it had totalled £133 million in the second calendar quarter and must, for seasonal reasons, have been greater than this

[a] Including some overseas official.

in the third. The debt structure of local authorities was changing in a similar way to that of the Exchequer for the reasons given on page 238.

It is a striking feature of the quarter under review that the substantial flow of funds into gilt-edged and local authority stocks took place despite some apparent fall in the financial surplus of the private sector. The explanation is that the marked change in preference between different financial assets was the stronger influence. There was perhaps some diversion of funds from other forms of public sector debt, such as Treasury Bills and National Savings; the changed credit situation made it easier for the private sector to draw funds from the banking system; and there may have been some unrecorded overseas inflow.