

## COMMENTARY

Sterling has been less strong since the middle of January, when it became clear that the negotiations for the entry of the United Kingdom into the European Economic Community were likely to fail, but the rate against the U.S. dollar has not fallen much. At home, the economy has lacked buoyancy. Industrial output, which was rising during the spring and early summer of last year, has since fallen back, and unemployment has grown month by month. By February, after weeks of severe weather, the total for Great Britain had reached 878,000. But neither output nor employment has yet had time to respond more than very partially to the various official measures of encouragement which have been announced during the past six months. The measures taken during September, October and November were discussed in the December issue of this *Bulletin*. They included the removal of credit restrictions, a number of important tax concessions, and an increase in public spending on capital account. Since then, the Chancellor of the Exchequer has reduced the top rate of purchase tax from 45% to 25%; Bank Rate has been reduced from 4½% to 4%; and social benefits have been, or are soon to be, increased, so helping to raise personal consumption.

**Domestic economy** Industrial output in the fourth quarter of 1962, though about 2% higher than in the fourth quarter of 1961, was about 1% lower than in the third quarter of 1962. Exports did not rise as had been hoped, and there was some weakening of business confidence. Manufacturers became less willing to build up stocks or to retain labour surplus to immediate requirements. The fall in employment, and the rise in unemployment, in turn affected consumer demand, which ceased to rise. Unused capacity increased, and many manufacturers became less willing to place orders for new plant and machinery.

Personal consumption was probably no higher in the fourth quarter of 1962 than in the third. Wage rates did not rise much. The total number of people at work in the country

declined, and there was more short-time. Some of those whose incomes were not affected seem nonetheless to have spent more cautiously, or to have refrained from entering into fresh hire purchase commitments. The volume of retail sales did not rise between the two quarters. Sales of clothing and of household durable goods were lower, but sales of food were higher. Purchases of new cars, on the other hand, were well maintained for the time of year, partly, no doubt, because of the reduction in purchase tax at the beginning of November.

Total stocks probably increased less in the fourth quarter than in the third. At the end of the third they were fully up to normal in relation to output. The cost of carrying them was distinctly lower than it had been a year earlier, but just as some private individuals were deciding to buy only for their immediate needs, so some manufacturers were unwilling to anticipate demand for their goods. Fixed investment by manufacturing industry, which had fallen in each of the first three quarters, fell again in the fourth. Other kinds of private fixed investment—in particular building of private houses, shops and offices—which had been rising during the second and third quarters of 1962, also fell in the fourth quarter, but this fall seems to have been largely due to bad weather. The number of private houses started was high for the time of year, and the number under construction at the end of the quarter was also unusually large.

The only factor making for higher output in the fourth quarter seems to have been public expenditure, both current and capital. This has been rising by more than 4% a year in real terms, and the rise probably continued during October—December.

Unemployment rose from 566,000 in December to 815,000 in January and 878,000 in February. Much the most important cause of the rise since December has been the severe weather; about 220,000 were temporarily out of work in February, largely for this reason, and the number wholly unemployed in the building industry was very large. But there

has, at the same time, been a continuing underlying increase. Seasonal factors apart, unemployment rose by some 10,000 a month during the first three quarters of 1962, and thereafter by some 20,000 a month. The continuing underlying increase has been in part associated with a change in the business outlook, arising from the persistence of highly competitive conditions at home and abroad, and relatively low profit margins. There have also been special difficulties for the shipbuilding and heavy steel industries; these have helped to make Northern England the worst affected region in Great Britain, although Scotland and Wales are not much better placed.

At the present time the resources of labour, capital equipment and finance for a substantial rise in output are available, but the factors that would be associated with it make a mixed showing. Current and capital expenditure by the Central Government and local authorities is likely to increase, and capital expenditure by some of the nationalised industries will probably go on growing. Expenditure on private house building seems likely to be greater: speculative builders (who account for over three-quarters of private house building) have planned to start about one-tenth more houses this year than last. Construction of offices and shops will probably rise; indeed aggregate demand upon the building industry seems certain to be heavy. Some growth in personal consumption can also be expected, despite the prevailing caution. Some substantial wage awards have been announced; social benefits are being raised (and higher contributions will not be paid until later); and many durable goods have been cheapened by the cuts in purchase tax. On the other hand, there is little sign of a substantial rise in exports; and fixed investment by manufacturing industry may fall further. Despite the improved capital allowances, there is likely to be a reluctance to invest until the outlook for profits is better and capacity is more fully used, and until the external commercial policy of the United Kingdom, following the breakdown in Brussels, is more clearly seen. In the circumstances, no great change in stockbuilding seems likely.

#### Short-term money rates

The reduction in Bank Rate from  $4\frac{1}{2}\%$  to  $4\%$  was made on the 3rd January, as soon as it was known that the strength of sterling had been unaffected by any end-year disturbance in the foreign exchange market; domestic considerations would have allowed an earlier move. The Bank of England advised the discount market at the same time that in future their loans to the market might on occasion be at a rate of interest higher than Bank Rate, instead of at Bank Rate.<sup>(a)</sup> The Bank will thus be able to vary not only the scale on which the discount market borrows,<sup>(b)</sup> but also the price which it has to pay for the facility at any given level of Bank Rate. Borrowing from the Bank provides an indication of the Bank's attitude towards short-term rates and affects the average cost of the market's borrowing; if the cost rises, or is expected to rise, the market is likely to seek a higher return on its assets—in particular Treasury Bills, which are the most easily influenced. The Treasury Bill rate will therefore tend to be firmer. At times a rise in this rate and in such other short-term rates as generally move in line with it may seem desirable because of the external monetary situation, while domestic considerations may be pointing to a stable Bank Rate. In their daily management of the market the Bank are not always able to determine within narrow limits the scale on which the discount houses borrow. Unforeseen developments may occur and the houses may on occasion borrow more, or less, than the Bank expect. The new arrangements will somewhat strengthen the Bank's ability to influence the Treasury Bill rate, directly and by implication.

The reduction in Bank Rate had long been expected by the discount market. Even in July the market's tender rate had been low in relation to a  $4\frac{1}{2}\%$  Bank Rate, and it fell further during the remainder of the summer. By mid-October it was down to  $3\frac{3}{8}\%$ . The rate then rose, partly because of the Cuban crisis, but it fell again after the middle of November and by early December it was  $3\frac{5}{8}\%$  once more, in spite of some borrowing from the Bank. The discount market was again

<sup>(a)</sup> The change was in fact a reversion to an earlier practice. For many years before the last war—back even into the 19th century—advances were generally made at a margin above Bank Rate. Before 1926, and particularly around the turn of the century, this margin varied; thereafter it was nearly always  $\frac{1}{2}\%$ .

<sup>(b)</sup> See the article on page 15.

expecting a reduction in Bank Rate. It was also particularly anxious to secure good allotments of Bills at this time, because it wished to have Bills available to sell to the banks while the final release of Special Deposits was being made, and also to have satisfactory portfolios at the end of the year, when most of the largest houses make up their accounts and when Bills begin to be seasonally short because of the revenue inflow.

After the reduction in Bank Rate the market's tender rate fell less than might have been expected, to  $3\frac{9}{16}\%$ ; the market was influenced by the Bank's new lending arrangements. At the next tender, on the 11th January, the market's tender rate fell to  $3\frac{1}{2}\%$ , but it did not change during the remainder of January, although, as expected, fewer Bills were being offered at the tenders.

Whereas during most of the fourth quarter of 1962 the Treasury Bill rate was tending to fall, the rates for money placed with local authorities for short periods were tending to rise. Towards the end of October the rate on three months' money, for example, rose, because overseas banks and other institutions in London taking dollar deposits were not switching out of these deposits and placing the sterling proceeds with local authorities but were on-lending in dollars for which there was strong demand. Thereafter the rate rose further, for seasonal reasons: local authority income from rates had slackened, and some lenders, who had balance sheets to make up at the end of the year and wished to show larger bank balances, withdrew their funds. After Bank Rate was reduced the rate for three months' money with local authorities fell by the full  $\frac{1}{2}\%$ , to  $4\frac{1}{4}\%$ ; but this was partly because end-year influences had now been reversed.

Among other borrowers of short-term money, the hire purchase finance houses were not seeking funds energetically during the fourth quarter; hire purchase business was generally quiet, and rates for deposits with the houses scarcely changed during the three months, although some funds were withdrawn during December. After the reduction in Bank Rate, the rate for three months' deposits with most of the leading houses fell by nearly the full  $\frac{1}{2}\%$ , to around  $4\frac{1}{4}\%$ . Building societies by contrast had to meet a strong demand for mortgages during the fourth quarter; they were

still offering lenders a high return and were able to obtain funds without difficulty. In January, the Building Societies Association recommended a reduction both in the rates paid by their members for funds and in the rates charged for mortgages. The new rates for shares would be  $3\frac{1}{2}\%$  free of income tax, instead of  $3\frac{3}{4}\%$ , and for mortgages  $6\%$ , instead of  $6\frac{1}{2}\%$ .

#### **The gilt-edged market**

The gilt-edged market had been exceptionally strong during the third quarter, and yields continued to fall during the first few days of October. The succeeding period to mid-January was very much quieter, except for a few days during the Cuban crisis when the market was particularly weak. Over the period as a whole most yields changed little, though those on five to fifteen-year stocks (which had fallen furthest during the three previous months) rose by about  $\frac{1}{4}\%$ . After the rapid fall in yields during the third quarter, a quieter time was only to be expected, but a continuing downward drift in yields seemed likely and official policy was designed to allow this to happen. Except around the turn of the year, the gilt-edged market lacked the support previously accorded to it by substantial bank buying; the clearing banks and Scottish banks, with the revenue season ahead and the prospective demand for advances uncertain, mostly preferred to buy Treasury Bills rather than gilt-edged stocks with the funds returned to them when Special Deposits were released during December. Little overseas buying of gilt-edged stocks was reported during mid-October to mid-January, but this was no new feature. While turnover declined generally, official activity also slackened. Official purchases of the next maturing stocks, 3% Exchequer Stock 1962/63 and  $4\frac{3}{4}\%$  Conversion Stock 1963, both of which mature in June, continued; there were also purchases of other stocks, and these were heavy around the time of the Cuban crisis in October. Official sales of stocks, mainly long-dated, were made between the end of October and the middle of January. These sales were rarely heavy.

In the second half of January the impending failure of the Common Market negotiations brought a rise in yields, and some official purchases were made. As soon as the final break-

down occurred the market rallied, but yields did not quite return to mid-January levels.

**Local authority mortgages** Longer-term borrowing by local authorities, by way of mortgage, cheapened during the fourth quarter, the rate for a five-year mortgage, for example, falling from about 6¼% to about 5¾%. Mortgage rates had however been slow to respond to the fall in gilt-edged yields during the earlier part of 1962. The cheapening of mortgage rates did not appear to have weakened their popularity, and there was probably a further movement away from temporary money and into mortgages; such a movement had been a feature of the second and third quarters of 1962. Mortgage rates fell a little further in January.

**The equity market** In spite of a sharp set-back during the Cuban crisis, equity prices were some 6% higher at the end of the fourth quarter than three months earlier. The market was encouraged by the official measures taken to stimulate business activity; a rise in prices on Wall Street was also helpful. There were also some favourable company reports, and the market had only a modest volume of new issues to absorb. During the second half of January the equity market, like the gilt-edged market, weakened as the Common Market negotiations reached their crisis, and then, once the outcome was certain, strengthened again. Over the month as a whole equity prices were little changed.

**The reserves; foreign exchange markets** Demand for sterling was well maintained in November and December. End-year operations by foreign commercial banks appear to have been on a smaller scale than in December 1961 and had no significant impact on the pound. Sterling strengthened further in the first half of January, in spite of the reduction in Bank Rate, and the Exchange Equalisation Account purchased some foreign currency. Thereafter, growing uncertainty over the outcome of the Common Market negotiations reduced the demand for sterling. The final breakdown in the negotiations at the end of January was followed by a sharp

speculative attack against the pound, but official support was provided and sterling quickly recovered.

The general firmness of sterling during the three months November—January was reflected in continuing accruals to the reserves of gold and convertible currencies. In November the reserves rose by £22 million. In December they fell by £28 million, but payments of interest and amortisation on U.S. and Canadian government loans at the end of the month amounted to £66 million. In January the reserves rose by £21 million.

The rise in the reserves during November—January was probably due more to the underlying condition of the balance of payments than to movements of short-term capital or to portfolio transactions. For most of the period there was only a small margin in favour of covered investment in U.K. rather than U.S. Treasury Bills. At the end of October it was 1⅜% per annum and at the end of December ⅜%. In the first half of January it fell further following the reduction in U.K. Treasury Bill rates, and in mid-January a small margin in favour of covered investment in U.S. Treasury Bills emerged. This reached ⅞% per annum for a short while when sterling was under pressure at the end of January, but then narrowed to ¼%.

The movement of overseas sterling holdings during the closing months of 1962 suggests that there may have been a small inflow of funds at this time: in the three months to end-December non-official holdings of countries outside the sterling area increased by £35 million. On the other hand, the fact that from November to January the rate for security sterling in New York continued to be below the rate for external sterling indicates that portfolio transactions by overseas residents produced hardly any net inflow of funds into the United Kingdom during the period.

British residents for their part had to pay more for the right to acquire foreign currency securities. The premium on the security dollar increased from just under 6% at the end of October to over 7% by mid-January; during the subsequent period of uncertainty leading to the breakdown in the Common Market negotiations the premium rose sharply, reaching a short-lived peak of over 10%. The size of the premium throughout the period and, indeed, in the previous quarter can be attributed

largely to the new arrangements introduced in May 1962 whereby it became possible for British companies to finance by the use of security dollars certain direct investment outside the sterling area for which official exchange is not authorised. The reserves are not affected by these transactions because British residents as a whole merely exchange one form of foreign asset for another.

Continental exchange markets were again affected by end-year operations, but the West German and Swiss authorities, by providing liquidity to their banks on favourable terms, were able to ensure that the markets were less disturbed than in recent years. Nevertheless the U.S. dollar was weak against most currencies on the Continent up to the end of the year; it recovered in early January.

**London gold market** Private demand remained slack throughout November—January. Demand from the Middle East declined during November and December, in anticipation of Indian government measures to reduce smuggling of gold into India. The London market price fell gradually from \$35.11 early in November to \$35.05 in the middle of January. The price rose slightly during the second half of January, to \$35.07; the failure of the Common Market negotiations and the brief speculative attack against sterling had no effect on the gold market. During the three months as a whole a significant quantity of sales by the U.S.S.R. and of new production elsewhere accrued to the monetary reserves of the principal Western countries, for the first time since early 1962.

**Balance of payments** The evidence so far available does not point to any marked change during the fourth quarter in the underlying balance of payments of the United Kingdom. Imports, seasonally adjusted, were a little below the high level to which they had risen in the third quarter. This was mainly because imports of food fell sharply; home supplies of vegetables had returned to normal. Arrivals of industrial materials continued to rise in the fourth quarter, and imports of finished consumer goods, and of capital equipment—mainly ships—were slightly higher. Exports, seasonally adjusted, remained unchanged in the

fourth quarter; it now seems clear that, apart from some erratic fluctuations in the monthly figures, there has been no significant increase since June. Thus the trade balance, as recorded in balance of payments estimates and seasonally adjusted, was probably a little better in the fourth quarter than in the third; but it was probably still in deficit.

The balance of current invisible transactions usually deteriorates between the third and fourth quarters. Travel payments fall sharply after the end of the summer holidays; but there is also some decline in travel receipts; and extra expenditure is incurred on interest, profits and dividends. This arises from the annual servicing of the post-war loans by the United States and Canada. Interest on these loans amounted to £37 million in December 1962.

The long-term capital account, as well as the current account, is affected by this debt service; capital repayments amounted to £29 million in December. The long-term capital account during the fourth quarter also contained two special transactions. In October the United Kingdom took up United Nations Bonds amounting to £4 million, and in November subscribed £9 million as the third of five instalments to the International Development Association. As has been mentioned above, there is no evidence that the long-term capital account benefited much in the fourth quarter, as it had in the early months of 1962, from overseas buying of U.K. securities.

Present information suggests that the balance of monetary movements was adverse in the fourth quarter. The reserves rose, but overseas sterling holdings rose more, and other known movements were small and largely offsetting. Details are given in the Quarterly Analysis of Financial Statistics on page 9.

**U.K. exports** The rest of this Commentary examines the performance of exports in 1962 and discusses their future development.

Total exports grew in the first half of 1962, in spite of a sharp fall in deliveries of ships. Exports of basic materials, notably metal ores and scrap, and of refined petroleum rose at an unusually fast rate. This rise was halted in the second half of 1962 and is unlikely to be resumed, at least at the same rapid pace,

although the cold winter in Europe will probably sustain exports of fuel oil and heating oil for a time. Exports of manufactured goods other than ships also increased strongly; whereas in the first quarter they had been lower than in the same period of 1961, in the second and third quarters of the year they were 6½% higher than a year earlier.

There were two reasons for this satisfactory increase in U.K. exports of manufactured goods. World trade was expanding; and U.K. exporters were holding their share at this time. Exports to the United States were especially successful, with about half the increase in road vehicles and the rest well spread. Total U.S. imports from manufacturing countries were rising and the United Kingdom seems to have increased its share of this market. Since the summer, demand in the United States has been growing more slowly. Reductions in taxation have been proposed; these, if enacted, could accelerate the growth of demand in 1964.

Exports to Canada were much reduced in 1962 even after allowing for a large fall in deliveries of ships. The reduction was partly due to the tariff surcharges imposed by Canada in June 1962 to meet the foreign exchange crisis. Canada's external position has now improved; in November and December the Bank of Canada was able to repay the balance of \$125 million received as aid from the United States in June under a swap arrangement, and to dispense with the remaining \$50 million of assistance extended by the Bank of England. Many of the tariff surcharges have already been removed, but, as in the United States, domestic demand seems likely to grow only slowly for the time being.

Exports to the European Economic Community in the second and third quarters of 1962 were substantially higher than in the corresponding quarters of 1961, with metals, machinery and road vehicles increasing most. Demand in these countries grew more slowly last year than in 1961 but U.K. exports to them expanded faster than both their total imports from manufacturing countries and their imports from each other. Costs in some of these countries have been rising more than in the United Kingdom; some countries have been encouraging imports as an anti-inflationary measure; and U.K. exporters may have anticipated part of the reduction in tariffs which

would have taken place if the United Kingdom had joined the Community, and quoted keener prices. The growth of demand in the Community is not likely to accelerate at present, and its pattern may go on changing, personal consumption and government expenditure playing a larger part and investment in plant and machinery a smaller. For both these reasons productive capacity in the Community may be better able to meet demand, and there may be a slackening in the growth of the Community's imports of manufactures from outside; indeed such a slackening may already have begun, to the detriment of U.K. exports. Moreover tariffs between member countries will be reduced further in the middle of this year. If British exports to the Community are to increase appreciably during 1963 it seems that as much emphasis will have to be laid on the lighter type of consumer goods as on the heavier engineering equipment recently sold in large quantities.

During 1962 the United Kingdom appears also to have increased its share of imports taken by the other countries of the European Free Trade Association, partly no doubt because it has been given tariff advantages. Road vehicles did especially well. Further reductions in tariffs may be made this year, and demand in these countries seems likely to continue to grow modestly.

Increased shipments to overseas sterling area countries contributed only a little to the growth of U.K. exports of manufactured goods in 1962. A substantial rise in sales of machinery and road vehicles was largely offset by reductions in some other classes. The United Kingdom's share of this market seems to have continued to fall a little. This is partly because aid to these countries from countries other than the United Kingdom has been increasing, and much of it has been used for the purchase of goods from the donor countries. But the value of these countries' own exports has been rising recently and, if the recent strengthening of the prices of some primary commodities is maintained, further growth of their total imports may be in prospect.

For the immediate future it seems likely that world demand for manufactures will continue to rise, if less quickly than of late. In these circumstances, U.K. exports cannot be expected to grow more than modestly unless there is an

improvement in the United Kingdom's share of trade. Such an improvement might have been easier to achieve if the United Kingdom had joined the European Economic Community. U.K. exporters would then have gained access on favourable terms to a large and growing market; entry would also have exposed British industry to greater competition at home, and thereby made it easier to promote the continuing changes which are needed. Both these advantages are now denied; further change has, therefore, become both more necessary and more difficult. The immediate needs are restraint of costs, which requires in its turn an effective incomes policy, and aggressive salesmanship. In the longer run not only are changes needed in our own industrial organisation, education and training, and perhaps in fiscal arrangements, but it is important to promote a more rapid increase in world demand for manufactured goods. This last will require close co-operation between the main countries, with respect both to their domestic policy decisions and to international monetary and commercial problems.

## QUARTERLY ANALYSIS OF FINANCIAL STATISTICS

20th September—12th December 1962

The financial surpluses<sup>(a)</sup> and deficits of the four main sectors<sup>(b)</sup> were probably not greatly changed in the fourth quarter of 1962 as compared with the previous quarter, after making some allowance for seasonal factors. Such differences as there were between the two quarters lay less in the size of the various surpluses and deficits than in the type of asset taken up, or liability incurred, by the sectors. For example, the very strong demand for long-

term fixed interest securities, which had been one of the striking features of the third quarter, and which was still present in the early part of the fourth quarter, ceased later in October. Longer-term securities were no longer regarded as outstandingly cheap, and there was less switching into them, while the supply of longer-term securities, from official portfolios, from local authorities and from companies, remained adequate to absorb new savings seeking long-term investment. The Cuban crisis and the Sino-Indian conflict served to reinforce tendencies which were already apparent in the market. The demand for long-term fixed interest securities recovered before the end of the quarter, but only partially. Long-term rates in mid-December were much the same as in mid-September; in the previous three months they had fallen sharply.

### Overseas funds

Judging from the statistics of visible trade for the fourth calendar quarter, there may have been a small deficit in the identified current balance of payments; and it must be presumed that there was a continuing net debit on account of government loans and direct investment overseas. Monetary movements were unfavourable in the fourth quarter, as is usual at this time of year. The official reserves rose by £5 million in the quarter and banks' net deposit liabilities in foreign currencies fell slightly. On the other hand, overseas sterling holdings rose by £68 million net: non-official holdings rose by £63 million, and holdings of international organisations by £15 million, while other official holdings fell by £10 million. There was also a known decrease of £13 million in assets (acceptances by U.K. banks). There is little evidence to suggest that there was any considerable unidentified movement of private funds to or from overseas during the fourth quarter, or of security purchases; thus the net movement

(a) The excess of current income over current expenditure, less additions to fixed assets, stocks and work in progress.

(b) (i) The private sector, *viz.*, private individuals, partnerships, unincorporated businesses, building societies and all companies outside the banking system.

(ii) The banking system, here defined as the London clearing banks, the Scottish banks and the Banking Department of the Bank of England.

(iii) The public sector, *viz.*, Central Government, local authorities, and public corporations.

(iv) Overseas residents.

of private overseas funds was apparently a moderate inflow, the most important element being the rise in recorded non-official overseas sterling holdings.

**Private sector**

The financial surplus of the whole private sector, after making some allowance for seasonal factors, appears to have risen a little in the fourth quarter. The savings of the private sector taken as a whole may have been lower, but a fall in expenditure on fixed investment and in the rate of addition to stocks and work in progress may have been more important factors.

The increase in the private sector's net claims on the public sector<sup>(a)</sup> during the quarter ended mid-December amounted to some £375 million, or a little more than in the previous quarter. (Both these movements include changes in unidentified overseas holdings.) The distribution of the take-up among the various forms of public sector debt was greatly changed. Part of this change may be accounted for on purely seasonal grounds. Thus private sector holdings of Bank of England notes, which fell by £4 million in the third quarter, rose by £82 million in the fourth. Another seasonal movement, but in a different direction, probably occurred in private holdings of local authority debt; the borrowing requirements of local authorities are normally less in the fourth quarter than in the third, because of the timing of the receipt of rates. On the other hand, the improved performance of National Savings—from a net decrease of £15 million to a net increase of £44 million—was much greater than would be expected on seasonal grounds. All forms of National Savings, with the exception of Premium Savings Bonds, proved more popular in the second half of 1962 than in the first; net purchases of Premium Savings Bonds continued at a rate of some £10 million a quarter. A part of the increase in National Savings can be explained in terms of an improvement in the relative yields obtainable on them. Yields on government stocks of around ten years to maturity, for example, had declined, and yields on local authority mortgages were falling.

The private sector increased its holdings of Tax Reserve Certificates by £45 million in the fourth quarter. This increase, though £11 million greater than in the third quarter, was small in comparison with the corresponding quarters of the last two years, in each of which the interest rate was higher.

Although the private sector took up more bank notes, more National Savings and more Tax Reserve Certificates in the fourth quarter than in the third, it probably took up much less marketable debt. "Other home and overseas non-official" holdings of government stocks rose by only £28 million as against £185 million; during both quarters non-official overseas holdings of stocks were probably little changed. On the other hand, holdings of Treasury Bills, which had fallen by £51 million in the third quarter, fell by only £3 million in the fourth; the relatively small decline suggests that there was less switching from Bills into longer-term securities; it may perhaps also be associated with the increase in non-official overseas sterling holdings.

Net claims by the private sector on the banking system normally rise in the December quarter, deposits rising while advances fall. The actual net rise of about £110 million was, however, somewhat smaller than might have been expected on seasonal grounds: advances, after seasonal adjustment, rose faster than deposits. Thus there may have been some continued underlying fall in the private sector's net claims on the banking system.

The next part of this analysis considers some of the component groups within the private sector (as defined), that is persons, companies, and accepting houses and overseas banks.

**Persons**

Identified borrowing by persons seems to have continued in the fourth quarter at about the same high rate as in the previous quarter, or perhaps to have accelerated a little. Advances by members of the British Bankers' Association to all borrowers apart from the nationalised industries increased by £26 million in the quarter ended mid-November. Adjusted for seasonal factors, the increase was about £140 million, much the same as in the previous quarter; advances to

<sup>(a)</sup> Including "indirect" claims; see footnote on page 12.

persons (as indicated by the categories "personal and professional" and "agriculture") accounted for nearly half this total. Hire purchase debt was fairly steady at a time of year when it usually falls. Net borrowing from building societies had reached the high figure of £82 million in the third calendar quarter and the total in the fourth quarter may have been somewhat higher, although some seasonal slackening might have been expected.

There seems also to have been a rise in the rate of addition to personal financial assets. The greater demand for National Savings may, as already suggested, have been partly due to changes in relative interest rates; but it may also have been attributable to the uncertainties of the time: the rise in unemployment may have encouraged many still at work to add to their savings, or to curtail their seasonal withdrawals from savings, as a precaution. Personal investment through the Special Investment Departments of the Trustee Savings Banks continued at the same high level as earlier in the year; and the flow of savings into building societies, and, on a smaller scale, into unit trusts, accelerated.

Although personal saving through certain identified channels increased, there may have been compensating reductions in the rate of addition to other financial assets. Moreover there was, as already noted, some increase in personal borrowing; thus it is not certain that the personal sector had a higher financial surplus. Even if the savings, and so the financial surplus, of individuals rose because of a cautious attitude to spending, this saving might have depressed the current income and savings of small traders, who are also part of the personal sector.

**Companies** In recent quarters there has been a tendency for the financial surplus of companies to recover (or their financial deficit to decrease). There is not yet enough evidence to say whether this trend continued up to the fourth quarter. Profits (seasonally adjusted) were rising up to the third quarter; but this rise could have been interrupted towards the end of 1962, when lower output and a greater degree of spare capacity might have been expected to

raise unit costs and so reduce profits and saving. On the other hand companies may have had some success in restoring profit margins by managing with a smaller labour force; and both fixed investment and the rate of stock accumulation were falling.

Up-to-date information about changes in companies' assets and liabilities is sparse. The B.B.A. analysis of advances suggests that, allowing for seasonal factors, total advances to "non-financial" companies were little changed in the three months to mid-November. Advances to manufacturing industry actually fell by £48 million, but this was not much more than expected on seasonal grounds. The amount raised through new issues of capital by "non-financial" companies fell from £83 million in the third calendar quarter to £55 million in the fourth. Equity issues fell steeply; the creation of new loan capital was also smaller than in the third quarter, but the proportion of new loan capital to total new capital was much higher than it has been in recent years.

Advances to the "other financial" group rose (during the quarter to mid-November 1962) by £29 million, when a seasonal fall might have been expected. This category includes property companies, which may well have accounted for much of the increase. Capital issues by financial companies (other than banks) were, at £18 million, about the same in the fourth calendar quarter as in the third. Deposits with hire purchase finance companies fell during the fourth quarter, as did also these companies' claims under hire purchase agreements; but these changes were at least partly seasonal.

**Accepting houses and overseas banks** Because of a change between June and September 1962 in the statistical series for the accepting houses and the overseas and foreign banks,<sup>(a)</sup> movements in their assets and liabilities during the fourth quarter cannot all be compared with movements in earlier periods. The period covered is a calendar quarter and so reflects end-year influences. As might therefore be expected, there was a movement towards greater liquidity. The deposits of the accepting houses and overseas banks with other U.K. banks (including inter-bank balances within this

<sup>(a)</sup> Described in an article in Volume II, No. 4, of this *Bulletin*, page 267.

group) increased during the quarter by £69 million, and their money at call by £66 million. Most of the increase in money at call may be regarded as indirectly lent to the Exchequer through the discount houses.<sup>(a)</sup> Direct claims on the public sector (for which earlier figures are roughly comparable) fell by £18 million, whereas in the fourth quarter of 1961 these institutions contributed directly to the financing of the public sector deficit. Treasury Bill holdings fell by £25 million. Holdings of gilt-edged stocks rose by £3 million; in the third quarter they had risen by about £50 million. The aggregate rise of £3 million conceals a movement of some £50 million from stocks with over five years to maturity to shorter-dated stocks; but 5% Exchequer Stock 1967 moved from the longer to the shorter group in November 1962. Lending to local authorities rose by £3 million, after falling by some £30 million in the previous quarter. This probably reflects a change in the sources of local authorities' borrowing; the total of their net new borrowing was almost certainly smaller in the fourth quarter than in the third.

Deposits of U.K. residents (including banks) with the accepting houses and overseas banks increased by £77 million while advances to U.K. residents fell by £28 million. Holdings of "Other sterling bills" increased by £16 million; earlier in the year they had fallen.

There appears to have been a small net inflow of overseas funds through these institutions in the quarter, for the deposits of overseas residents and banks increased by £72 million, while advances to them rose by £49 million.

**Banking system** During the discussion of the financial transactions of the private sector it was suggested that in the fourth quarter the banking system incurred net liabilities to the private sector (persons and companies) amounting to about £110 million, and that this was a somewhat smaller increase than might have been expected on seasonal grounds. Within this total, net deposits with the London clearing banks rose by £105 million in the quarter, a greater increase than could be

accounted for on seasonal grounds, while net deposits with the Scottish banks rose by £6 million. There were also increases of £74 million in the "other accounts" of the London clearing banks and £10 million in the "other accounts" of the Scottish banks; these increases were probably associated with a largely seasonal rise in credits in course of transmission, which can be regarded as liabilities of the banking system to the private sector. At the same time advances by the clearing banks and Scottish banks to all borrowers apart from the nationalised industries rose by £63 million and £8 million respectively, when seasonally a fall was to be expected. Changes in other claims on the private sector, such as commercial bills, were small during the quarter.

The banking system's claims on the public sector increased by about the same as the estimated increase of £110 million in its liabilities to the private sector. The net claims of the Banking Department of the Bank of England on the Exchequer fell by £145 million, mainly because of the release of £119 million of Special Deposits; while the clearing banks and Scottish banks increased their direct and indirect holdings of government debt and Bank of England notes by £240 million (as shown in the table below) and also increased their advances to the nationalised industries by £15 million. Included in the total increase in lending to the Government by the clearing banks and Scottish banks were net purchases of £78 million of government stocks. Purchases by the London clearing banks alone totalled £81 million, and raised the ratio of their investments to gross deposits from 16.3% at mid-September to 16.6% at mid-December. The clearing banks' liquid assets also rose, and the liquidity ratio moved up from 33.7% to 34.0%.

The banking system's lending to the Exchequer included a rise of £91 million in the amount lent indirectly through the discount market. The discount houses' borrowing from sources outside the banking system rose by about £40 million in the quarter, so that their total borrowing rose by some £130 million. Most of this was matched by additions to their holdings of marketable government debt, in particular Treasury Bills.

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

**Public sector** The Exchequer Group's cash deficit (which is only part of the public sector's total deficit) amounted to £260 million in the quarter ended mid-December, composed as follows :

	<i>£ millions</i>
Budget: above the line ... ..	- 66
below the line ... ..	-160
overall ... ..	<u>-226</u>
Internal extra-budgetary funds ... ..	- 5
Exchange Equalisation Account ... ..	- 27
Other external items ... ..	- 2
Cash deficit ... ..	<u><u>-260</u></u>

The overall budget deficit in the quarter was some £50 million less than for the corresponding quarter of 1961, the difference being mainly "above the line". This difference may, however, have been partly due to unevenness in the timing of government expenditure. The Exchequer cash deficit was some £150 million less than in the previous year. The recovery in the reserves in the closing months of 1961 (which made it possible to repay part of the borrowing from the International Monetary Fund) gave rise to net sterling expenditure on external items outside the Budget of £132 million during the fourth quarter of that year; in 1962 external transactions were on a smaller scale and net sterling expenditure on external account was only £29 million.

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 ... ..	-145	
Indirect holdings ... ..	—	-145
Clearing banks and Scottish banks :		
Treasury Bills ... ..	+ 22	
Stocks ... ..	+ 78	
Indirect holdings ... ..	+ 91	+191
Bank of England notes (including coin) ... ..	+ 49	<u>+ 95</u>

(a) Including some overseas official.

*£ millions*

**Holdings of the public, other than the banking system**

Government debt :		
Overseas official holders :		
Treasury Bills ... ..	- 42	
Stocks ... ..	- 16	- 58
Other home and overseas non-official holders :		
National Savings ... ..	+ 44	
Tax Reserve Certifi- cates ... ..	+ 45	
Treasury Bills ... ..	- 3	
Stocks ... ..	+ 28	
Indirect holdings <sup>(a)</sup> ... ..	+ 27	+141
Bank of England notes		<u>+ 82</u>
		<u>+165</u>

Net official sales of stock of £100 million, taken up mainly by the banks during this quarter, met less than half the Exchequer's cash requirement; in the previous quarter, net official sales had covered the whole of it. The figure of net sales of £100 million conceals substantial official purchases of the shorter stocks, which were more than offset by sales of the longer stocks. Thus net sales of stock with more than fifteen years to maturity amounted to more than £250 million, largely because of official sales of 5½% Treasury Stock 2008/12, which were mainly concentrated in the first month of the period under review.

The public sector's deficit is met not only through the financing of the Exchequer's cash requirement but also through local authorities' net borrowing from the public and, to a small extent, by borrowing by the nationalised industries from the banks. In this quarter the nationalised industries, as already mentioned, borrowed £15 million from the banking system. Local authorities' borrowing from the general public had totalled some £160 million in the third calendar quarter, but was probably smaller in the fourth because of the timing of half-yearly rate payments, as mentioned earlier.

There are signs that the financial deficit of the public sector is now starting to increase, and because of measures already taken this

increase should continue. The U.K. current balance of payments, after improving earlier in 1962, appears to have weakened in the second half of the year; there may be little change during 1963. The financial surplus of the private sector, taken as a whole, may not have changed much during last year; but there is some possibility that it rose a little because companies moved back from financial deficit towards a surplus as their capital expenditure

fell. The outlook is for some continuing rise in the private sector's surplus. How this rise is shared between companies and persons will depend largely on the course of personal consumption. The faster this grows the greater is likely to be the rise in profits and in the financial surplus of companies; and the less will be the need for an increase in new capital issues, at least until fixed investment and the rate of stockbuilding recover.