COMMENTARY

At the very end of January, and again for a short while in March, sterling came under strong pressure, and the reserves fell. These losses were largely offset by borrowing from overseas monetary authorities; their assistance showed once again that the present international payments system can remain unshaken by such short-term pressures. Sterling was steady in April and May and the reserves rose in each month. At home, output has been recovering well from the setbacks of the winter. The Budget, which the Chancellor of the Exchequer introduced at the beginning of April, was designed to promote a steady and sustainable expansion of economic activity. Monetary policy has meantime sought to maintain the easier credit conditions and lower rates of interest established earlier.

The pressure on sterling

The sudden and temporary loss of confidence in sterling on two occasions during the first three months of the year was not due to any real deterioration in the United Kingdom's balance of payments; indeed the underlying situation was probably improving at that time. A combination of other factors seems to have been responsible. The breakdown of the Brussels negotiations at the end of January was the prime cause of the first loss of confidence. This was not a well founded reaction, for even if the breakdown were ultimately to make a significant difference to the balance of payments it would not do so for a considerable time. A second factor had been latent for some time, and arose from the quite separate discussions about the renewal of the European Monetary Agreement, which were being held in Paris. In February a change in the arrangements was agreed. Under the new arrangements, which came into force on the 1st March, the guarantee, in terms of U.S. dollars, of sterling held by other member central banks was limited to a total of £11¼ million. Hitherto there had been no limit on the amount subject to this guarantee, and the change, following quickly upon the Brussels breakdown, appears to have had some effect on market sentiment for a time; and it prompted some sales of sterling by overseas official holders, especially in one or two cases where holdings had been unusually large. Two other influences merged with these factors to weaken confidence. In the first place it was thought that the Budget, when it was introduced, might be such as to strain the balance of payments, by bringing about a sharp rise in imports. Secondly, there was at this time some discussion, outside official circles, of the supposed contribution which a devaluation of sterling might make to the longer-term growth of the economy.

The severe but short-lived pressure on the pound took various forms. Sterling was sold short, and these sales were reflected in rising forward discounts for the pound and in higher rates for sterling borrowed from lenders outside the United Kingdom. For example, the rate paid for three months' sterling in Paris rose from 4¼% towards the end of January to nearly 5½% at mid-March. Sterling was also sold forward for periods up to some years ahead by overseas holders with interests in the United Kingdom which they wished to protect. U.K. residents, for their part, appear to have entered into forward contracts to purchase foreign exchange on a more extensive scale than during most of 1962; sterling was then strong, and importers had been more content to carry their own risk in this respect.

The spot rate for sterling against the U.S. dollar was not allowed to fall much below parity, and the cost of the pressure fell mainly on the reserves. The transactions at the end of January affected the reserves in February, and during the two months of February and March the reserves would have fallen quite sharply but for the short-term assistance from overseas monetary authorities. This support totalled £89 million, and the reserves in fact fell by no more than £18 million over the two months.

Sterling strengthened after the Budget, and the reserves rose by £12 million in April and by £29 million in May. No further assistance was received from overseas monetary authorities during these two months and none repaid. During May a swap arrangement was made between the United States and the United Kingdom which provides for mutual currency help up to the value of $500 million should the occasion arise.

Foreign exchange and gold markets Although the spot rate for sterling against the U.S. dollar did not weaken much, the discount on three months' forward sterling rose from the equivalent of just over $\frac{1}{2}$% per annum before the first speculative attack to $1\frac{3}{8}$% per annum in mid-March. Largely for this reason, the margin in favour of covered investment in U.S. rather than U.K. Treasury Bills, which had appeared in the middle of January, rose to $\frac{15}{16}$% per annum in mid-March. Thereafter it fell, both because the U.K. Treasury Bill rate rose and because the forward discount narrowed; and by the end of April the margin was no more than $\frac{3}{32}$%. Early in May the forward discount narrowed further, and the margin disappeared.

The interest obtainable on three months' deposits with local authorities, after allowing for the cost of forward cover, remained above the rate paid by London banks on U.S. dollar deposits right up to the end of February. It then dipped below, partly because the forward discount widened and partly because the dollar deposit rate rose, and remained below during the rest of March and April, even though the local authorities raised their rates for deposits. Thus during March and April residents of non-sterling countries will have tended not to renew either their Treasury Bills or their local authority deposits as they fell due, and banks in the United Kingdom taking foreign currency deposits from abroad may also have chosen to hold more of their assets in foreign currencies rather than in sterling. Some loss of reserves may well have occurred for both these reasons.

The pressure on sterling made little difference to the rates for the U.S. dollar in continental markets, or to the gold market. Private demand for gold was mostly moderate, but it revived sufficiently in March and April to absorb the supplies of new gold becoming available and some small sales by the U.S.S.R. The price remained within the range of \$35·06 to \$35·12 between the end of January and the end of April.

External liabilities and claims Some of the effects of the developments in the exchange markets during the first quarter of 1963 can be traced in the statistics of overseas sterling holdings, now renamed "External liabilities and claims in sterling".[a] Liabilities to residents of countries outside the sterling area fell by £114 million during this period; the main change was a reduction of £79 million in liabilities to central monetary institutions in Western Europe. These statistics were not affected by the borrowing from overseas central banks, because none of the assistance was provided in sterling. On the previous occasion when such temporary borrowing from overseas monetary authorities was undertaken, in 1961, some of the assistance took that form; details were given in the September *Bulletin* of that year.

Balance of payments The United Kingdom had a small current account surplus in the fourth quarter of 1962. The surplus in the first quarter of 1963 was probably larger. Imports, as measured by the Trade and Navigation Accounts, were about 1% higher, but exports were about 2% higher, and there was probably a seasonal improvement in invisible items.

Part of the improvement in visible trade was due to ships and aircraft, a category which tends to move erratically. Imports of these goods were lower in the first quarter than in the fourth, and exports higher. But there was also an underlying improvement in other exports, particularly in exports of machinery and of motor vehicles. An encouraging sign for exports generally was the increase in sales to the European Economic Community and to

[a] See article on page 98.

some important markets in the overseas sterling area. On the other hand exports of machinery were running ahead of orders.

In April imports, seasonally adjusted, were higher than the monthly average for the first quarter, while exports were lower.

The strength of exports in the first quarter of 1963 may owe something to an improvement during 1962 in one important aspect of the United Kingdom's competitive position. Costs of raw and semi-finished materials seem to have changed little recently in all the main manufacturing countries, but labour costs per unit of output have moved diversely. Only rough comparisons can be made, because the statistics are uncertain, but it seems that between 1961 and 1962 labour costs in the United Kingdom rose less rapidly than in most of the other leading countries in Western Europe, or in Japan. In the United States labour costs appear to have fallen.

Domestic economy

Industrial output in the first quarter of 1963, after the usual seasonal adjustment derived from the experience of earlier years, was about 3% lower than in the fourth quarter of 1962 and about 5½% lower than in the third. The first quarter was, however, a most unusual period, with some of the worst weather ever recorded in this country. If full allowance could be made for the loss of production from this cause it might be found that the underlying trend did not continue downward in these three months, but steadied, or even turned upward. Some forms of output certainly rose: considerably more cars were produced than in the fourth quarter (indeed production was at about the level of the record year 1960) and the extra demand from the motor manufacturers brought some increase in certain forms of steel production.

The severe weather makes it equally hard to judge how the main components of demand have really been moving since the turn of the year, but here again there are some signs of expansion. Exports were higher, as has been noted. Total personal consumption may also have risen a little. Unemployment will have reduced the incomes of many families, but benefits were raised in March and there were a number of wage increases during the quarter. Reductions in purchase tax made cars cheaper from November, and some other goods cheaper after the New Year. Although expenditure on fuel increased, and although more cars were newly registered during January—March than during any previous first quarter, purchases from the shops were about the same in volume in the first quarter of this year as in the fourth quarter of 1962.

Total stocks rose, after seasonal adjustment, by around £65 million (½%) in the third quarter, but by only about £5 million in the fourth; this change was one reason why output was lower in the fourth quarter than in the third. There are as yet no reports of any large movement in total stocks during the first quarter of 1963, so that it does not seem as if output suffered significantly on this account at this time.

Fixed investment, and particularly building, was seriously affected in January and February by the weather; for example, only about three houses were started during the first quarter for every four a year earlier. In these circumstances it is impossible to judge whether the underlying trends in the construction industry changed (during the second half of 1962 more housing work was done both for private purchasers and for local authorities than in the first half, together with more of other kinds of public building, whereas industrial building was declining). Investment in plant and machinery will have been less affected by the conditions in January and February than was building, so that the statistics for deliveries of engineering goods may provide some guide to the trend of this form of investment by manufacturing industry. These figures suggest that it was still declining early in 1963, but perhaps more slowly than during the closing months of 1962.

The March issue of this *Bulletin* noted that unemployment in Great Britain rose to 878,000 in February. This total, which represented almost 4% of all employees, was the peak, and unemployment fell in each of the three succeeding months, reducing the total to 554,000, or 2½%, in May. Allowing so far as is possible for the hard winter, it seems that the underlying growth of some 20,000 a month in unemployment in the fourth quarter of 1962 was checked during the first quarter of 1963, and has since given place to an underlying fall. Unemployment was none the less higher at mid-May than at that time in any other post-war year.

Outlook When the Chancellor presented his Budget on the 3rd April there were already signs that the general level of activity might be rising. Clearly, however, there was still widespread under-employment of resources. The Budget was therefore expansionary in character. Its longer-term objective, of an annual rate of growth of some 4%, was in line with that of the National Economic Development Council. The Budget also sought to give special help to those regions where unemployment was particularly high.

The total of some £250 million in new tax reliefs proposed by the Chancellor for this financial year should give a considerable impetus to demand. The earliest effects are likely to be seen in consumers' expenditure, when the various changes in income tax begin, next month, to affect wages and salaries. Consumption may also be helped by some revival of consumer credit: judging from the number of contracts entered into for cars, hire purchase debt will have risen in May, as it did in March and April.

The outlook for investment is more mixed. Capital expenditure by the public sector, particularly on electrical generating and distribution capacity, is already on a strongly rising trend. So is private house building, which now also has arrears of work to make up after last winter's delays. For private manufacturing industry, the last official survey late in 1962 suggested a further fall in investment. With much capacity still unused, this still looks likely. The full effects of the recent increases in tax allowances on capital expenditure can hardly be seen until there is firmer evidence of rising demand; but some recent improvement in home orders for engineering equipment and a slight increase in approvals for industrial building are hopeful signs for the future. Expansion during 1963, however, is likely to be based mainly on public expenditure (both current and capital), on personal consumption, and, if recent trends continue, to some extent on exports.

There is ground for hope that expansion can continue without danger to the balance of payments. The current account was probably comfortably in surplus in the first quarter. Although demand in the main European countries may rise only slowly this year, the prospects for continued expansion in the United States now look brighter than they did a few months ago; and primary producers are beginning to obtain larger incomes. There is therefore a better chance of some further rise in U.K. exports, provided that costs of production can be held at a competitive level. In the earlier stages of expansion, following a period in which resources have not been fully employed, output per man may rise rather faster for a time than can be sustained in the longer-term. In this situation, and if costs of production are to be held at a competitive level, the rise in personal incomes must be related to the longer-term trend of productivity.

Resumed expansion is likely to be followed, though not necessarily very quickly, by an increase in stocks and imports. The balance of payments should be strong enough, particularly if it is reinforced by a further increase in exports, to take this strain. If, however, the necessary process of expansion were to weaken the balance of payments for a time, this would be a situation where it was proper to draw on reserves or resort to short-term borrowing, so long as the underlying economic position remained sound.

Short-term money rates The Treasury Bill rate weakened a little between the end of January and the middle of March. The discount market raised its bid on three occasions and lowered it only once, and its tender rate fell from $3\frac{1}{2}\%$ to $3\frac{13}{32}\%$ over the period as a whole. The market was awkwardly placed at this time. In the first place, Bills were scarce. This was partly because the Exchequer's borrowing requirement had been very small over the last two years and many times covered by subscriptions to National Savings and official sales of stock, and partly because of the particular circumstances of the time. The revenue inflow was heavy, and the Exchequer Group was receiving sterling as a result of sales of foreign exchange by the Exchange Equalisation Account. Only £180 million of Treasury Bills were offered at the tender on the 15th February, the lowest amount for ten years, and the total of Treasury Bills outside official portfolios at mid-March was £231 million lower than a year earlier and £464 million lower than two years earlier. In the second place, the discount market had to meet exceptionally keen competition at the tenders from other money market institutions. This also was partly a long-term, and partly a short-term, phenomenon. During the early 1950s industry and commerce increasingly found Treasury Bills a useful short-term investment. Their demand for Bills grew further after Bank Rate was raised to 7% in 1957 and the Treasury Bill rate exceeded $6\frac{1}{2}$%, and was stimulated again in 1961, when the Treasury Bill rate nearly reached $6\frac{3}{4}$%. The increased competition at the tenders in recent years is a reflection of this greater demand. The demand is also frequently strongest in the first weeks of each year even though these weeks are within the revenue quarter; it seems that a number of industrial and commercial companies wish to employ liquid funds in Treasury Bills for a few weeks, until they pay their taxes. At all events the discount market obtained only 14% of the Bills offered on the 8th February, the lowest percentage for many years.

Official policy during February and the first half of March was to keep rates firm, and the discount market was forced to borrow on a number of occasions, though not very heavily. Towards the middle of March sterling came under pressure, and a rise in the Treasury Bill rate appeared to the authorities to be desirable. On the 19th March the Bank made advances to the discount market at $4\frac{1}{2}$%; this was the first time that loans had been made at above Bank Rate since the Bank had made it known at the beginning of January that they might on occasion wish to revert to their earlier practice in this respect. At the succeeding tender, on the 22nd March, the discount market lowered its bid sharply, and its rate rose from $3\frac{13}{32}$% to $3\frac{13}{16}$%. During the rest of March and April the rate did not fall back much. The market was forced to borrow from the Bank from time to time, but all loans were made at Bank Rate.

A feature of the three months February—April was a rise in the supply of commercial bills. The banks, for liquidity reasons, were not averse to their customers using bill finance rather than advances; and until the second half of March bills tended to be the cheaper form of finance. The total supply of commercial bills at the present time is not known, but is probably of the order of £1,000 million. Judging from known movements in the holdings of the banks and discount houses, the total may have risen by nearly £50 million between mid-January and mid-April.

Local authority short-term rates, like the Treasury Bill rate, were higher at the end of April than at the end of January. February and March are months when local authority income from rates is low and borrowing needs are heavy. Short-term rates were also kept up in February to counteract withdrawals of foreign money; even so, by early in March, as already mentioned, a covered three months' deposit with a local authority had become less attractive than a U.S. dollar deposit. Towards the end of March, after the Treasury Bill rate had risen, the rate for three months' money rose from $4\frac{1}{4}$% to $4\frac{1}{2}$%; at this point short-term borrowing from the market was as expensive as an advance from a local authority's own banker. The three months' rate did not fall in April, even though income from rates will have begun to increase. The Treasury Bill rate was still high, and the three months' covered rate for local authority money was still below the dollar deposit rate.

Hire purchase houses were not active seekers of short-term funds during February—April. More sales of cars were being financed than a year earlier, but average prices were lower. Rates for three months' deposits were very little changed over February—April.

The gilt-edged market

The market was sensitive during February, and yields rose generally. Sterling was less strong than at the beginning of the year, and there were also fears that the Budget would be followed by much heavier official borrowing on gilt-edged stocks. Official policy at this time did not favour a sharp rise in yields, which might have hampered an expansion of the economy. Some official purchases of stocks were made, primarily of the issues maturing in June (3% Exchequer Stock 1962/63 and $4\frac{3}{4}$% Conversion Stock 1963) but also of other stocks. There was some selling by the banks during this period, but it was mostly of the forthcoming maturities and had no great impact on the market as a whole. Towards the middle of March sentiment improved, and yields of around 6% on long-dated and undated stocks attracted buyers. The Budget was well received, and yields fell during the rest of April. The announcement in the third week of the month that no conversion offer would be made to holders of the maturing stocks, and that only £400 million of new stock, 5% Exchequer Stock 1976/78, would be issued, encouraged the market, because it meant that official supplies of long-dated stocks were not immediately being augmented and that the total of gilt-edged stocks outstanding might decline by almost £600 million after the middle of June. By the end of April yields on long-dated and undated stocks were almost back to the low points reached in October 1962; yields on medium-dated stocks were about ½% above the lowest October levels. Official policy during April was not to oppose the decline in yields, and there was also no desire to reduce the offerings of Treasury Bills at this time; official sales of stocks were rarely more than light.

Other medium and long-term rates During the second half of 1962 local authority mortgage rates were slow to respond to changes in gilt-edged yields, and a similar lag has been seen in 1963. Mortgage rates were steady during February and the early part of March, while gilt-edged yields were rising, but rose a little in the early part of April, while gilt-edged yields were falling. The rise in early April may have arrested the trend away from temporary money and into mortgages which was characteristic of local authority finance during the last three quarters of 1962 and perhaps at the beginning of 1963; local authorities would have been less anxious to lengthen their debt if they saw that their long-term rates were rising and thought that they would shortly turn down again.

Rates on Defence Bonds and National Savings Certificates were lowered during March. Interest on Defence Bonds, which had been 5% since 1958, was reduced to 4½%, and it was announced that a new issue of Savings Certificates would be made in May. The new issue, the eleventh, yields the equivalent of £6:3:8% a year over six years to tax payers at the standard rate; the tenth issue, which was on sale from 1956 to March 1963, yielded £6:17:0% a year over seven years.

Building societies Most building societies reduced their rates for shares and deposits in April; the new rate for shares was 3½% free of income tax instead of 3¾%, and for deposits 3¼% instead of 3½%.

Equity market The equity market was firm during most of the three months February—April. Prices were helped at first by the ending of the uncertainty caused by the Brussels negotiations, and thereafter by some encouraging company reports and by indications that profits generally were rising. The Budget itself was followed after a few days by a further rise in equity prices, and by the end of April the F.T.-Actuaries index of industrial shares was nearly 6% higher than three months earlier.

The banking situation Some important developments occurred during the early months of 1963. Advances and other accounts of the London clearing banks rose by £186 million between the January and February make-up days, a greater rise than in any previous month. Thus although deposits fell rather less during these five weeks than might have been expected on seasonal grounds, and although the banks made substantial sales of investments, the combined liquidity ratio fell from 34½% to 31½%. Early in March it became known that advances were still rising rapidly, and that some banks would not be able to maintain their usual liquidity ratio of 30% without further sales of investments—extending beyond the June maturities—or without imposing strict restraint on their new advances. Neither course seemed appropriate in the circumstances, and the Bank therefore informed the clearing banks that they would raise no objection if any bank showed a liquidity ratio somewhat below 30% at the March make-up day. In fact the total of the banks' advances rose by £106 million between the February and March make-up days and three banks had liquidity ratios below 30%. The rise in advances slowed down after mid-March (perhaps more because of repayments of advances taken earlier than because of a slackening in new advances) and the increase over the two months to mid-May totalled £58 million. At both mid-April and mid-May two banks had liquidity ratios just below 30%.

A variety of reasons can be given for the rise of almost £300 million in advances between mid-January and mid-March, which was about twice as great as a year earlier. A sharp rise would in any case have been expected on seasonal grounds;[a] and the exceptionally severe winter will have added to the usual seasonal influences and compelled some customers—particularly in the building industry—to borrow especially heavily from their banks. A third possible explanation is that bank customers paid more of their taxes than usual with the help of a bank advance, rather than by encashing holdings of government debt. A fourth may lie in the external situation. Sterling was less strong and some British importers may have chosen to pay for supplies from abroad more promptly than usual, borrowing from the banks to do so; or some British exporters may have had to wait longer than usual before they received payment for their goods and could repay an advance from their bankers. Lastly, part of the rise in advances may have represented the continuation of an upward trend, which first appeared in the middle of 1962, and which applied particularly to lending to individuals.

Scottish bank advances rose by £22 million in the two months to mid-March. This increase was only a little larger than a year earlier, when Scottish bank advances had risen by £19 million. It seems that the Scottish banks were unaffected, or less strongly affected, by some of the factors described above, and perhaps particularly unaffected by the pressure on sterling.

The rise in the advances of the London clearing banks took the ratio of advances to total deposits to almost 50% at mid-March. This was the highest point reached since the war and may well have caused some banks to consider whether they might not shortly need to restrict their advances lest these came to represent an uncomfortably large proportion of deposits. The Budget, however, is likely to ease the difficulty. Later in the year the Exchequer is expected to be in greater deficit than during 1962, and this will tend to make bank deposits rise, though the extent of the rise will depend in some measure on the relative attractiveness of bank deposits and government debt.

QUARTERLY ANALYSIS OF FINANCIAL STATISTICS

13th December 1962—20th March 1963

The financial surpluses[b] and deficits of the private sector, public sector, and banking system are greatly affected by seasonal factors, in particular by the concentration of Exchequer revenue in the first quarter of each year. Thus whereas in the other quarters there is usually a public sector deficit and private sector surplus, in the first quarter the positions are reversed. One result of this is that the private sector's net claims on the banking system usually fall sharply. The seasonal factor makes interpretation of the underlying trends of the various sectors' surpluses and deficits in the first quarter particularly difficult. It seems likely, however, that the trend in recent months has been towards some increase in the private sector's surplus. This has been associated with an improvement in the current balance of payments and perhaps with the first signs of an increase in the public sector's deficit. Yet, at the same time, the private sector's net claims on the banking system have been decreasing more than seasonally.

Overseas funds Judging from the trade results it seems certain that there was a current account surplus in the first calendar quarter. On the other hand there was probably continued net expenditure on account of direct investment overseas and government loans. On balance, a favourable total of

[a] Seasonal adjustments are discussed in an article on page 95.

[b] The excess of current income over current expenditure (sector saving) less additions to fixed assets, stocks and work in progress (sector investment).

monetary movements might perhaps have been expected. Present information in fact indicates little net monetary movement. The reserves rose by £3 million and net external liabilities in sterling declined by £90 million,[a] but there was an increase of £89 million in other liabilities because of the support given by overseas monetary authorities. It is therefore possible that there was some unidentified outflow in the quarter; it may be that there was some speeding up in payments for imports and some slowing down in receipts from exports.

Private sector

The financial deficit of the whole private sector in the quarter to mid-March appears to have been less than in the corresponding quarter a year before,[b] and there may have been some increase in the sector's underlying financial surplus. It does not necessarily follow, however, that private sector saving has also risen. Indeed the impact of the severe weather upon building output in particular, and on production in general, in the first quarter, may have depressed private investment to an extent sufficient to explain the apparent increase in the underlying surplus.

The private sector's net claims on the public sector[c] were probably little changed during the quarter, as in the corresponding quarter last year. The figures include some unidentified movements in overseas claims, and whereas last year there was probably an inflow from overseas, this year there was more probably an outflow abroad. Thus claims of the domestic private sector may have fallen last year and risen this year.

Net subscriptions to National Savings totalled £114 million and were, as in the previous quarter, considerably greater than would be expected on seasonal grounds. The substantial rise perhaps owed something to the uncertainties of the time. Moreover the returns offered on Savings Certificates and Defence Bonds were particularly attractive; the withdrawal on the 12th March of these securities—which were to be replaced later by new issues offering less favourable terms—came too late in the quarter to affect the figures.

Private sector holdings of Bank of England notes decreased by £57 million, and of Tax Reserve Certificates by £163 million, for seasonal reasons. But both issues and surrenders of Certificates were lower than usual. Many holders will have preferred to retain for a further year Certificates issued early in 1962 and bearing a high return, and to have paid their tax in other ways. The sector's take-up of local authority debt probably increased substantially, as is usual in this quarter.

Private sector holdings of marketable government debt decreased during the quarter. Within the total, there were some unusual movements. "Other home and overseas non-official"[d] holdings of stocks decreased by £72 million, the first decrease in this item since the second quarter of 1961, but holdings of Treasury Bills rose by £23 million, the first increase since the third quarter of 1961. Some holders of stocks may well have switched to Treasury Bills during February and March because they preferred to be more liquid at a time of some uncertainty in the gilt-edged and foreign exchange markets.

Net claims by the private sector on the banking system usually decline in the March quarter, deposits falling while advances rise. The actual net fall of about £560 million was greater than usual: seasonally adjusted, advances rose more than deposits.[e] It cannot however be concluded from this that there is a continuing downward trend in the private sector's net claims on the banking system. The more than seasonal increase in advances may have been due to several special factors[f] some of which will in due course be reversed.

(a) Statistics of external liabilities and claims in sterling are given on page 104.

(b) Each of these quarters contained fourteen weeks. Of other recent quarters, those ended mid-December 1961 and 1962 each contained twelve weeks, and those ended mid-June and mid-September 1962 thirteen weeks.

(c) The private sector's net claims on the public sector include 'indirect' claims. The sector's net lending to the discount market is regarded as being indirect lending to, or claims on, the public sector.

(d) The new figures for external liabilities and claims in sterling by type of asset refer to calendar quarters; this analysis still perforce relates to quarters ending on banking dates, and does not therefore draw on the new information in this respect.

(e) See the article on page 95.

(f) See page 89.

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

Persons Borrowing by persons rose in the first quarter, but allowing where possible for seasonal factors, apparently less rapidly than in the previous quarter. Advances to persons[b] by members of the British Bankers' Association rose by £41 million in the quarter ended mid-February, rather less (after seasonal adjustment) than in the previous quarter. Hire purchase debt declined slightly over the quarter (although it rose a little in March). The underlying trend in building society lending was clearly upward during 1962 but this trend did not continue in the first quarter of 1963, no doubt because of the severe weather and the fall in economic activity.

While personal borrowing (before seasonal adjustment) rose in the first quarter, there was probably also some further increase in personal holdings of financial assets. The greater demand for National Savings has already been mentioned. There were increases too in the flow of funds into the Special Investment Departments of the Trustee Savings Banks and to building societies; and net receipts by unit trusts in the first quarter were a record.

The evidence so far available suggests that if, as is thought, the private sector's financial surplus (after seasonal adjustment) increased, persons shared in that increase. But movements in unidentified assets and liabilities—for example, unpaid fuel bills—could upset this tentative conclusion.

Companies The recovery in the financial surplus of companies appears to have continued in the fourth quarter of 1962, when there was both some rise in company profits and a fall in the rate of addition to fixed assets and stocks. Allowing roughly for seasonal movements, it seems that the recovery went further in the first quarter of 1963, if only because of delays in expenditure on fixed investment caused by the severe weather.

Advances to 'non-financial' companies in the quarter ended mid-February probably accounted for over half the rise of £265 million in B.B.A. lending to customers other than the nationalised industries. Advances to the building trades rose by about three times the seasonal average, and to manufacturing industry about twice. How far the exceptional weather contributed to these increases is not known, and it is therefore impossible to judge whether there has been a change in the trend of borrowing by companies from the banks. The amount raised through new issues of capital by 'non-financial' companies was £80 million in the first calendar quarter compared with £55 million in the fourth. The proportion of new loan capital to total new capital fell slightly from the high level of the previous quarter. If the financial surplus of companies was in fact still rising in the first quarter, the increased borrowing in this period must have been accompanied by some increase in financial assets—liquid assets, for example, or trade credit outstanding.

As regards financial companies, the "other financial" group in the B.B.A. analysis, which includes property companies, increased its borrowing in the February quarter to a greater extent than expected seasonally. This is the third successive quarter in which there has been an underlying increase in borrowing by this group. Hire purchase finance companies, having no great need for finance in the quarter, reduced their borrowing from their bankers, and also their deposit liabilities to other lenders. Capital issues by financial companies (other than banks, and property companies) were about the same in the first quarter as in the fourth.

Accepting houses and overseas banks The new statistical series for the accepting houses and the overseas and foreign banks provides comparable figures only for the fourth calendar quarter of 1962 and the first calendar quarter of 1963. Until a longer run of figures is available it is hard to judge how far end-year influences affect the movements between these two quarters. It may have been that the

(a) This term includes not only private individuals but also partnerships, unincorporated businesses etc.
(b) As indicated by the categories "personal and professional" and "agriculture".

reduction in their liquidity in the first quarter was partly seasonal (though it could also have been related to an outflow of overseas funds). Deposits with U.K. banks fell by £41 million and money at call by £46 million whereas in the previous quarter they had increased by £68 million and £67 million respectively. Among their other assets, direct claims on the public sector increased by £72 million in the first quarter, again perhaps partly for seasonal reasons : the increase was divided fairly evenly between Treasury Bills, gilt-edged stocks, and loans to local authorities. At the same time there appears to have been a less rapid growth in the net liabilities of accepting houses and overseas banks to the rest of the private sector. Deposits by U.K. residents (including banks) increased by £53 million, after rising by £77 million in the previous quarter, while advances to U.K. residents (excluding banks) increased by £35 million after falling by £28 million. Holdings of "Other sterling bills" however fell by £10 million after rising by £17 million. Some indication of a flow of funds abroad through these institutions can be seen from the fact that advances to overseas residents increased by £150 million while deposit liabilities to them rose by only £110 million.

Banking system As already mentioned, the net liabilities of the banking system to the private sector decreased by about £560 million in the quarter to mid-March.

Advances by the clearing banks and Scottish banks to all borrowers other than the nationalised industries increased by £353 million. This increase was significantly greater than could be accounted for by seasonal factors. Within the total increase, the clearing banks' advances rose by £327 million and the Scottish banks' by £26 million. Holdings of commercial bills by the clearing banks and Scottish banks also increased sharply, by £42 million. On the other hand, the fall of £65 million in the clearing banks' net deposits was less than might have been expected on seasonal grounds. Net deposits with the Scottish banks fell by £23 million, about the same as in the first quarter of the previous year. There were also decreases of £74 million and £5 million in the "other accounts" of the clearing banks and Scottish banks respectively.[a] These decreases in "other accounts" correspond closely to increases in the previous quarter and it is likely that they largely represent a return to more normal levels of credits in the course of transmission (seasonally high in the fourth quarter).

The fall in the banking system's net liabilities to the private sector was matched by a drop in its claims on the public sector. The banking system's holdings of government debt and of Bank of England notes fell by £570 million; this includes a fall of £81 million in indirect holdings (see the table on page 93). Within this total, the clearing banks' direct holdings of Treasury Bills fell by £319 million and of stocks by £83 million. The fall in the clearing banks' total liquid assets was steeper than usual and their combined liquidity ratio fell to 30·5% at mid-March; three banks had liquidity ratios below the conventional 30% minimum. The ratio of investments to deposits declined to 16·0% and the ratio of advances rose to 49·9%.

The discount market's total borrowing fell by £125 million during the quarter (of which £81 million reflected withdrawals by the banking system). The market's holdings of Treasury Bills fell by £76 million and of gilt-edged stocks by £47 million.

Public sector The Exchequer Group's cash surplus in the quarter ended mid-March amounted to £742 million. This was composed as follows :

	£ *millions*
Budget: above the line	+777
below the line	−120
overall	+657
Internal extra-budgetary funds ...	+ 3
Exchange Equalisation Account ...	+114
Other external items	− 32
Cash surplus	+742

(a) The movements in "other accounts" are here regarded as movements in liabilities to the private sector.

The overall budget surplus was £20 million larger than in the corresponding quarter of 1962, but this small increase was more than offset by a decrease in net receipts of extra-budgetary funds. The cash surplus was £166 million greater than in the previous year, for whereas in the first quarter of 1962 external items cost the Exchequer £118 million, in the first quarter of 1963, when sterling was occasionally under pressure, they contributed £82 million to the Exchequer.

£18 million of the assistance provided by overseas central banks and described in the Commentary was received before the 20th March, and so comes within the quarter under review. The assistance formed part of the Exchange Equalisation Account's holdings of gold and convertible currencies. The sterling counterpart of this assistance was invested in Treasury Bills. These Bills are treated, for convenience of analysis, as an overseas official holding of marketable government debt in the table below, and in Table 2 of the Statistical Annex.

The reduction in government liabilities, resulting from the Exchequer's cash surplus, 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 ...	− 3	
Indirect holdings ...	− 1	− 4
Clearing banks and Scottish banks:		
Treasury Bills	−336	
Stocks	− 92	
Indirect holdings ...	− 80	−508
Bank of England notes (including coin) ...		− 58
		−570
Holdings of the public, other than the banking system		
Government debt		
Overseas official holders:		
Treasury Bills ...	+ 28	
Stocks	− 3	+ 25
Other home and overseas non-official holders:		
National Savings ...	+114	
Tax Reserve Certificates	−163	
Treasury Bills ...	+ 23	
Stocks	− 72	
Indirect holdings[a] ...	− 42	−140
Bank of England notes		− 57
		−172

The greater part of the Exchequer's cash surplus financed a reduction of £575 million in marketable government debt; the fall of £361 million in Treasury Bills was more than accounted for by decreases in the holdings of the clearing banks, the Scottish banks and the discount market. These institutions also reduced their holdings of stocks by £139 million.

Total net official purchases of stocks amounted to £214 million during the quarter. Net purchases were largely confined to the short end of the market, particularly the two June maturities. There were small net sales of stocks with more than fifteen years to maturity.

The public sector's surplus or deficit includes not only the cash requirement of the Exchequer Group but also the financial requirements of local authorities, which are met by borrowing from the market; the nationalised industries also borrow small amounts from the banks (£8 million in this quarter). Local authority borrowing from the market totalled about £100 million during the fourth calendar quarter of 1962, but was almost certainly greater than this in the first calendar quarter of 1963, because receipts from rates will have been lower.

[a] Including some overseas official.

Looking ahead, it seems certain that the public sector's financial deficit will increase—the overall budget deficit is estimated to be £621 million greater in the financial year 1963/64 than in 1962/63 (partly because the nationalised industries will be borrowing more). Thus the financial surplus of the whole private sector will almost certainly rise and both persons and companies may be expected to share in this increase.

The increased borrowing requirements of the public sector will probably mean a rise in most, if not all, forms of its liabilities to other sectors. The Government should meet a substantial part of its needs from National Savings and an increase in the note circulation. How the rest of the Government's requirement will be met is uncertain, but in view of the reduction in market Treasury Bills over the past three years, the present liquidity position of the banks, and the trends in the gilt-edged market, less weight need be placed on the objections which can often apply to substantial reliance on Treasury Bill financing.

The last two June issues of this *Bulletin* have each contained an article reviewing the financial surplus of the private sector during the preceding calendar year. It is hoped to publish an article reviewing developments during 1962 in the September issue of this *Bulletin*.