COMMENTARY

Sterling has been generally firm since March, and the short-term assistance provided by overseas central banks during the first quarter of the year was repaid in June. At home the economy has been expanding, and there has been a greater fall in unemployment since February than would have been expected merely from better weather and other seasonal factors. Credit meanwhile remains easy for the most part, and interest rates have not changed very much during recent months.

Domestic economy

Industrial output, after seasonal adjustment, was nearly 4½% higher in the second quarter of 1963 than in the first, and a little over 1% higher than in the third quarter of 1962, the previous best quarter. The improvement between the first and second quarters of 1963 was partly due to recovery after unusually bad weather. But it seems likely that there was also an underlying rise in activity between the two periods; this was probably due mainly to increases in exports (which are discussed later) and in personal consumption.

Personal incomes benefited both from the fall in unemployment which occurred after February and from the increase in social benefits which took place in two stages in March and May. The total volume of retail sales was about ½% larger in the second quarter of 1963 than in the first; sales of household durables were particularly high in May, and fell back only a little in June. Among other forms of personal consumption, demand for cars was exceptionally strong in the second quarter, and considerably more new cars were registered than in any previous quarter. Sales of both cars and household durables were no doubt still receiving a stimulus from the lowering of purchase tax some months earlier.

Among other components of demand, total fixed investment was probably higher in the second quarter than in the first, but it is hard to judge whether such an increase was due wholly to the better weather. House building, both for public authorities and for private purchasers, is clearly on a rising trend, and so are other forms of public investment, for example in roads, power stations, hospitals and schools. But private investment by manufacturing industry has been declining for almost two years, and may still be falling, though more slowly. In the second quarter deliveries to the home market of engineering goods, particularly machine tools, continued to run below the level of a year earlier, and there was little if any improvement in demand for heavy steel products.

The rise in output in the second quarter probably owed little to stockbuilding. Total stocks fell in the first quarter, but this was largely because of a reduction in building work in progress and a steep fall in stocks of coal. Manufacturing output had been sustained in the first quarter by some making for stock, and by the end of March stocks of some finished goods were on the high side in relation to the level of output then ruling.

After reaching a peak of 878,000 in February, unemployment in Great Britain fell in each of the succeeding five months, and by July was down to 449,000, or 2% of all employees. The decline was greater than might have been expected on seasonal grounds, whereas during 1962 the underlying trend was upward.

Unemployment rose by 52,000 in August 1963, to 501,000, but an increase of this size is not unusual for the time of year, when many boys and girls have left school and not yet started work. As a result of the improvement since February, unemployment in August, though higher than at that time in any other post-war year, was more a regional problem, affecting particularly Scotland, the North of England, and Wales, than a country-wide problem; special measures to help regions of high unemployment were announced by the Chancellor of the Exchequer in his Budget last April.

Outlook The available evidence in August pointed to a continuing underlying rise in output (though some seasonal decline in, for example, the motor industry was to be expected). Industrialists themselves were more hopeful about their prospects than they had been earlier in the year, and more orders than previously were being received for some engineering products and for ships and aircraft. As regards the main types of demand, it seemed that personal consumption might increase further as a result of the reduction in direct taxation which took effect in July, and of generally greater confidence in the economic prospects. There were hopes of a further rise in exports. Public capital expenditure was expected to increase sharply, and, judging from forecasts by private builders, there would also be a further rise in private house building. Indeed there were signs that in certain areas the construction industry might soon have too heavy a load of work, and be hampered by shortages of skilled labour.

The results of the latest official survey of industry's investment intentions became available in mid-August. These indicated that total fixed capital expenditure by manufacturing industry would fall by about 10% between 1962 and 1963 and then show little further change in 1964. These changes between annual totals imply that the trend of manufacturing investment may continue to fall for some months yet but should be rising next year. The official survey suggested that fixed investment in distribution and other services (including the shipping industry) might fall by around 2% between the years 1962 and 1963 and then rise by 5% between 1963 and 1964. Judging from these results, investment in this group of industries is unlikely to fall below the level reached at the end of last year and should already be on a rising trend.

Short-term money rates The supply of Treasury Bills did not increase much between the beginning of May and the end of July; the Exchequer's deficit was not particularly large (because government expenditure had not at this time greatly expanded) and much of it was being financed in other ways. Meanwhile competition for the available Bills remained keen. The discount market's tender rate, however, at no time weakened much; indeed over the three months as a whole it rose slightly, from $3\frac{3}{4}$% to $3\frac{25}{32}$%. Official policy was to encourage firmness of rates, and the market was forced to borrow substantial amounts at Bank Rate, particularly towards the end of May and again towards the end of June. During each of these periods the U.S. Treasury Bill rate was rising and during the second half of July the Federal Reserve Banks raised their rediscount rates from 3%, at which they had stood since August 1960, to $3\frac{1}{2}$%. The changes in the two Treasury Bill rates did not give rise to any important movement of short-term funds into or out of the United Kingdom, as is noted later.

The enforcement of heavy borrowing at the Bank—the level of market advances at the end of June was higher than at any previous date—led to a rise in the cost of the market's borrowing from other sources, and the average cost of the market's total borrowings was probably higher in July than in any previous month this year. Even so it was appreciably below the Treasury Bill rate.

Commercial bill rates, unlike the Treasury Bill rate, were slightly lower at the end of July than at the beginning of May. This was not because of any contraction in the supply of commercial paper : indeed it almost certainly increased at this time. The discount houses, because their Treasury Bill holdings were low, were able to carry a larger portfolio of commercial bills and were encouraging their use, while some of the clearing banks, finding that the ratio of their advances to their deposits was unusually high, were content for some of their customers to turn to bill finance. The market wished to foster the growth of commercial paper and to keep its cost attractive compared with the cost of a bank advance; and the margin between the average cost of the market's money and the Treasury Bill rate had become wide enough to permit a comparatively low commercial bill rate. Thus the market's buying rate for three months' prime bank bills, which was $3\frac{7}{8}\%$ early in May, stood at $3\frac{27}{32}\%$ at the end of July; it was then much closer to the Treasury Bill rate than usual.

The rate for three months' money with local authorities also declined between the beginning of May and the end of July. It had risen from a little over 4% in mid-January to $4\frac{1}{2}\%$ in the second half of March, after the discount market had been forced to borrow at above Bank Rate, and remained generally at that point until mid-June. By this time local authority income from ratepayers had no doubt risen, and the rate for three months' money fell to $4\frac{1}{4}\%$. Local authorities were probably not obtaining an important share of their borrowed funds from overseas lenders, either directly or indirectly, during this period, because, except on rare occasions, a three months' covered deposit was less attractive than a U.S. dollar deposit. The cost of forward cover fell fairly steadily throughout the period and offset the fall in the local authority three months' rate, but there was a rise of about $\frac{1}{4}\%$ in the U.S. dollar deposit rate.

Hire purchase finance houses no doubt needed more finance because their business was expanding. The three months from May to July are the peak period for car sales, and, although it is likely that car buying is now being financed to a rather greater extent by the banks and to a rather smaller extent by the hire purchase houses than a few years ago, the number of hire purchase contracts entered into this summer has been very large. Moreover, although the average amount of finance provided for each car, whether new or second-hand, was lower than twelve months earlier, the drop was only about 6%, or less than half as great as the fall over the year in the average price of cars. Sales of consumer durables were also higher during the middle months of 1963 than for a considerable time. To finance the rise in total business the hire purchase houses appear to have relied partly on bank borrowing and bill facilities, and partly on deposits. But there was no rise in the rates paid for three months' deposits; indeed they were mostly somewhat lower at the end of July than at the end of April.

The gilt-edged market

The gilt-edged market was firm during most of the period May to July, and yields on medium and long-dated stocks declined by about $\frac{1}{4}\%$ and on undated stocks by about $\frac{3}{16}\%$ over the period as a whole. Sentiment was helped by the steadiness of sterling; and equities did not provide a strong counter-attraction at this time. Official operations were not on a large scale during the three months, and during most weeks total sales and total purchases were roughly in balance. Purchases were mostly of the shortest-dated stocks. Two issues, 3% Exchequer Stock 1962/63 and $4\frac{3}{4}\%$ Conversion Stock 1963, were redeemed in June, and thereafter the shortest stocks were $4\frac{1}{2}\%$ Conversion Stock 1964 and $2\frac{1}{2}\%$ Exchequer Stock 1963/64. Sales were mainly of 4% Treasury Stock 1965 and 5% Exchequer Loan 1976/78.

After the middle of June the market was in a position to absorb a substantial flow of new issues by local authorities, overseas governments and other public bodies. One issue was made in July by the Federation of Malaya, the first in London by that country since it became independent, and another, shortly after the end of July, by the Japanese Government (details are given below). The greater flow of new issues moderated the decline in gilt-edged yields, while probably not straining bank liquidity to the extent that official sales of stocks to the public would have done. The banks were not themselves active in the gilt-edged market during this period, and neither were the investment trusts nor overseas residents generally; but there was steady buying by some domestic investors.

Other medium and long-term yields Local authority mortgage rates, like gilt-edged yields, also declined: the rate for a 5 to 15-year mortgage, for example, fell from about $5\frac{7}{8}$% towards the end of April to about $5\frac{3}{4}$% in mid-June, and then remained steady. It is likely that the trend away from temporary money and into mortgages, which developed in the second quarter of 1962 but was interrupted in the first quarter of 1963, was resumed in the second quarter; a period of falling yields is often a time when lenders lengthen their portfolios in this way.

Debenture yields also fell during this period, by about $\frac{3}{16}$% (to an average of around 6% at the end of July) for stocks with about twenty years to maturity. In June, for the first time since 1960, a company debenture offering a yield to redemption of less than 6% was issued.

This general decline left most long-term yields—whether on gilt-edged stocks, local authority mortgages, or debenture stocks—about $\frac{3}{4}$% to 1% lower than a year earlier, and up to $1\frac{1}{2}$% lower than in July 1961.

Foreign bond issues The first issue of a foreign currency loan on the London market since before the war was arranged by a group of banks during May. This issue, by the Belgian Government, consisted of U.S.$20 million 5% bonds 1966; it was placed privately by a London merchant bank. In July a second foreign currency issue was arranged in London, but marketed in other financial centres as well. This was an issue by the Italian state-owned corporation, Autostrade, of $15 million $5\frac{1}{2}$% bonds redeemable between 1972 and 1978. The London market's role in both these issues was mainly that of a financial intermediary. A substantial part of the Belgian issue was subscribed by U.K. banks, but subscriptions to the Italian issue came almost entirely from non-residents. In both cases the funds subscribed were largely Euro-dollar in origin.

Early in August a £5 million issue of 6% bonds 1983/88 was made by Japan. Except for some loans to Scandinavian countries, this was the first sterling loan since the war to a country outside the sterling area; it was issued wholly in bearer form. The proceeds will go towards the redemption of an existing sterling issue of the Japanese Government which falls due in December.

Equity market The equity market was quiet during most of May, June and July, and there was very little change in the general level of prices over the three months as a whole. The market did not have to absorb a particularly large volume of new equity issues (partly because debenture issues were popular) and it was encouraged by evidence that the trend of profits was still upwards. It was also helped by the reduction in stamp duty, which had been announced in the Budget and which, because it applied to deals settled after the end of July, reduced the cost of deals entered into after mid-July. On the other hand the average earnings yield on ordinary shares was lower than it had been in the past, which suggested that the rise in profits was wholly or partly discounted.

The banking situation Advances and other accounts of the London clearing banks rose by £305 million in the three months to mid-April and by £126 million in the three months to mid-July. There were probably two main reasons for the smaller rise in the second three months. In the first place, seasonal influences are much less strongly upward at that time than earlier in the year; secondly, advances may have been repaid on a larger scale than usual, following exceptionally heavy borrowing between mid-January and mid-March, when the winter was at its most severe and when sterling was temporarily under pressure. If there was any falling off over the six months in the underlying demand upon the clearing banks for new credit, it was probably not substantial. The increase of £16 million in advances between mid-July and mid-August, although this is a period when seasonal factors exert a strong downward influence, supports this view. The ratio of advances to total deposits at mid-August, at exactly 50%, was approximately the same as at mid-May (when it had exceeded 50% for the first time since the war), and the combined liquidity ratio was only 31½%. Nevertheless lending by the clearing banks does not in practice appear to have been impeded by balance sheet considerations. The liquidity position of the banks during the next few months will naturally depend on the size of the Exchequer deficit; on the extent to which they, rather than the private sector directly, finance the deficit; and on the absolute movements in advances and deposits. The range of possibilities is very large. However, the deposits and liquid assets of the banks are likely to rise during the closing months of 1963 if the Exchequer moves more heavily into deficit in line with the estimates.

Scottish bank advances rose by £34 million in the three months to mid-April, or by little more than in the same period a year earlier. In the three months to mid-July—a period when seasonal influences are unimportant—they fell by £18 million, which suggests that there is at present no strong underlying demand for advances in Scotland.

Gold and foreign exchange markets Private demand for gold slackened a little during May and the market was quiet until early July. Demand then revived and was occasionally heavy, and the price rose from \$35·08 in mid-July to just over \$35·10 early in August. Over the three months May to July central banks were able to acquire some gold for monetary use, but the bulk of new production continued to move into private hands.

In the foreign exchange market, the steadier conditions which had returned in April after the flurries of February and March persisted during May, June and July, and the rate for sterling against the U.S. dollar remained close to \$2·80. Markets were well balanced and turnover was quite heavy at times.

The good tone of sterling was probably mainly due to the recent strength of the balance of payments on current account. Commercial demand for foreign exchange may also have been less than usual at this time of year, because the pressure on sterling during January and March partly took the form of advance payments by traders. Sterling does not appear to have benefited much from overseas buying of U.K. securities during May, June and July (the rate for security sterling in New York was steady at around \$2·79) and private short-term capital movements were probably small.

Interest rate considerations did not provide a strong incentive to move funds over the exchanges during this period. The U.S. Treasury Bill rate rose, as has been mentioned, so that the uncovered advantage in favour of U.K. Treasury Bills fell from about ¾% at the end of April to about ½% at the end of July. Meanwhile the three months' forward discount on sterling narrowed, and whereas there had been a small covered margin in favour of U.S. Treasury Bills during most of May, there was a small covered margin in favour of U.K. Treasury Bills during June and July. During most of the three months, as has been noted, a U.S. dollar deposit offered a better return than a covered three months' deposit with a U.K. local authority, but the margin never exceeded ¼%.

Reserves and liabilities The steadiness of sterling in the market from April onwards was accompanied by some accruals to the reserves. By end-July the reserves were only £29 million lower than at end-March, even though the United Kingdom repaid in full during June the help amounting to £89 million received from European central banks in February and March; no fresh borrowing, for example from the International Monetary Fund, was undertaken when the repayment was made. The standby agreement with the I.M.F. was renewed for a further year from the 8th August. It provides for drawings up to the equivalent of \$1,000 million (£357 million) in case of need. This facility is immediately available to limit the impact on domestic policies of any disturbance to the balance of payments, such as might be caused by a temporary weakening of the visible balance, or by an outflow of short-term capital.

Net liabilities in sterling to all overseas countries rose by £49 million in the second quarter. Those to sterling area countries rose by £74 million, or by about what might have been expected on seasonal grounds. Those to countries outside the sterling area fell by £25 million. This fall in net liabilities is more than accounted for by a rise, probably seasonal, in the amount of credit extended to these countries; but there was no substantial rebuilding of deposits or Treasury Bill holdings by countries which had reduced them sharply during the first quarter.

Balance of payments

The current account was comfortably in surplus in the first quarter of 1963. The second quarter of a year is usually better for the current account than the first, and probably was again this year: it seems unlikely that there was any great change in the underlying situation.

Imports, as measured by the Trade Accounts and seasonally adjusted, were 5½% higher in the second quarter than the first. However, sugar is valued in the Accounts at the world price, which rose sharply between April and June, whereas most of our supplies were bought at lower fixed prices, and to that extent this increase overstates the rise in the cost of imports to the United Kingdom. Leaving sugar aside, the rise in the c.i.f. value of imports may have been about 4%. Imports of industrial materials showed signs of growing again as industrial output rose. There were also larger imports of tobacco and some further growth in imports of finished manufactures.

Exports were 2½% higher in the second quarter than in the first, and nearly 5% higher than the quarterly average in the second half of 1962. Shipments to the European Economic Community increased sharply in the second quarter, and sales to the United States, which had been depressed for some time, began to revive. All the main classes of exports rose between the first and second quarters, except ships and aircraft which had been abnormally high in the first quarter.

Imports in July were substantially higher than the monthly average for the second quarter. Food imports were larger, and there was a further, and more substantial, rise in industrial materials. Exports in July were also higher than the monthly average for the second quarter, but this rise was smaller than the rise in imports.

The rise in exports so far this year has been achieved at a time when conditions in the main overseas markets have been no more than reasonably favourable, and it seems that the United Kingdom's share of world trade has been maintained. The rest of this Commentary touches on the conditions in some of the main overseas countries.

Conditions abroad

In the United States gross national product was growing at a rate of nearly 5% per annum during the first half of 1963, thanks largely to private consumption and government expenditure. Private fixed investment fell in the first quarter but rose substantially in the second. Stockbuilding was moderate and some further rise in total stocks seems possible, although steel stocks are being run down from the level reached just before the settlement of wage negotiations in the industry in June.

The rise in demand has increased employment, but not sufficiently to keep pace with the continuing growth in the population of working age. Unemployment was a little higher than a year earlier, being equal to 5·7% of the labour force at the end of June. The scope for further growth in the economy thus appears to be considerable. The U.S. Administration has proposed tax reductions and tax reforms, and these are being considered by Congress.

In July, the President submitted a special message to Congress on the U.S. balance of payments. The President put forward several measures to reduce the external deficit, in association with the rise in rediscount rates mentioned earlier in this Commentary. There had been some increase in the U.S. surplus on goods and services account, accompanying the expansion of domestic output. But outflows of short and long-term capital, which were unusually large in the first half of 1963, had continued to exceed that surplus.

In the European Economic Community expansion of output was hampered early this year by the severe weather and some strikes, but has since been resumed at a pace similar to that in the closing months of 1962. It is difficult to discern the underlying trend. Expenditures by governments and on private construction are rising fast. Personal consumption has been growing, but not as fast as last year. The rate of growth of private investment other than construction has been falling, and its future behaviour seems to be the main uncertainty in the outlook. It may continue to fall off and cause a further slackening in activity generally. On the other hand some members of the Community are experiencing a revival in export demand and there are some signs that rises in costs and falls in profit margins may be about to moderate.

Doubts about the outlook in the Community affect assessment of the prospects for primary producers, in particular producers of industrial materials. A number of these countries have benefited recently from some hardening of their export prices; Australia and New Zealand, for example, have been enjoying good demand for wool. Among suppliers of food, the sugar-producing countries will have benefited to some extent from the recent rise in its price. No further general rise in the prices of primary products seems likely, but provided that demand from Europe is sustained they should broadly speaking remain steady. The primary producing countries by and large have recently been expanding their exports more than their imports. If demand for their goods is in fact maintained these countries should soon be able to allow their imports to grow rather more rapidly.

Looking at the world as a whole, it seems that trade will continue to expand, if not particularly quickly. The opportunities therefore exist for a further expansion of British exports. Much progress has been made in the modernisation of British industry which will improve its competitive position; and if, as is hoped, output rises further, this will help to spread overheads and hold down costs. But continuing restraint in incomes and prices is needed if these advantages are not to be dissipated and if the opportunity for laying a secure foundation for further growth is not to be missed.

QUARTERLY ANALYSIS OF FINANCIAL STATISTICS

21st March 1963—19th June 1963[a]

During the last quarter of 1962 and the first quarter of 1963 there was apparently some underlying increase in the private sector's financial surplus.[b] This was associated with some improvement in the current account of the balance of payments and some increase in the public sector's deficit. Present information suggests that after rough allowance has been made for seasonal factors there was little change in the financial surpluses and deficits of the various sectors[c] in the second quarter,

---

(a) This quarter contained thirteen weeks, like the comparable quarter in 1962. The quarter ended mid-March 1963 contained fourteen weeks.

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

(c) This analysis covers four sectors, namely:

(i) The private sector, that is 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, that is the Central Government, local authorities, and public corporations.

(iv) Overseas.

These sectors are therefore fewer than, and defined rather differently from, the six sectors which are the subject of an article on page 184. It is not yet possible to attempt a six-sector analysis quarterly, because of lack of information.

and in particular that there was no further rise in the private sector's underlying financial surplus. Such judgments must necessarily be tentative. In the first place the statistics used in this financial analysis are still somewhat rudimentary. Secondly, the seasonal movements from quarter to quarter are usually very large in relation to any likely change in the underlying situation, particularly when one of the quarters examined is the first quarter, which is the Exchequer's main revenue quarter. A further special difficulty this year lies in judging how far the statistics may have been affected by the very severe weather in January and February.

Overseas funds

The current account of the balance of payments was comfortably in surplus in the first calendar quarter of 1963 and a further improvement is to be expected on seasonal grounds in the second quarter. The surplus should be more than enough to offset the outflow which usually occurs on account of direct investment overseas and government loans. This would imply that monetary movements were at least moderately favourable in the second quarter. The evidence so far available supports such an inference: the reserves fell by £36 million in the quarter and there was an increase of £62 million in external liabilities in sterling,[a] but the £89 million of assistance received from overseas central banks in the first quarter was repaid, external claims in sterling rose by £10 million, and there was probably a small withdrawal of overseas funds from local authorities and finance houses. This all points to the conclusion that there was no substantial unidentified inflow or outflow of funds in the second quarter.

Private sector

Allowing as far as possible for seasonal factors it seems that there was no great change between the first and second quarters either in the balance of payments or in the public sector's position. It follows that the position of the private sector as a whole was broadly unchanged, though, as will be seen, there were probably changes in the type of asset acquired and liability incurred, and also changes in the surpluses and deficits of the private sector's component parts.

In the first quarter, which is the main revenue quarter, the private sector's net claims on the public sector usually fall, while in the second and subsequent quarters they usually rise. Making an allowance for this pattern, it seems that the private sector acquired public sector debt on a slightly smaller scale in the quarter under review than in the previous quarter. Moreover the flow of private sector funds into public sector debt—allowing again for seasonal factors—seems to have been somewhat different in character, with perhaps a smaller net take-up of government debt and Bank of England notes in the second quarter than in the first and perhaps a slightly larger net take-up of local authority debt.

Private sector holdings of Bank of England notes increased by £34 million in the second quarter. Compared with the same quarter of previous years this increase seems a little on the low side, whereas the change in the first quarter had been much as usual. But the varying date of Easter makes exact comparisons difficult, and private sector holdings of notes sometimes move erratically over short periods. Payment of wages by cheque was made legal on the 1st March 1963, but this change is not thought to be having a significant effect so far on the private sector's demand for notes.

New subscriptions to National Savings totalled £28 million. This was the smallest second quarter figure since 1958; it is partly accounted for by the fact that the old issues of Defence Bonds and National Savings Certificates ceased on the 12th March, while sales of the new issues did not begin until the 25th March and the 13th May respectively. Even allowing for these intervals, the drop in new subscriptions between the first and second quarters was greater than usual, and was largely accounted for by lower subscriptions to the new Defence Bonds, which, like the new Savings Certificates, yield less than the old.

Private sector holdings of Tax Reserve Certificates increased by £30 million in the second

[a] See Table 20 of the Statistical Annex.

quarter. Issues were very low, even though the interest offered was not unattractive compared with the yield on other short-term securities. It seems that some companies preferred the extra liquidity which a marketable form of debt provides. It may also be that during the first half of 1963 some companies and other holders who have been in the habit of buying Certificates regularly each year, holding them for perhaps a year, and then using them to pay taxes, decided to retain for a further year Certificates bought in 1962, which are earning more than those bought in 1963, to pay their tax in other ways, and to refrain from buying new Certificates; certainly surrenders in both quarters were, like issues, lower than usual.

Although total government borrowing on marketable debt decreased in the first quarter and increased in the second, private sector holdings of marketable debt appear to have declined in each quarter.[a] Within the totals, there appears to have been a change in the private sector's preference for Treasury Bills as compared with stocks. In the first quarter, which was a time of some uncertainty following the Brussels breakdown, private holdings of Treasury Bills increased while holdings of gilt-edged stocks fell. In the second quarter the reverse movement occurred, even though two gilt-edged issues were redeemed in June.

Private sector holdings of local authority debt usually rise less in the second quarter of each year than in the first, because local authorities receive more income from rates and so need to borrow less. Allowing for this difference, it is likely that this year there was a greater underlying rise in private sector holdings of local authority debt in the second quarter than in the first. Local authority borrowing was restrained in the first quarter because the weather hampered fixed investment, whereas in the second quarter some of these arrears will have been made good and the rising trend in local authorities' fixed investment, which has been a feature of recent years, will probably have been resumed.

The private sector's net claims on the banking system[b] declined during 1962 and there was a further sharp decline, greater than could be expected on seasonal grounds, in the first quarter of 1963. In the second quarter there was an actual increase of about £100 million in net claims by the private sector; this was much as would have been expected in view of seasonal influences, which tend to raise deposits while advances change little. Thus the underlying fall in the private sector's net claims on the banking system was at least greatly moderated in the second quarter, if not entirely checked. Such a check would be consistent with an underlying fall in net lending by the private sector to the public sector, if the financial surplus of the private sector and its acquisition of overseas assets were indeed broadly unchanged.

This analysis now turns to the component parts of the private sector, and then to the banking system and the public sector.

Persons[c]

The rate of personal borrowing appears to have increased more during the second quarter than would have been expected on seasonal grounds. Borrowing from building societies, which had been held back in the first quarter when the weather seriously interrupted building work, increased very sharply. Hire purchase debt also rose sharply in the second quarter, the first increase on such a scale for two years. Advances to persons[d]

(a) The evidence lies in three sets of statistics: first, "other home and overseas non-official" holdings of marketable debt (see Table 2 of the Statistical Annex); secondly, statistics derived from the registers of government stocks; and thirdly, the new series of "United Kingdom External Liabilities and Claims in Sterling". The latter two sources make it possible to arrive at the changes in private holdings of overseas residents held direct, and through banks, respectively, and so to estimate the changes in domestic holdings. The estimates are not precise, because the basic information is for slightly different dates and incomplete.

(b) Largely the private sector's deposits with, less its advances from, the system.

(c) This term includes not only individuals but also partnerships, unincorporated businesses, etc.

(d) As indicated by the categories "personal and professional" and "agriculture"; see the article on page 196.

by members of the British Bankers' Association increased by £45 million (seasonally adjusted) in the three months to mid-May; this increase, though substantial, was a little less than in the previous quarter.

Persons seem to have added less to their financial assets in the second quarter than in the first (if some allowance is made for seasonal factors). This is evident mainly in the sharp fall in net subscriptions to National Savings already mentioned. Net acquisitions of shares and deposits with building societies were also smaller than in the first quarter (though still very high compared to most earlier periods). But the flow of funds to the Special Investment Departments of the Trustee Savings Banks was well maintained; and net receipts by unit trusts continued to increase.

This evidence of more borrowing and smaller additions to assets points to some decline in the financial surplus of persons. It is supported by indications that fixed investment[a] by persons recovered in the second quarter, and that personal consumption, and particularly the purchase of cars, increased.

Companies If the financial surplus of the whole private sector was broadly unchanged between the first and second quarters of 1963 while the surplus of persons fell, it follows that the financial surplus of companies increased (or their deficit diminished). It is indeed likely that profits recovered quite sharply in the second quarter from the low point to which they had fallen in the first because of the bad weather and the fall in output. Meanwhile there was probably little or no revival in expenditure on fixed investment and stocks taken together; fixed investment by private manufacturing industry has been on a declining trend for almost two years.

Little up-to-date information about changes in the financial assets of companies is available quarterly, but some support for the belief that the financial surplus of companies increased in the second quarter is given by the statistics of borrowing by companies, whether from the capital market[b] or from the banks. New capital issues by industrial and commercial companies, together with property companies, raised £67 million in the second calendar quarter, compared with £80 million in the first. Borrowing by industrial and commercial companies from members of the British Bankers' Association rose by £40 million (seasonally adjusted) in the quarter to mid-May, compared with £68 million in the previous quarter.[c]

Capital issues by financial companies (excluding banks) raised slightly less in the second calendar quarter than in the first. The " other financial " group (which here includes property companies) borrowed less from the banks in the quarter ended mid-May than in the previous three months (£19 million, seasonally adjusted, compared with £30 million).

Accepting houses and overseas banks Total deposit liabilities of the accepting houses and overseas banks rose by £210 million in the second calendar quarter, compared with £164 million in the first. Within the total of £210 million, deposit liabilities to U.K. residents (including banks) increased by £124 million. Advances to U.K. residents (excluding banks) rose by £57 million, money at call by £21 million and balances with U.K. banks by £56 million, so that total net liabilities to the rest of the private sector and to the banking system fell slightly. Deposit liabilities to overseas residents rose by £86 million, while advances to them increased by £55 million, so that net liabilities to overseas residents increased.

The accepting houses and overseas banks' direct claims on the public sector increased by £39 million during the second quarter, or by

---

(a) Largely investment in private houses, but also includes investment by farmers, unincorporated businesses, etc.

(b) " Borrowing " here includes equity issues.

(c) As indicated by the categories " total manufacturing industries ", " building and contracting ", and " retail trade "; see the article on page 196.

only about half as much as in the previous quarter. Holdings of Treasury Bills fell by £8 million, but holdings of gilt-edged stocks rose by £34 million and loans to local authorities by £13 million.

Banking system

As already mentioned, the net liabilities of the banking system to the private sector increased by about £100 million in the second quarter. Net deposits with the London clearing banks rose by £160 million, or by about £50 million more than might have been expected on seasonal grounds. Net deposits with the Scottish banks rose by £29 million. Total advances by the clearing banks and the Scottish banks to borrowers other than the nationalised industries increased by £98 million. The clearing banks' share in this increase was £90 million. The seasonal movement during the second quarter is small, and the underlying increase was therefore of about the same order as the actual increase. This is a distinctly smaller rise than in the first quarter, but, as explained in the June issue of this *Bulletin*, some special influences were operating then.

The banking system's claims on the public sector, including indirect claims through the discount market, increased by roughly £100 million in the second quarter; this was rather more than might have been expected judging from the recent trend. Within the total, the clearing banks' holdings of Treasury Bills rose by £139 million and the Scottish banks' holdings by £17 million, but the two groups reduced their holdings of gilt-edged stocks by £32 million and £3 million respectively. They reduced their advances to the nationalised industries by £30 million in total.

The discount market's borrowing from the banking system fell by £31 million in the quarter, but its borrowing from other sources, including the accepting houses and overseas banks, rose by £40 million, leaving its resources slightly greater on balance. The only appreciable changes in the market's assets were a decline of £16 million in holdings of Treasury Bills and a rise of the same amount in other bills.

Public sector

The Exchequer Group had a cash deficit of £216 million in the quarter ended the 19th June, made up as follows :

	£ *millions*
Budget: above the line	−247
below the line	− 31
overall	−278
Internal extra-budgetary funds ...	+ 97
Exchange Equalisation Account ...	− 38
Other external items (net)	+ 3
Cash deficit	−216

The overall budget deficit was £4 million less than in the same period of 1962, though for the financial year as a whole the deficit is expected to be some £600 million greater. Government expenditure did not rise very much in the second quarter, and the income tax reductions announced in the Budget did not come into effect until July. External items cost the Exchequer Group much the same in the second quarter as a year earlier, but internal extra-budgetary funds contributed some £20 million more this year than last, so that the cash deficit was about £20 million smaller.

The Exchequer's cash deficit was financed as follows :

GOVERNMENT DEBT AND BANK OF ENGLAND NOTES

£ *millions*

Holdings of the banking system

Bank of England, Banking Department:		
Direct holdings ...	− 4	
Indirect holdings ...	− 16	− 20
Clearing banks and Scottish banks:		
Treasury Bills	+156	
Stocks	− 35	
Indirect holdings ...	− 15	+106
Bank of England notes (including coin) ...		+ 41
		+127

£ millions

Holdings of the public, other than the banking system

Government debt		
Overseas official holders:		
Treasury Bills ...	+ 58	
Stocks	− 5	+53
Other home and overseas non-official holders:		
National Savings ...	+ 28	
Tax Reserve Certificates	+ 30	
Treasury Bills ...	−100	
Stocks	+ 29	
Indirect holdings[a] ...	+ 15	+ 2
Bank of England notes		+34
		+89

£18 million of the assistance provided by overseas central banks during the first three months of 1963 was received before the 20th March, and £71 million after that date. The whole of the £89 million of assistance was repaid before the 19th June, so that there was a net repayment of £18 million in the quarter under review. This repayment has been treated for statistical purposes as a reduction in overseas official holdings of Treasury Bills; it was, however, more than offset by other overseas official purchases of Bills during the second quarter.

The table above has shown that the main contribution to the financing of the cash deficit came from the banks, notably in the form of Treasury Bills. Meanwhile the private sector, while adding to its other assets, was reducing its holdings of Treasury Bills.

The following table departs from sector analysis and simply shows the financing of the Exchequer's cash deficit by type of liability incurred, whatever the holder. The figures in the two parts of the preceding table are rearranged, and the changes in the discount market's stocks and Bills taken into account; these were previously classified as changes in indirect holdings of the various holders:

£ millions

Exchequer financing by type of liability

Exchequer net sales +/purchases −		
Net indebtedness to Bank of England Banking Department		− 4
Non-marketable debt		
National Savings ...	+28	
Tax Reserve Certificates	+30	+ 58
Marketable debt		
Treasury Bills ...	+98	
Stocks	−11	+ 87
Bank of England notes		+ 75
		+216

The small figure of £11 million for net purchases of stock by the Exchequer Group combines on the one hand net purchases of stocks with less than five years to maturity, and the redemption payments to market holders of the two stocks in this group which matured in June, and on the other hand net sales of longer-dated stocks. These operations would have lengthened the average life of dated government stocks in the hands of the market if time had stood still; in fact the passage of time provided an approximate counterbalance. The average life, which, as a result of substantial official sales, had lengthened from just over twelve years in mid-June 1962 to just over thirteen years in October 1962, has since changed little from quarter to quarter, and in June 1963 it was still about thirteen years.

The public sector's surplus or deficit also includes the financial requirements of the local authorities, which are mainly met by borrowing from the market. Such borrowing totalled about £185 million in the first quarter, but, for seasonal reasons, was almost certainly lower in the second. Finally, the public sector's surplus or deficit has also to take account of borrowing by the nationalised industries from the banks. Such borrowing fell by £30 million in the second quarter, as has been noted.

To sum up, it seems that the net effect of these movements was to leave the public sector's deficit broadly the same, apart from seasonal variations, in the second quarter as

[a] Including some overseas official.

in the first quarter. But there was a tendency for the public sector's deficit to be financed a little more by the banks, and a little less by the private sector, than hitherto.

Although the public sector's deficit in the second quarter had not yet begun to reflect the increase in the Budget deficit planned for this financial year, there are signs that it began to do so during the third quarter, and this rise is expected to continue. This means that the private sector's surplus is likely to increase. The way this rise is shared between persons and companies will affect the manner in which the public sector's deficit will be financed. Judging by previous form, the greater the increase in the financial surplus of persons (which in the short run will be largely determined by the course of personal consumption) the more the surplus is likely to appear as small savings, as distinct from additional holdings of marketable debt. A larger financial surplus of persons might also give rise to larger bank deposits, or smaller advances. A larger financial surplus of companies should affect bank deposits and advances too, but it may also be expected to make for larger holdings of marketable government debt.