COMMENTARY

In the early weeks of 1964 evidence that the economy was expanding and resources being absorbed continued to come forward, and doubts began to arise whether the pace might not be a little faster than could be sustained in the longer run. These doubts were reinforced in the public mind in the second week of February, when it became known that the January figures showed an unusually large trade gap. Sterling, after holding steady for the best part of a year, then came under some pressure, though this was neither very severe nor long-lasting.

It was against this broad background that Bank Rate was raised on the 27th February from 4%, at which it had stood since January 1963, to 5%. It was hoped that the move, though aimed mainly at moderating the pace of expansion, might also lead to a more normal pattern of short-term rates: for some months the Treasury Bill rate had been unusually close to Bank Rate, and at the first tender after the rise in Bank Rate it rose by only a little more than ½%. In raising Bank Rate it was no part of the authorities' intention to attract short-term funds across the exchanges.

The rest of the Commentary describes the situation before the change in Bank Rate.

Domestic economy

Industrial output, after seasonal adjustment, rose in each quarter of 1963 except the first. For the year as a whole it was 3% higher than in 1962; on a comparison of fourth quarters it was 7½% higher.

Personal consumption, which is much the largest component of demand, primarily accounted for the growth of output during 1963. Retail sales rose sharply in the third quarter (when the tax reductions announced in the Budget took effect) and were well maintained in the fourth quarter; demand for household durable goods and clothing was particularly strong during both quarters. Among other forms of personal consumption, purchases of new cars were already very large in the second quarter, and held up much more strongly than usual in the third and fourth quarters. At the end of the year total consumer spending appeared still to be rising, without any fresh stimulus. Spending seems likely to grow further in the coming months: earnings have risen and employment prospects are good.

The volume of exports, seasonally adjusted, rose notably during 1963. A considerable increase occurred during the first half of the year. There was then some slowing down, but, as is noted later, there is reason to hope that it will prove to have been temporary—even though the January figures were disappointing—because the opportunities for exports in the coming months look promising.

Public expenditure is on a rising trend. Although, judging from the Exchequer Accounts, the increase during 1963 was less rapid than had been expected, it appears to have gained some impetus by the turn of the year. The volume of capital expenditure by the public sector, after seasonal adjustment, was already 6% higher in the third quarter than in the second—with particularly large increases for electricity supply, roads, and housing—and it almost certainly rose further in the fourth quarter. A fresh increase in public capital expenditure has been forecast for 1964/65, without taking account of the carry-over of uncompleted work from 1963/64 which is now expected; the increase will come at a time when other demands on the economy are likely to be growing as well.

Private house building rose considerably during 1963; there was also some increase in investment in shops and offices. The decline in investment by manufacturing industry, which began during the autumn of 1961, was probably checked before the end of 1963. During 1964, most, if not all, forms of private fixed investment are likely to be increasing. For example, the number of new houses under construction is likely to grow further; orders for ships have risen, thanks in part to the Government's recent credit scheme for British shipowners, and in part to more orders from abroad; and a recent survey by the Board of Trade suggested that manufacturers expected to spend 8% more on fixed investment in 1964 than in 1963. Because manufacturers' capital expenditure was falling during much of 1963, and is likely to be rising throughout 1964, the increase in the rate of spending between the fourth quarters of the two years is likely to be distinctly greater than 8%.

Total stocks and work in progress, which had risen during April to June, fell during the succeeding three months, and the rise in output at this time was not due to stockbuilding. In the fourth quarter, when the business cycle had reached a more expansionary stage, all kinds of stocks increased. The amount of work in progress rose sharply; and there were also additions to stocks of materials and fuel (following an increase in imports of industrial materials) and of finished goods. A further increase in stocks seems very likely during 1964 as industrial output rises.

As the economy has expanded unemployment has fallen steadily. During the six most recent months, to mid-February, a period when the total for Great Britain might have been expected for seasonal reasons to have risen by about 50,000, it has in fact fallen by 37,000, to 464,000. The downward trend has brought a good many reports of shortages of skilled workers in various parts of the country. At the same time there are still some areas, particularly in Scotland and the North-East, where unemployment is well above the national average. There are indeed signs of response to the inducements offered by the Government to industry to develop in these areas, but it will be some time before they have their full impact upon employment.

Incomes and prices

In manufacturing industry, earnings per man-hour rose in the year ended October 1963 by about $4\frac{1}{2}$%; this was probably more than the rate of increase in output per man-hour likely to be sustained on average over a period of years, though it may well have been within the increase achieved in this period of re-expansion. In the same year, the prices of fuel and materials (except food) rose by about $2\frac{1}{2}$%; and aggregate trading profits of companies recovered to reach, by the third calendar quarter, a level some $7\frac{1}{2}$% higher than a year before. These movements were reflected in increases of just over $1\frac{1}{2}$% in manufacturers' selling prices at home, and of 2% in retail prices generally. Towards the end of 1963, however, there were clear signs that incomes were beginning to rise more strongly; and the prices of some materials also rose further about this time. The pressure towards higher prices seems to have continued since the New Year. Retail prices may, however, be affected by the abolition of resale price maintenance, which is proposed in legislation now before Parliament.

Short-term money rates

The discount market's tender rate for Treasury Bills remained at, or very close to, $3\frac{3}{4}$%, in the three months November to January. The market was conscious of the firmness of the U.S. Treasury Bill rate and it assumed that official policy would be directed, as necessary, to maintaining rates. The average cost of borrowing from all sources rose further, although the market was not in fact forced to borrow very heavily from the Bank. It was usually fairly well supplied with Bills, and during most of the second half of the period competition at the tenders from other applicants was a little less keen than previously.

The market's buying rate for three months' prime bank bills was also fairly steady, at around $3\frac{7}{8}$%, during November to January.

There was more commercial paper as a whole in the market at the end of 1963 than a year earlier. Credit of all kinds—including bank advances and hire purchase credit—had clearly increased, and commercial bills had probably at least held their share of the total, because they were usually competitive with bank advances. In January 1964 the Bank increased their average weekly purchases of prime bank bills by about a third, because they wished their portfolio to continue to represent an adequate sample of such bills in the London market.[a]

Rates for local authority temporary money, unlike rates for Treasury Bills and commercial bills, rose during November and December.

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[a] The Bank's general policy was described in the article "Commercial Bills" in the December 1961 issue of this *Bulletin*.

The rate for three months' money, for example, went up from around $4\frac{3}{16}\%$ to around $4\frac{9}{16}\%$. November and December are a flush period for receipts from ratepayers, but other factors caused the local authorities to bid strongly for deposits. For reasons given below, their receipts from mortgages diminished after November, and the rate for U.S. dollar deposits in London, which can serve to draw funds away from local authorities, was rising. Moreover, during the closing weeks of any year, companies with financial years ending on the 31st December tend to withdraw deposits from local authorities so as to show larger bank balances in their accounts. In the New Year the manoeuvre is reversed, and the deposits are returned. This reflux, and a fall in the rate for U.S. dollar deposits, brought the rate for three months' money back to $4\frac{1}{4}\%$ in the first half of January.

Rates for three months' deposits with hire purchase finance houses were little changed during November to January. The business of the houses, which had been expanding month by month from February to November 1963, contracted a little for seasonal reasons in December, and at the same time fewer deposits were withdrawn than is usual at the end of a year.

Gilt-edged market

The gilt-edged market had been generally steady between July and October, but in the last few days of that month, and again towards the middle of November, it weakened sharply, and by early December yields on medium and long-dated stocks had risen by between $\frac{3}{8}\%$ and $\frac{1}{2}\%$. The market feared that the Government's plans for large-scale public expenditure over the next four years, which were published in October and November, would lead to heavier government borrowing. Another cause of the weakness was the growing volume of fixed interest issues by local authorities and by industry. The financial institutions were finding a large part of their available funds committed in this way, particularly because a high proportion of the industrial issues took the form of placings, which are more likely to be made with these bodies than with the general public, and which often require larger initial payments than do offers for sale.

Official policy did not seek to oppose the rise in yields which was then developing, but there were some official purchases on a few occasions when the market was rather thin, for example, at the end of October, and again to a small extent towards the middle of November.

The market remained sensitive in December and January, but yields were little changed over these two months. There were, as is usual, many transactions on official account, aimed at smoothing market conditions. Some official sales were made, particularly early in January, mainly of 5% Exchequer Loan 1976/78 and 4% Exchequer Loan 1968. Later in January some support was given to the market which was finding some new fixed interest issues difficult to digest.

During the three months November to January, whenever opportunity offered, purchases were made of two stocks, $4\frac{1}{2}\%$ Conversion Stock 1964 and $2\frac{1}{2}\%$ Exchequer Stock 1963/64, which reach final maturity in May. This was done to reduce the eventual dislocation to the market which large redemption payments may cause. Purchases were smaller than in the three previous months, but they had then been heavy. Doubtless many of the remaining holders preferred the liquidity which these stocks offer to the higher yield obtainable on slightly longer-dated issues. There was also some buying of the May maturities other than by the authorities.

Other medium and long-term yields

Rates for local authority mortgages were scarcely affected by the rise in gilt-edged yields in November. The rate for five to fifteen-year mortgages, for example, remained at $5\frac{3}{4}\%$ throughout October to January. As a result receipts of mortgage monies fell away in December and January. The failure of these rates to respond quickly to a rise in gilt-edged yields (and similarly to a fall) is no new phenomenon. It seems that local authorities, rather than adjust their mortgage rates to what may be short-lived fluctuations in the gilt-edged market, prefer to rely on temporary money until a new level of long-term interest rates is more clearly established. Mortgage rates rose a little in February.

Debenture yields responded promptly to the rise in gilt-edged yields. The average yield on debenture stocks with about twenty years to maturity, which had been just below 6%

throughout September and October, reached 6¾% early in December, and was still near that mark at the end of January.

Equity market During November and December the F.T.-Actuaries index of industrial share prices rose by about 2%, bringing the rise during the year as a whole to about 20%. In the closing weeks of 1963 evidence that the economy was expanding and that profits had been rising continued to come forward, and the prospects for output during 1964 appeared to be good.

Early in January, however, sentiment changed abruptly, and there was a growing belief that the level of prices paid insufficient regard to the political and economic uncertainties of the future, and to the possibility that the pace of expansion might have to be modified later in the year. There was also a sharp rise after mid-December in new equity issues, which came forward in greater volume than for more than a year. During January the F.T.-Actuaries index of prices fell by over 6%, bringing it back to the level of the previous September. Prices recovered a little in the first half of February.

The banking situation Mid-November to mid-February covers several weeks of heavy Exchequer deficit followed by the first half of the Exchequer's main revenue quarter. During this time total advances of the London clearing banks rose by just over £200 million, about half of which was probably due to seasonal factors. The remaining increase, averaging some £35 million a month, was rather larger than during most of 1963. The greater part of it occurred during the last five weeks of the period, when companies may have needed to borrow more heavily from their bankers to finance a rise in stocks. The increase in borrowing during the three months would have been greater but for substantial capital issues, some of which were used to repay bank advances.

Net deposits with the clearing banks fell by some £50 million between mid-November and mid-February. Allowing for seasonal factors, this implies an underlying rise of about the same amount. This represents a slowing down in the growth of deposits. It seems that, if some allowance is made for seasonal variations, holders of government debt outside the banks, and particularly overseas official holders, acquired rather more of such debt after mid-November than in the preceding few months.

The combined liquidity ratio of the clearing banks was near to 30% at mid-February, thanks in part to quite substantial sales of investments during the preceding five weeks; this ratio takes no account of any remaining holdings by the banks of the May maturities. The ratio usually falls by about a point between mid-February and mid-March, and changes little in the month to mid-April. It seems that nearly all the banks should be able, without selling more investments, to keep their liquidity ratios above 28% which has been accepted as a suitable minimum figure for the present.

Advances by the Scottish banks fell slightly between mid-November and mid-January but, like the clearing banks', increased sharply in the five weeks to mid-February. Net deposits with the Scottish banks fell by £16 million during the three months, or by rather less than in the same period in most previous years.

Reserves In the three months November to January the reserves fell by £29 million. The fall was more than accounted for by special transactions, which cost on balance £50 million. At the end of December rather more than £36 million was paid in interest on the U.S. and Canadian loans, and rather more than £30 million as amortisation of principal; on the other hand £17 million was received from Western Germany as provision for future payments for military contracts. But for these transactions the reserves would have increased in each of the three months.

Short-term capital movements The reserves were probably not greatly affected in the three months as a whole by flows of short-term capital. Certainly interest rate considerations gave little inducement to move funds across the exchanges. If the exchange risk was left uncovered there was a small interest margin in favour of U.K., rather than U.S., Treasury Bills throughout the three months. However, with forward dollars at a small premium, the covered differential fluctuated very narrowly either side of interest parity until the end of December. The forward rate then moved slightly against sterling, and a covered margin in favour of New York persisted throughout January, but never exceeded $\frac{1}{4}$%. For most of the three months it was possible, after taking the cost of forward cover into account, to obtain a slightly higher return on dollar deposits in London than on funds placed with local authorities. Rates for dollar deposits rose sharply early in December and, although local authority rates rose also, this covered margin widened to $\frac{1}{4}$%. Over the turn of the year dollar deposit rates eased more rapidly, and for a short while, until the forward rate moved against sterling, deposits with local authorities were at a small premium.

Differences in interest rates are of course not the only influence upon movements of short-term capital. Security, for instance, must always be a prime consideration. Early in December a New York broking firm, Ira Haupt and Company, was forced into liquidation by the failure of Allied Crude Vegetable Oil and Refining Company, a large U.S. trader in edible oils. These insolvencies had been preceded in October by the failure of a German concern, Hugo Stinnes OHG. Both Hugo Stinnes OHG and Ira Haupt and Company defaulted on short-term dollar obligations to some European banks. These developments weakened confidence in the Euro-dollar market, and there are indications that some institutions preferred to hold sterling claims upon local authorities during November to January rather than certain types of dollar deposits, even though the pattern of interest rates rarely favoured such a course.

Conditions in continental centres also affect short-term capital flows. Commercial banks in Western Europe traditionally realise some of their holdings of foreign currencies during the closing weeks of the year, partly in order to show a greater holding of domestic currency in their end-year balance-sheets. In the fourth quarter as a whole, however, non-official sterling holdings of Western European countries increased. This suggests that sales of sterling for end-year purposes were small, although some withdrawals may not have been recorded. For the most part continental banks appear to have repatriated dollar assets, including some dollar deposits from London. This outflow was probably largely financed by a reduction in the London banks' own foreign currency claims.

The foreign exchange market

The market was generally calm during November to January. President Kennedy's tragic death on the 22nd November resulted in remarkably little disturbance. As European markets were then closed, the first impact was felt in New York, where the Federal Reserve Bank immediately appeared as a seller of all leading foreign currencies. This action was backed by the massive resources available under swap facilities with the monetary authorities of a number of leading industrial countries, and served to restrain speculation.

The Federal Reserve Bank drew the equivalent in sterling of \$10 million under the \$500 million swap facility arranged with the United Kingdom in May 1963,[a] and used most of it to give immediate support to the dollar. By the end of the month the Federal Reserve Bank was able to acquire sufficient sterling in the market to permit full repurchase early in December of the dollars sold to the Bank of England in November. Superficially these transactions appear to have made the United Kingdom's reserves \$10 million higher in November than they would otherwise have been, and \$10 million lower in December. But had the U.S. authorities not activated the swap, and used the proceeds to intervene in the market, the U.K. authorities would probably have intervened themselves. Such intervention would have had much the same effect upon the reserves as the action of the Federal Reserve Bank.

The rate for sterling against the U.S. dollar was generally steady at about \$2·79$\frac{13}{16}$ during most of November. Early in December it weakened to \$2·79$\frac{5}{8}$, but recovered to nearly \$2·79$\frac{15}{16}$ early in January, before reacting to \$2·79$\frac{13}{16}$. For most of the three months markets were well balanced and the authorities were from time to time able to take in small amounts of foreign exchange.

[a] June *Bulletin*, page 84.

The gold market The assassination of President Kennedy did not greatly disturb the gold market, but private demand was steady for most of the period and strong for the rest. The U.S.S.R. continued to make sales from time to time, and these were particularly heavy in November. In the three months November to January the buying syndicate[a] was again able to accumulate a surplus. The price remained close to $35·08 per fine ounce throughout this period.

Developments in other markets: security (or investment) dollars; foreign bond issues It is convenient here to mention two other features of recent months, not closely connected. First, there has been a sharp rise in the premium on the security dollar, otherwise known as the investment dollar. The market in investment dollars arises because residents of the United Kingdom who realise foreign currency securities abroad may not only use the proceeds to buy other foreign currency securities but may also sell the proceeds to other residents for the same purpose. Demand comes either from prospective purchasers of foreign currency securities or from companies planning to make a direct investment outside the sterling area of a kind which, since July 1961, has not qualified for exchange at the official rate (because it does not promise a clear and early benefit to the balance of payments) but which, since May 1962, has normally been allowed to be financed with investment dollars. During 1963 these dollars commanded a premium of from 6% to 12% on the official rate. In January 1964 demand for them strengthened, partly because the equity market was strong in the United States and weak in the United Kingdom, and partly because of a steady demand from companies planning direct investment. Just before the end of the month the premium reached a peak of a little over 14%.

The second feature has been a steady flow of U.S. dollar issues on the London and other European capital markets. Borrowers during December and the first few weeks of 1964 included the Belgian and Austrian Governments, a bank and a municipality in Norway, and companies in Denmark, Israel and Japan. The loans were largely placed by syndicates composed of U.K. and foreign banks. These decisions to raise funds in Europe, rather than in the United States, were no doubt influenced by the proposal of the U.S. administration, in July 1963, to tax acquisitions of certain foreign securities by U.S. residents from foreigners. The proposal is now before Congress, and meanwhile the New York foreign bond market has virtually been closed to new issues. It remains to be seen how much of the business will continue in Europe after the tax has become law.

The balance of payments The current account of the U.K. balance of payments normally improves between the third and fourth quarters, despite the interest payments on the U.S. and Canadian loans. Although it is clear, from the Trade Accounts, that the improvement in visible trade between the third and fourth quarters of 1963 was rather smaller than might have been expected on seasonal grounds, it may have been enough to bring the current account out of deficit. The long-term capital account in the fourth quarter was affected by two recurrent transactions: the repayments of loan capital to the U.S. and Canadian Governments cost just over £30 million in December; and in November the United Kingdom paid the fourth instalment, amounting to £9 million, of the five instalments making up its initial subscription to the International Development Association.

Imports, as measured by the Trade Accounts and seasonally adjusted, rose by $2\frac{1}{2}$% in the fourth quarter. This was a slower rate of growth than in the two preceding quarters. Imports of food were reduced, but there was a further strong rise in imports of industrial materials, which was probably associated with a revival of stockbuilding. Exports grew very little in the fourth quarter, but the trend may be better than recent figures suggest. Sales of sugar, oil and some basic materials were abnormally large earlier in the year, and returned nearer to normal in the fourth quarter. On the other hand, sales of machinery, which form a substantial part of total U.K. exports, began to expand again towards the end of the

[a] This term is explained in the article " The London Gold Market ".

year. There was also a marked steepening in sales of road vehicles.

Analysis of exports by market shows a mixed pattern in the fourth quarter. Shipments both to Western European and to overseas sterling area countries fell somewhat. Those to the United States, however, continued to increase and there was a further slight recovery in those to Canada. Exports to the rest of the world were also expanding.

In January exports of food, basic materials and fuel continued to decline; and exports of machinery and road vehicles contracted sharply. These falls were spread over all main markets, but concentrated in the European Economic Community. Imports of food and finished manufactures were appreciably higher than the monthly average in the fourth quarter; and imports of industrial materials continued to grow. As a result the trade gap widened considerably. Too much importance should not, of course, be attached to the figures for any single month, which can be affected by the vagaries of trade and statistical reporting.

For some years before 1963 the terms of trade moved in favour of the United Kingdom, but last year this movement was arrested. It is unlikely that it will be resumed in 1964. Moreover this year will almost certainly see a further rise in the volume of imports. Thus it is the more necessary to achieve a substantial increase in the volume of exports. The outlook is reasonably promising. The survey conducted by the National Institute for Economic and Social Research at the end of 1963 showed that engineering exports were likely to rise during 1964; new export orders had already increased sharply in the closing months of 1963. Conditions abroad remain generally favourable. In particular there seems to be scope for increased exports to some of the primary-producing countries. These countries have benefited from the rise in commodity prices, but it appears that much of the increase in their earnings has yet to be reflected in additional imports. And their purchasing power will be well maintained if, as seems likely, commodity prices remain firm.

General assessment

Total demand upon the domestic economy seems certain to expand further during 1964. The recent survey of the Federation of British Industries, the order books of manufacturers and builders, and the upward trend in vacancies for labour are only some of the indications pointing in the same direction. The growth of fixed investment is likely to be particularly marked. Public capital expenditure, which has risen in the current financial year (though less rapidly than had been expected), seems certain to rise no less fast throughout 1964. At the same time investment by private manufacturing industry, which probably ceased to decline before the end of 1963, seems likely to rise substantially this year.

To meet this growing demand it will be important to make the most efficient use of the resources available, and to watch costs. Failing this, there may be a weakening in the United Kingdom's competitive position, leading ultimately to serious disturbances in overseas payments. During a phase of business expansion accompanied by stockbuilding, some temporary enlargement of the deficit on overseas trade is only to be expected. It is important that such a deficit should neither be confused with, nor aggravated by, a weakened competitive position. Should further official action to discourage the growth of demand from outdistancing the growth of output become necessary, then any such moderating policy should aim to avoid abruptness and to cause as little disturbance as possible to two activities now essential to the economy—exports and the continuous modernisation of industrial capacity.

QUARTERLY ANALYSIS OF FINANCIAL STATISTICS

1st October to 31st December 1963

It may be helpful first to recall briefly the main changes in the financial position of the various sectors[a] in the earlier quarters of 1963. After allowing for seasonal influences, the financial surplus[b] of the private sector was probably rising for the greater part of this period. So probably was the financial deficit of the public sector, but to a rather greater extent, with the difference being matched by some reduction in the surplus of the United Kingdom as a whole with the overseas sector.

During the fourth quarter of 1963, with which this analysis deals, there was probably some further underlying increase in both the private sector's surplus and the public sector's deficit, but little change in the overseas sector's position.

Before proceeding with more detailed analysis of the individual sectors, the usual warnings should be given. The statistics, especially for the latest quarter, are incomplete, and some of the judgments rest on no more than broad estimates. Secondly, the banking figures for calendar quarters, introduced in the last *Bulletin,* are not available far enough back for seasonal adjustments to be made.

Overseas sector

For the convenience of this analysis, all overseas countries and international institutions are regarded as constituting a single " overseas sector ", whose financial surplus or deficit is the reciprocal of the United Kingdom's balance of payments on current account. In the first half of 1963, before seasonal adjustment, the sector was in substantial deficit, but this changed to a fairly small surplus during the third quarter. Present information suggests that the sector probably reverted to rough balance during the fourth quarter.

The overseas sector increased its claims on the public sector during the fourth quarter. Claims under the U.S. and Canadian post-war loan agreements decreased by £30 million, following the end-year repayments of principal by the United Kingdom, but overseas holdings of marketable government debt rose by about £100 million. This increase was more than accounted for by Treasury Bills, as the table on page 14 shows. Meanwhile identified overseas claims on both the private and banking sectors appear to have changed little.[c] Deposits with the banks fell by £14 million, and advances from them by £13 million. The small net movement contrasts strongly with those of the two previous quarters, during which net claims increased by a total of £173 million. The reason why there was little change in overseas claims on the banks, but a considerable increase in holdings of public sector debt, lies in the type of overseas holder whose assets were increasing. It was central monetary institutions (which largely hold Treasury Bills and gilt-edged stocks) which added to their claims in the fourth quarter, and not " other " overseas holders (who largely hold bank deposits).

(a) The four sectors examined here are:

(i) The private sector: persons, industrial and commercial companies, and financial institutions (other than banks).

(ii) The banking sector: domestic banks, overseas banks, accepting houses, and discount houses.

(iii) The public sector: the Central Government, local authorities and public corporations.

(iv) The overseas sector.

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

(c) Movements in the United Kingdom's reserves, and in external liabilities and claims in sterling, were favourable to the overseas sector in the fourth quarter by over £100 million. The United Kingdom's current account was probably roughly in balance, and long-term capital transactions are most unlikely to have caused an outflow from the United Kingdom of as much as £100 million, even allowing for the repayments of the U.S. and Canadian loans. This all suggests that unidentified overseas claims on the United Kingdom fell (or unidentified obligations increased).

Private sector The last *Bulletin* noted that in the third quarter the private sector's financial surplus tended to find its counterpart in increased claims on the banks rather than in increased holdings of public sector debt. This seems to have continued in the fourth quarter; whereas the private sector's total holdings of public debt probably rose by about £100 million (largely because of an increase in its holdings of local authority debt), its net claims on the banks went up between three and four times as much.

In contrast to the third quarter, it does not seem possible to explain any substantial part of this phenomenon by reference to the effect of the calendar on holdings of bank notes (which are regarded as public sector debt). The fourth quarter began on a Tuesday morning and ended on a Tuesday evening; the private sector's holdings of notes may fall during banking hours on Tuesday and its holdings of bank deposits may rise, but the changes are believed to be small. During the quarter private holdings of bank notes rose by £21 million. The trend of the note circulation is upward, along with the national income; it may also be that some of the extra notes drawn for Christmas spending had not been returned to the banks by the end of the year.

Net investment in National Savings amounted to £9 million, compared with £18 million in the previous quarter. The change was largely due to withdrawals from the savings banks before Christmas. Net investment in other forms of National Savings was much the same in total in both quarters. More Defence Bonds were bought in the fourth quarter, but more Savings Certificates were realised. Purchases of Tax Reserve Certificates were much the same in both quarters, but fewer certificates were surrendered in the fourth quarter because less tax is paid at that time; thus net holdings rose by £46 million, compared with £31 million in the third quarter.

Private holdings of marketable government debt fell by £95 million, after rising by about £25 million during the third quarter. This swing of £120 million is remarkably similar to that in corresponding quarters of the preceding two years; it may therefore be largely seasonal, but it is hard to be quite sure, because it is possible to find special circumstances affecting the gilt-edged market in each of the three fourth quarters. Slightly more than half the swing between the third and fourth quarters of 1963 occurred in Treasury Bill portfolios, which fell by £40 million after rising by £29 million. Holdings of government stocks fell by £55 million, compared with £2 million in the third quarter; this change, and a similar change in overseas holdings, was evident in the weakening of the gilt-edged market during November, noted in the Commentary.

Private claims on local authorities, as distinct from claims on the Central Government, no doubt increased substantially in the fourth quarter, even if less than in the third. Local authorities' borrowing from the private sector to finance their large capital programmes is continuous, but is reduced somewhat in the second and fourth quarters when they receive most of their income from rates.

The very large increase in the private sector's net claims on the banking sector has already been noted. Current and deposit accounts rose by about £530 million; and even if virtually all the small increase in transit items is attributed, as seems right, to the private sector, net deposits rose by little less than this amount. Only about one-quarter of this rise was offset by increased borrowing from the banks: advances rose by less than £100 million, and borrowing by means of commercial bills and call money by just over £50 million. The private sector's preference for bank deposits rather than government debt was probably partly seasonal; but some falling away in net acquisitions of government debt is not surprising at a time when prices were falling.

The analysis now turns to the component groups of the private sector: persons; industrial and commercial companies; and financial institutions. In some ways the most interesting and potentially useful information which might be discovered through this style of analysis relates to these component groups. Unfortunately this is the area where at present few statistics are available promptly and where many do not exist at all. Thus only hazardous estimates are possible here, whether the problem is approached on national income lines (saving, minus investment in physical assets) or through financial statistics (change in net financial claims on other sectors).

Persons[a] In the December issue of this *Bulletin* it was suggested that the financial surplus of persons had probably changed little between the second and third quarters of 1963. It is probable that at some stage of an upswing in economic activity the financial surplus of persons will tend to increase, as the incomes of persons rise more quickly than their outlays on consumption and fixed investment. At the same time, the financial surplus of companies may tend to decrease as they find that their revenue is rising more slowly than their expenditure on fixed investment and stockbuilding. It is possible that this began to happen, on a small scale, during the fourth quarter. Personal saving probably increased, because consumption probably rose more slowly than incomes. Personal investment no doubt increased also, because house building was increasing, but the rise in investment was probably less than the rise in saving.

The financial statistics give some support to this general proposition. Net claims of persons on the banks rose by some £200 million compared with under £100 million in the third quarter. It is unlikely that seasonal factors account for more than a part of this change. It is also probable that claims of persons on other financial institutions rose quite strongly during the quarter. Claims on building societies by way of shares and deposits increased more strongly than in the third quarter, or than in the fourth quarter of 1962. These claims are almost entirely personal. Lending to the Special Investment Departments of the Trustee Savings Banks was on the same substantial scale as in the third quarter, and persons continued to subscribe considerable amounts to unit trusts.

Industrial and commercial companies If, as has been suggested, persons were taking a greater share of the financial surplus of the whole private sector in the fourth quarter than in the third, then industrial and commercial companies were probably taking a smaller share. This again would fit in with the theoretical expectations sketched above, and also, to some extent, with known movements in companies' financial assets and liabilities. Although their current and deposit accounts rose by £252 million compared with only £153 million in the third quarter, their borrowing from banks by way of advances rose by £82 million, after falling by £65 million in the third quarter. Moreover, total borrowing from the banking sector by way of commercial bills rose by some £60 million compared with £10 million in the third quarter —and a large part of this borrowing is probably by companies. They also borrowed more heavily during the fourth quarter through capital issues.[b]

It is also possible that companies reduced their holdings of public sector debt somewhat. Total private sector holdings of Treasury Bills fell by £40 million, as has been noted; judging from previous experience it seems reasonable to suppose that most of the fall can be attributed to companies, rather than to financial institutions. Private sector holdings of government stocks fell by £55 million, and as financial institutions are almost always net buyers over a quarter as a whole, it would seem very likely that companies and persons were net sellers in the fourth quarter. On the other hand, the value of Tax Reserve Certificates outstanding rose by £46 million during the quarter. £12 million of this increase was in personal holdings, and most of the rest, probably, in holdings of companies, rather than financial institutions.

Financial institutions Under this heading are included insurance companies, hire purchase finance companies, building societies, the Special Investment Departments of Trustee Savings Banks, pension funds, investment trusts, unit trusts, and a few special finance agencies. Fourth quarter figures for several of these sub-groups are not yet available.

As a group, the institutions increased their net claims on the banking sector during the fourth quarter. Current and deposit accounts rose by £61 million, and advances by £15 million. It is not yet possible to make firm estimates of the group's position vis-à-vis the public sector but, judging from past performance,

[a] This term includes not only individuals, but also partnerships, unincorporated businesses, etc.
[b] 'Borrowing' is here used to cover equity as well as debenture issues.

it is likely that its total holdings of public sector debt rose by nearly £100 million. The group's holdings of company and overseas securities probably rose by about £200 million.

The demand for hire purchase facilities, after allowance for seasonal variations, continued to rise in the fourth quarter, and debt owed direct to finance houses increased by £3 million at a time when a sizable fall is to be expected on seasonal grounds. Deposits with finance houses were virtually unchanged, when some seasonal withdrawals might have been expected.

Building societies' gross receipts on shares and deposits considerably exceeded the third quarter total, which was itself a record. Their advances on mortgage were also higher in the fourth quarter than ever before. Liquidity ratios rose very slightly during the quarter, after falling in the previous three months.

Banking sector

The main changes in the banking sector's liabilities to, and claims on, other sectors during the quarter are summarised in the following table. Further detail is given in Table 9 of the Statistical Annex.

£ millions

	1963 III	1963 IV
Current and deposit accounts	+488	+494
Adjustment for transit items	−153	− 30
Net deposits	+335	+464
Claims on:		
Public sector:		
Notes and coin	+ 73	+136
Treasury Bills	+195	+171
Government stocks ...	+ 66	+ 44
Advances	+ 56	+ 3
Bank of England, Banking Department, net claims on Exchequer ...	− 49	− 15
Private and overseas sectors:		
Advances: to private sector ...	− 97	+ 93
to overseas sector ...	+ 63	− 13
Miscellaneous claims(1) ...	+ 7	+ 56

(1) Call money, commercial bills discounted and other securities.

The table includes transactions in foreign currencies as well as sterling.

The increase in net deposits was £129 million greater in the fourth quarter than in the third, but the increase in the banks' claims on the public sector was much the same in each quarter (£339 million, as against £341 million). The extra deposits thus largely reflect increased lending to the private sector; such lending had fallen during the third quarter.

As between the separate groups within the sector, much the greater part of the rise in deposits accrued to the domestic banks, whereas in the third quarter the increase had been shared roughly equally with the overseas banks. This was because deposits of overseas residents, which for the most part are held with overseas banks, did not rise so much in the fourth quarter. The domestic banks' advances to the private sector rose by about £50 million in the fourth quarter, probably largely for seasonal reasons; in the third quarter they had fallen sharply. This group was the only one to increase its holdings of government stocks significantly; but both the domestic banks and the discount market added substantially to their holdings of Treasury Bills, again largely for seasonal reasons.

Public sector

The Exchequer Group had a cash deficit of £413 million in the quarter, made up as follows:

	£ millions
Budget: above the line	−207
below the line	−226
overall	−433
Internal extra-budgetary funds ...	+ 22
Exchange Equalisation Account ...	+ 33
Other external items	− 35
Cash deficit	−413

The overall budget deficit was £88 million smaller than in the corresponding quarter of 1962. However, for a significant comparison, account must be taken of changes in extra-budgetary funds; these consist largely of departmental balances, and it is only when they are spent by the departments that budget monies pass out of the central government sector. In the last quarter of 1963 net receipts from extra-budgetary funds were £147 million lower than a year earlier. Taking the two items together the deficit was £59 million greater. This compares with increases of £6 million and £65 million respectively when the second and third quarters of 1963 are compared with the corresponding quarters of 1962. The growth of the deficit thus appears to have slowed down in the fourth quarter, if only temporarily.

External items cost the Exchequer £2 million, against £33 million a year earlier, so that the cash deficit, at £413 million, was only £28 million larger.

The contributions of the various sectors to the financing of the Exchequer deficit are shown in the following table:

£ millions

	Banking sector	Private sector[1]	Overseas sector	Total financing
Net Exchequer indebtedness to Bank of England, Banking Department	− 15			− 15
Bank of England notes	+136	+21		+157
Non-marketable debt:				
National Savings		+ 9		+ 9
Tax Reserve Certificates ...		+46		+ 46
Marketable debt:				
Stocks	+ 44	−55	− 21	− 32
Treasury Bills ...	+171	−40	+117	+248
	+336	−19	+ 96	+413

(1) Including any holdings of government debt by local authorities and public corporations.

In the third quarter the Exchequer had been financed mainly by sales of marketable debt to the banking sector. Such sales, it will be seen, were again the main source in the fourth quarter, but contributions also came from a seasonal rise in the banks' holdings of notes, and from a take-up of Treasury Bills by the overseas sector.

As may be seen from Table 1 of the Statistical Annex, the figure for net official stock purchases of £32 million comprises, on the one hand, net sales of £51 million of stocks in the 5-15 year range, and, on the other hand, net purchases of £62 million in the 0-5 year range and £21 million in the over 15 year range. In the third quarter there were net official sales totalling £100 million.

Little detailed information is available concerning the other components of the public sector. Borrowing by local authorities from the banks rose by £19 million. Bank advances are, however, not a main source of finance for local authorities, which, as mentioned above, at present borrow largely from the private sector. The net liabilities of the public corporations to the banks fell by £28 million, mainly because they reduced their bank advances. Borrowing by the corporations from the Exchequer is included in the Budget and therefore reflected in the Exchequer's own borrowing from other sectors.

Prospects The main changes in the financial positions of the sectors during the fourth quarter have now been sketched in such detail as is possible at this stage. It remains to touch on the implications of these changes, and of other known financial factors, for the future course of the economy.

In the months immediately ahead the main movements identified in the fourth quarter of 1963 seem likely to be maintained. The public sector's underlying financial deficit is probably still rising as its investment rises; the private sector's financial surplus is likely to be growing with, at this stage of the cycle, perhaps a rather larger share accruing to persons and a rather smaller to companies.

So far as the supply of bank credit is concerned, much depends on imponderables: for example, the scale of the Exchequer deficit and the extent to which it is financed by banks or by other holders of debt. On the demand side, company demand for bank advances to help finance stockbuilding and other investment may increase as the financial surplus of companies falls, or rises less quickly.

Similarly, company calls on the capital issue market are likely to rise further. The supply of funds in the capital market should continue to be plentiful if the financial surplus of persons does rise, though the funds may be largely channelled through financial institutions. The effect of these developments on the gilt-edged market will depend to some extent on the distribution of company issues between equities and fixed interest securities, which in turn will depend significantly on the buoyancy of the equity market.

It would be unrealistic to examine likely developments in the capital markets or in the domestic economy as a whole without considering the overseas sector's position. For example, the higher the import content of company stockbuilding, the more likely it is that any decline in the financial surplus of companies will be matched by a rising surplus of the overseas sector rather than of persons. How the overseas sector disposed of its surplus, whether by purchases of U.K. public debt or U.K. company securities, or by demands upon the gold and foreign currency reserves, would of course depend at least in part upon overseas confidence in the prospects for the U.K. economy.