COMMENTARY

Bank Rate was raised from 4% to 5% on the 27th February. The increase did not stem from any considerable change in the United Kingdom's domestic or external situation. Some rise was thought desirable to help moderate the growth of demand at home, which otherwise seemed likely to lead to increases in costs and prices that would jeopardise the long-term growth of the economy and cause difficulties in the external field. Furthermore, Bank Rate at 5% would provide more room for short-term money rates to rise, especially were comparable rates abroad to move higher. An increase of 1% was of conventional amount, and seemed the minimum change required to achieve the objectives in view and avoid the creation of further uncertainties.

The full consequences of a change in Bank Rate are always hard to assess, especially soon after the event; nor can they be isolated from the influence of other events, particularly when so close to the Budget. But it may be claimed that the move, by its early and moderate nature, encouraged rather than discouraged both business confidence and sentiment in the gilt-edged market; it allowed a greater freedom of manoeuvre to be restored in the money market, where the rates for Treasury Bills and prime bank bills had been for some time unusually and uncomfortably close to Bank Rate; and it also helped the foreign exchange market to recover from its temporary difficulties towards the end of February, without provoking an inflow of short-term funds from abroad.

The Budget, some six weeks later, was framed with the same objective of maintaining expansion without inflation. To this end the Chancellor proposed an increase of about £100 million in 1964/65 in the duties on tobacco and alcoholic drinks; and to encourage savings he increased the limits on holdings of the current issue of National Savings Certificates and Premium Savings Bonds, and introduced a new and more attractive National Development Bond to take the place of Defence Bonds. The Chancellor emphasised that the size of the increase in taxation needed to steady the economy without giving a definite check to expansion must be a matter of judgment, not of exact calculation; and that should circumstances alter—for example, should the rate of savings decline, or should government expenditure or incomes rise too fast—further remedies might be required.

Domestic economy

Industrial output continued to expand strongly in the first quarter; the average for January to March, after seasonal adjustment, is put provisionally some 2% higher than in the previous quarter. This was rather less than the increase of 3% which occurred between the third and fourth quarters of 1963, but some moderation of pace was not surprising at this stage after last year's very rapid expansion. There is growing evidence of overload in the building industry. In other industries, too, some firms must be raising output more slowly as they approach the limits of their present capacity. But activity generally continues to increase, and manufacturing industry should be capable, with improved organisation or additions to equipment, of sustained growth.

All the main sources of demand continue strong. Personal spending is still high, supported by the increase in employment and incomes. Sales in the shops in the first four months of the year, allowing for seasonal factors, were running a little above the high figures of the fourth quarter of 1963. In addition, demand for cars remains particularly heavy, and in April and May the numbers of new hire purchase contracts for cars were at a record level. Hire purchase debt outstanding on goods of all kinds increased by some £50 million in the first four months of the year to total just over £1,000 million.

Total expenditure on fixed investment began to rise in the spring of 1963, largely as a result of increased public spending especially on electricity, roads and houses. Private house building began to rise about the same time, but it was not until the fourth quarter that investment by manufacturers and other private industry turned convincingly upwards. Previously, since the autumn of 1961, the total of investment by manufacturers had been declining, while that by other industry had been running no more than level. Investment in manufacturing industry in the fourth quarter, seasonally adjusted, was 2% higher than in the third; and there was a further rise of 5% in the first quarter of 1964. What is known of public and private investment intentions suggests that total expenditure must be expected to continue to increase. A further pointer for the future is that the area of new industrial building approved by the Board of Trade in the first three months of this year was about 25% bigger than in October to December 1963. More than one-quarter of the total was for the North-East and Scotland, suggesting that the Government's measures to encourage industrial development in these areas are having some success.

Total stocks and work in progress rose sharply in the fourth quarter of last year after a fairly modest increase during January to June and a fall in the third quarter. Nevertheless this rise may have been no more than sufficient to keep pace with the growth of output. In the first quarter of this year, there was a further large increase in manufacturers' stocks, but wholesalers' and retailers' stocks were little changed. Stockbuilding as a whole was probably rather smaller than in the last quarter of 1963.

Overseas trade is discussed in some detail later. It may be noted here that the trend of imports in recent months gives some grounds for supposing that purchases of industrial materials from abroad may be levelling out. Total exports rose in the first quarter, despite the fall recorded in January, and, although there was also a fall in April, prospects are promising.

The number unemployed fell by 132,000 between January and May, appreciably more than would be expected on seasonal grounds alone. The total of 369,000 at the middle of May represented 1·6% of all employees, the lowest national percentage since the autumn of 1961; and in the Midlands, and in London and the South-East, the figure was down to 1% or just under. From these areas, and elsewhere, reports continue to be received of growing shortages of labour, especially skilled workers.

Import prices, which had been falling for several years, began to rise towards the end of 1962, and by March of this year were about 8% above their low point in 1962. Food prices moved most sharply, but industrial materials have also risen, especially since last autumn. Home prices of manufactured output rose by just over $1\frac{1}{2}$% between October and April, or rather more than in the previous six months. The growth of personal incomes, though still somewhat in excess of the sustainable rate of increase in productivity, does not seem to have accelerated this year.

Bill rates

Until the 28th February the discount market's tender rate for Treasury Bills remained at, or near, $3\frac{3}{4}$%, as it had since March 1963 when the Bank charged the market $4\frac{1}{2}$%, or $\frac{1}{2}$% above Bank Rate, for advances. The margin of about $\frac{1}{4}$% between the Treasury Bill rate and Bank Rate was unusually small; but the market was aware of the continuing firmness of the U.S. Treasury Bill rate, which made it undesirable for the U.K. rate to fall. Altogether the discount houses had little room for manoeuvre. For example, in February, when they were having some difficulty in selling prime bank bills, they could not easily have widened the unattractively small margin between such bills and Treasury Bills. For the reason given they did not seek to lower the Treasury Bill rate. Yet they were reluctant to raise the rate on prime bank bills which was, in its turn, close up against Bank Rate.

The change in Bank Rate made it possible to ease this congestion. The authorities had no wish, however, to attract short-term funds from abroad, and this fact was recognised in the market. Accordingly, as against the rise in Bank Rate of 1%, the market raised its bid at the next tender by only about $\frac{1}{2}$%, to $4\frac{5}{16}$%, and for the time being the clearing banks' top rate for overnight money rose by a similar amount to $4\frac{1}{4}$%. The average cost of the market's borrowing probably rose a little more than that, but this still left it with a reasonable earnings margin. The market maintained the same tender rate until the middle of May, obtaining satisfactory allotments at this price, and the discount houses were thus able to sell without undue loss Bills taken up before Bank Rate changed. The authorities were content that the rate should be stable because, as noted later, an acceptable pattern of international rates had also been established. Throughout the period from the 15th January to the end of May there was no market borrowing at the Bank, an unusually long clear spell.

The difficulties in the market for prime bank bills in February had arisen only partly because rates were relatively unattractive; the banks and others had also been unwilling to hold such bills because they were expecting Bank Rate to go up. After the increase in Bank Rate, the market raised its buying and selling rates for prime bank bills by $\frac{9}{16}$% to $4\frac{1}{2}$% and $4\frac{3}{8}$%. At these rates, and with the uncertainty removed, buyers reappeared.

Other short-term rates

Most rates for local authority temporary money rose by about $\frac{3}{4}$% after the increase in Bank Rate. Three months' money, for example, went up that amount to $5\frac{1}{8}$%. It remained around this level throughout March, when local authorities' borrowing requirements tend to be high because rate income is low, large repayments have to be made to the Public Works Loan Board, and some companies withdraw money at the end of the month for balance-sheet purposes; but during April the rate eased to about 5%. The larger hire purchase finance houses on average raised their rates for three months' deposits by $\frac{7}{8}$% after the change in Bank Rate, and the total of deposits with members of the Finance Houses Association, which had already reached a record level in February, rose by a further 10% in March and April to nearly £400 million. The demand for new credit, mainly to buy cars, continued very strong. Hire purchase charges were generally raised by $\frac{1}{2}$% on the total amount initially borrowed, or effectively by about 1%.

Gilt-edged market

Until the change in Bank Rate, the gilt-edged market remained generally weak, as it had been since the previous October. By the end of February yields on the longest-dated stocks, for example, had risen to around 6%, a comparatively high rate. Immediately after the change in Bank Rate there was a further small rise in yields, but the change in fact made for greater confidence and yields soon turned down. Demand was mainly concentrated on long-dated stocks and, in a fairly thin market, yields on these fell during March and early April by up to $\frac{1}{4}$%. There were lesser falls in the yields on medium and short-dated stocks.

After the Budget the mood changed again, as it was realised that the Exchequer, despite the proposed increase in taxation, would need appreciably more finance in 1964/65 than in the previous year. By the latter half of April yields had broadly returned to where they stood before the change in Bank Rate, but thereafter the market steadied.

Official portfolios of medium and long-dated stocks were replenished by issues of £400 million $5\frac{1}{4}$% Funding Loan 1978/80 on the 19th February and £400 million $5\frac{3}{4}$% Funding Loan 1987/91 on the 4th May. Otherwise, official operations during February to April were largely concentrated on smoothing undue short-term fluctuations. Although no attempt was made to prevent prices falling in April when the market was weak, the authorities were content in May to see the market a little firmer. Official purchases were made at the end of February when some banks were selling stock for liquidity reasons. The discount houses were also selling at this time, but they rebuilt their portfolios after the change in Bank Rate. During the period as a whole substantial official purchases were made of the two stocks, $4\frac{1}{2}$% Conversion Stock 1964 and $2\frac{1}{2}$% Exchequer Stock 1963/64, which were to reach final maturity in May; and opportunities were taken from time to time to sell fair amounts of other short-dated stocks and of the new $5\frac{1}{4}$% Funding Loan.

Local authority capital borrowing

Demand for local authority mortgages had been small since the autumn, for their rates had not followed the rise in gilt-edged yields; they remained at about $5\frac{3}{4}$% for all terms until February, when they were marked up a little. The change in Bank Rate was seen as confirming the need to move towards higher yields and the local authorities then adjusted their rates, which stayed at 6% to $6\frac{1}{4}$% for all terms during March but were reduced during April to $5\frac{3}{4}$% to 6% for 1–5 years and 6% to $6\frac{1}{8}$% for longer periods. Business in both months continued fairly light.

The fall in rates during April, which contrasted with the rise in gilt-edged yields, was due partly to the local authorities' easier financial position and partly to the introduction on the 1st of the month of the new borrowing arrangements foreshadowed in a White Paper last October (Cmnd. 2162). These provide that local authorities shall eventually be allowed to obtain up to 50% of their annual long-term loan finance from the Public Works Loan Board at government lending rates, that is, the rates at which the Government itself borrows—subject to a small addition to cover the Exchequer's costs. To introduce the scheme gradually, in this first year of its operation, each local authority will be allowed to obtain in this way 20% of its long-term borrowing needs (or £50,000, whichever is the greater). The rates charged by the Board during April for borrowing within this quota ranged from $5\frac{1}{8}\%$ to $5\frac{7}{8}\%$, as against the market rates of $5\frac{3}{4}\%$ to $6\frac{1}{8}\%$ mentioned above.

Another recent development has been the issue by Manchester Corporation of one-year bonds to the discount houses. Four such issues totalling £3 million have been placed : the first in February at $4\frac{1}{2}\%$, and the others, since the change in Bank Rate, at 5% or a little above. A number of other local authorities are examining the possibility of issuing similar short-term bonds, but it is too early to say how wide a market will develop. At present very few local authorities have powers to borrow in this way, but general powers will be conferred by regulations due to be issued under the Local Government (Financial Provisions) Act, 1963.

Debenture and equity markets Debenture yields moved broadly in sympathy with the gilt-edged market during the months under review. The average yield on debenture stocks with about 20 years to maturity, which had been rising since the autumn, reached $6\frac{3}{8}\%$ by the end of February. It remained fairly steady in March, but rose further after the Budget, to reach $6\frac{1}{2}\%$ by the end of April. The flow of new issues, at these relatively high interest rates, remained heavy.

Equity prices, which had suffered a sharp set-back in January, steadied in February and then turned up again. There were a number of reasons for the recovery. The Bank Rate move helped to steady the market. Then the announcement early in April that the General Election would not be held until the autumn removed uncertainty on this score; and the Budget, shortly after, further stimulated the market as the proposed increases in taxation proved smaller than some had expected. A steady flow of good company results also encouraged buyers. Altogether, during February to April, the F.T.-Actuaries index of industrial share prices rose by more than 6%. Towards the end of April it was again approaching the peak reached at the beginning of the year, but it then turned down.

The comparative weakness of fixed interest markets in the early part of this year helped to bring equities back into greater favour in the new issue market. Companies raised £80 million in this way in the first quarter out of total new issues of just over £180 million. The total of new issues was the biggest since the third quarter of 1961 and included the very large figure of £80 million for manufacturing industry—foreshadowing perhaps the higher level of fixed investment expected later this year. The larger flow of new issues continued in April, and so did the greater use of equity issues.

The London clearing banks The unusually large increase of £162 million in the clearing banks' total advances in February—some £65 million more than might have been expected on seasonal grounds—probably arose because the banks' customers were relying more heavily than usual upon advances to help meet tax payments. It was not repeated in the following months. In the three months March to May the total increased by a further £73 million; there was a fall of £30 million in advances to the nationalised industries and an increase of £103 million in those to other borrowers. This was some £75 million more than seasonally expected—a rather slower rate of growth than had obtained during 1963, although by May the trend of advances seemed again to be rising more sharply.

Much of the recent demand for advances may be coming from smaller borrowers; for industry generally does not yet seem to be looking particularly to the banks to finance expansion. Though manufacturers are no doubt spending more on stocks and fixed investment, they are borrowing heavily, as has been seen, from the capital markets and their earnings are still high. It may be, too, that the increase in Bank Rate discouraged speculative stockbuilding, and so lessened industry's demands on the banks.

Net deposits rose by £94 million during March and April, when the expected seasonal movement is slightly downwards, and by £20 million in May, when the seasonal change is small. The large rise in March and April was associated with financing of the Exchequer. In March, towards the end of the financial year, there was an acceleration in government spending. In April, although government spending slowed again, the Exchequer's total outgoings—including those needed to finance a rise in the reserves—were still large : but the banks' customers took up only a small part of the consequent increase in marketable government debt, and deposits rose further.

After quite substantial sales of investments by the banks during February, only two banks sold stock to any extent during March and none in April; and during May the banks made small net purchases. The combined liquidity ratio in May was 29·7%, the same as the low point reached in March, but the May ratio was unduly depressed. This was because the make-up date came immediately after Whitsun and cheques in course of collection (and therefore gross deposits, on which the ratio is calculated) were unusually high. The minimum liquidity ratio of 28% which was accepted last autumn remains for the time being the figure which the clearing banks are asked to observe.

With economic expansion continuing, the demand for advances must be expected to increase; yet many of the clearing banks now have advances ratios over 50% and low investment ratios. Their position will be eased should deposits rise in the coming months as a result of the increased government expenditure proposed this year.

Foreign exchange market and reserves In the third week of February a number of events combined to bring pressure against sterling for a short time. Confidence was impaired by the announcement of the surprisingly bad trade figures for January, and also by unofficial forecasts that balance of payments difficulties might develop later in the year if the growth of demand were not moderated. About this time, too, there were persistent rumours that the deutschemark would be revalued, and the movement of international funds to Western Germany was a further adverse factor for sterling.

The rate for sterling against the U.S. dollar, which earlier in February had fluctuated around $\$2{\cdot}79\frac{13}{16}$, fell during the third week to $\$2{\cdot}79\frac{7}{16}$; the fall was moderated by official intervention. Selling of sterling was not substantial; and there were already signs before Bank Rate was raised on the 27th February that pressure against the pound was lessening. Immediately after the change in Bank Rate there was a sharp rise in the rate to $\$2{\cdot}79\frac{13}{16}$ and the authorities recovered a considerable part of the exchange previously sold in support. Most of these transactions were for settlement in March and the reserves in February showed a fall of £17 million.

Sterling was firm in March and April with turnover at times substantial; and the reserves rose by £31 million. This movement included two special transactions which largely cancelled out. In March £9 million was paid to the United States in final settlement of the U.K. share of debt incurred for logistic support to Commonwealth troops during the Korean war; and about the same amount was received as a result of special transfers by Western Germany to provide for payments under military contracts. The reserves rose by a further £17 million in May.

The reserves were again helped in the early part of this year by the generally favourable payments position of countries in the overseas sterling area. In the first quarter these countries increased their sterling holdings, net of U.K. claims, by £53 million.

Short-term capital movements Over the three months February to April there was probably, on balance, no substantial movement of short-term funds across the exchanges. As noted earlier, the outflow in February was neither protracted nor severe. To the extent that speculative positions were adopted at that time, some benefit to sterling could be expected later when they were reversed; much of this benefit may already have been felt in the following two months.

The increase in Bank Rate did not provoke an inflow of volatile funds. Nor did the authorities intend that it should. International money and forward exchange rates quickly settled into a pattern which was unlikely to cause large movements of short-term capital. The yield on U.K. Treasury Bills rose by only $\frac{1}{2}$% after Bank Rate was raised; and the cost of forward cover against the U.S. dollar rose by a little over $\frac{1}{4}$%. As a result, the small covered premium (seldom more than $\frac{1}{4}$%) commanded by U.S. Treasury Bills during most of February was eliminated. This broadly balanced relationship persisted throughout March and April.

Until the end of February, if the cost of forward cover was taken into account, dollar deposits in London generally offered a slightly higher return than three months' money with local authorities or finance houses. After the change in Bank Rate local authorities raised their rates by about $\frac{3}{4}$% and finance houses by $\frac{7}{8}$%. In consequence small covered margins emerged in favour of deposits with local authorities and finance houses. Early in April the local authorities reduced their rates and the covered margin in their favour disappeared; that in favour of the finance houses was little changed throughout March and April. All in all, interest rates, allowing for the cost of forward cover, offered little inducement during these months to switch currency funds into sterling.

Continental foreign exchange markets Conditions in continental exchange markets were unsettled from time to time in the early months of this year. Switzerland and Western Germany continued to attract a substantial volume of foreign capital. At the end of January the Swiss authorities proposed measures to arrest the inflow. These had some success in reducing the demand for Swiss francs but, in conjunction with rumours that the deutschemark would be revalued, intensified the movement of funds to Western Germany. In March, therefore, the West German authorities also took steps to discourage the capital inflow and, in addition, to promote capital exports.

These large capital movements, though owing something in the case of Western Germany to high interest rates and the strength of the economy, were from the autumn of 1963 more broadly associated with a weakening of confidence in the lira. This in turn stemmed from a sharp deterioration in Italy's trading position, allied to political uncertainties. Pressure on the lira increased early this year; and in March credits equivalent in total to $1,000 million were made available to Italy by the United States, Western Germany and the United Kingdom. In addition, Italy drew the equivalent of $225 million from the International Monetary Fund.

Gold market Misgivings about the lira, and increased buying from the Middle East arising from the trouble in Cyprus, provoked a brief flurry in the gold market early in March; but for the most part private demand was moderate during February to April and was more than matched by supplies from new production. In mid-March and again during April the U.S.S.R. made substantial sales, most of which ultimately accrued to the official buying syndicate. The daily fixing price ranged from the equivalent of rather more than $35·09 per fine ounce early in March to rather less than $35·06 just after the middle of that month.

Overseas trade The visible trade deficit, seasonally adjusted and on a balance of payments basis, increased from £33 million in the fourth quarter of 1963 to £105 million in the first quarter of 1964. Much of the deterioration was due to the surprisingly low export figures for January. Exports—as recorded in the Trade and Navigation Accounts and seasonally adjusted—were rather less than 2% higher in the first quarter than in the fourth. Imports on the other hand were 7% higher.

The increase in imports was spread over all the main categories. There was a notable rise in imports of finished manufactures, especially capital goods, such as machinery and ships. In the first quarter, taken as a whole, imports of industrial materials were considerably higher than in the preceding quarter, but this was entirely due to a sharp rise around the end of the year. After that, there was little further increase, a change possibly associated with a lower rate of stockbuilding in the first quarter.

The sharp fall in exports recorded in January contrasted strongly with their strength in December, February and March. It affected all the main classes of goods and was most noticeable in markets outside the sterling area. It is difficult to account for so abrupt a movement, which may cast some doubt on the analysis of trade patterns in the first quarter. As recorded, exports to Western Europe expanded again after falling slightly in the fourth quarter, those to the United States and Canada contracted, and those to the overseas sterling area started to grow again. This last rise owed much to an upturn in shipments to Australia, which for most of 1963 had been declining. Analysis by commodity shows that exports of machinery, road vehicles and chemicals were doing well in the first quarter, apart from falls in January.

Total exports were lower again in April, but changes from month to month are often erratic, and the fall does not warrant any supposition that the underlying strength of exports has significantly weakened. Export orders outstanding, notably for engineering products, have been well sustained.

Conditions abroad

Certainly economic prospects overseas hold out promise of a large rise in U.K. exports again this year. Economic expansion in the United States has entered its fourth year, and shows no sign of ending. The growth of demand so far has done little more than absorb the natural increase in the labour force, and unemployment remains relatively high; a margin of spare capacity still exists in many industries; and prices have been remarkably stable. Substantial tax cuts, which became effective in March, should have a powerful expansionary impact during the year: consumers' expenditure may be expected to rise vigorously following the increase in disposable incomes. Profits have been buoyant and surveys of business intentions indicate that industrial fixed investment may expand by 10% or more in 1964; public expenditure, too, should continue to rise, though more moderately towards the end of the year as proposed economies in federal spending take effect. Further, though smaller, tax reductions will come into force in 1965.

In the European Economic Community, the rate of expansion was quickening towards the end of 1963 and in the early months of this year. The main impetus came from Western Germany, where there was a persistently strong export demand and some revival of industrial fixed investment. Activity was also rising faster in the Netherlands following substantial wage increases early this year. On the other hand the growth of personal consumption in France and Italy appears to have been less rapid. The underlying shortage of labour continued throughout the Community and prices remained under pressure. In April the E.E.C. Council of Ministers recommended to members a range of measures designed to help stabilise costs and prices.

Expansion is likely to accelerate in Western Germany during 1964, but may slow down elsewhere as restrictive measures bear more heavily on the growth of demand. This conflict of trends makes it difficult to assess how total demand in the Community may develop. But it seems very possible that activity will rise no less fast than in 1963, though there may be some shift of emphasis from consumption to investment. The chief uncertainty relates to Italy, where it is still difficult to foresee how the economy may fare during the rest of the year.

The export earnings of the primary-producing countries in general rose strongly in 1963 both because they sold more and because commodity prices rose. As a result of this, and thanks to increased receipts of aid, their aggregate reserves rose substantially from a depressed level. The sustained expansion in prospect for the main industrial countries this year suggests that demand for primary products will remain strong; and prices, though unlikely to be as buoyant as in 1963, should be rather higher on average. After a long period of stagnation, imports of manufactures into the primary-producing countries turned up during 1963, but lagged behind the growth of export earnings. Such imports may in general be expected to increase in line with export earnings throughout 1964, and perhaps faster if reserves accumulated during 1963 are drawn down.

Exports of manufactures from the main industrial countries rose by over 8% in 1963 and are likely to expand even more rapidly this year: any slackening in their rate of growth to the European Economic Community should be at least offset by increased demand from the United States and primary-producing countries. The existence of buoyant markets is of course no more than a pre-condition for sustained growth in U.K. exports; and while it seems likely that the United Kingdom at least maintained its competitive position in relation to most other industrial countries in 1963, the economy is now working much closer to capacity. If, in these circumstances, costs and prices can nevertheless be prevented from rising unduly, the opportunities for selling more exports should be considerable. As the pressure of demand increases further, it will become more difficult, though no less important, to keep the growth of incomes within bounds and to ensure that the home market does not absorb too large a share of the available resources.

QUARTERLY ANALYSIS OF FINANCIAL STATISTICS

1st January to 31st March 1964

Though it concentrates on the most recent period, this analysis attempts each quarter to sketch the trends developing over a longer period in the financial position of the various sectors.[a] The following account of the situation in the first quarter of this year is thus written with last year's trends very much in mind. Detailed discussion of these can be found in the article " Sector Financing 1961-63 " on page 109 of this *Bulletin*. The features of greatest interest in 1963 are firstly the substantial increases compared with 1962 in the public sector's financial deficit and the private sector's surplus[b]—the latter increase having been about equally divided between companies and persons; and secondly the relatively small increase in the financial deficit of the overseas sector.[c]

Within these annual changes, and after allowing so far as possible for seasonal factors, it would seem that the public sector's deficit increased only slowly during the first half of 1963 and gathered pace later in the year. Much the same appears to have been true of the private sector's surplus. The deficit of the overseas sector was falling from the second quarter onwards, but here the rate of change slowed down in the second half of the year.

The task of carrying the story forward to the early months of this year is complicated by the big swing in the Exchequer's financial position which always occurs during the main revenue quarter, and which makes it particularly difficult to estimate the underlying trends. However, it seems probable that there was some further increase in the public sector's deficit during the quarter (or, in other words, the surplus before seasonal adjustment was smaller than might have been expected). The improvement in the position of the overseas sector seems to have regained momentum, the sector having probably moved from a position of small deficit in the second half of 1963 to a fair-sized surplus in the first quarter. It is likely that the increase in the public sector's deficit was greater than the improvement in the overseas sector's position, and consequently that the private sector's underlying surplus also increased somewhat.

Overseas sector The unadjusted figures for the overseas sector show a change very like that of the seasonally-adjusted movement just noted, from rough balance to a fair-sized surplus—though this statement is subject to the possible qualification stated below.

In spite of its financial surplus, the overseas sector's net claims on the public sector fell during the quarter: it borrowed from the

[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; and

(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] The counterpart of the U.K. balance of payments on current account: when the United Kingdom has a current account surplus, the overseas sector has a corresponding deficit.

British Government (notably by drawings on E.C.G.D. loans), while its holdings of marketable government debt were unchanged (a rise in overseas holdings of stocks being offset by a fall in Treasury Bill portfolios, as shown in the table on page 98). This would appear to imply that overseas claims on the banking and the private sectors taken together must have risen very considerably.[a] Identified overseas claims on the banks indeed rose substantially, a rise in overseas deposits of £110 million being only partly offset by increased bank lending abroad. However, such figures as are available suggest that this may have been to a considerable extent counterbalanced by a rise in overseas liabilities to the private sector, caused by an increased net outflow of private capital.

Thus there would appear to have been little net change in the overseas sector's identified financial assets. This suggests that the sector's unidentified net claims on the U.K. sectors have risen very substantially, or that its financial surplus has been over-estimated, or, most likely, some mixture of the two. An unidentified inflow of funds from overseas is thought to have occurred in some earlier first quarters, when funds withdrawn by overseas holders before the 31st December for balance-sheet purposes were returned. It is also possible that the calculated financial surplus for the sector overstates the true position, because the recorded fall in U.K. exports in January may not have been fully reflected in export proceeds.

Private sector

In recent issues of this *Bulletin* it has been noted that during the second half of 1963 the private sector's financial surplus tended to be held in the form of increased claims on the banks rather than increased holdings of public sector debt. As the quarter under review is the Exchequer's main revenue quarter, seasonal influences dominate the picture to an extent which makes it very difficult to say whether this trend has continued; and because the existing series of banking sector figures dates only from March 1963 no estimate of the size of seasonal swings can yet be made. In the first quarters of both 1963 and 1964, however, the private sector's net claims on the banks fell very heavily and its claims on the public sector appear to have risen by nearly twice as much as they did in the intervening quarters. Indeed experience over several years shows that private take-up of public debt tends to be high in the first quarter.

The estimated increase (about £200 million) in the private sector's claims on the public sector in the first quarter is only in small part due to claims on the Central Government; as the table on page 98 shows, such claims increased during the quarter by only £28 million. It is unlikely that there was much change in the claims on the public corporations; but there was probably a substantial rise in lending to local authorities, which tend to borrow heavily in the first and third quarters when receipts from rates are low.

Although the total increase in claims on the Central Government was small, in all but one of its main categories private sector lending to the Exchequer rose significantly during the quarter. The exception was Tax Reserve Certificates, net holdings of which fell heavily (by £172 million) as normally happens during the Exchequer's main revenue quarter. New issues of certificates continued to run at the low level of the last two years, and total issues in the financial year 1963/64 were the lowest for many years. The rate of interest on Tax Reserve Certificates was raised at the end of the quarter from $2\frac{1}{4}\%$ to $2\frac{3}{4}\%$, following the change in Bank Rate.

During the quarter, private holdings of Bank of England notes (which are here regarded as public sector debt) rose by £56 million, compared with a rise of £21 million during the previous quarter. On this occasion the comparison is not greatly complicated by the daily movement of notes, as both the quarters began and ended in mid-week; but the incidence of Christmas and Easter, and the issue of new £10 notes in February (which may have led to an increase in the total circulation), introduce some complications. It seems likely, however, that even when some allowance is made for these factors, there was a small underlying increase in the note circulation during the early months of 1964.

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[a] The banking sector figures for the first quarter have been affected by the introduction of ten new contributors. Some of the figures for the private sector, and for companies, used in this analysis differ from those given in Table 9 of the Statistical Annex; see footnote [1] to the table on page 97.

In the National Savings field there was no apparent change of trend. The savings banks had high net receipts during their seasonally best quarter. Receipts from Premium Savings Bonds were much the same as usual. Purchases of National Savings Certificates and Defence Bonds were again modest: total holdings fell by some £5 million, compared with a rise of £29 million in the corresponding quarter of 1963.

Private holdings of marketable government debt rose by £59 million, after falling by £95 million during the previous quarter. The rise was about equally shared between stocks and Treasury Bills.

The heavy fall in the private sector's net claims on the banks has already been noted. Current and deposit accounts fell by £243 million; but there was a large increase in transit items, the bulk of which should probably be attributed to the private sector, and net deposits will have fallen by over £100 million more than current and deposit accounts alone. Meanwhile bank advances to the private sector rose by £341 million. The short run of the new banking sector figures must limit the comment that can be made, but it is worth noticing that while the fall in private sector deposits during the quarter seems to have been roughly comparable with that in the first quarter of 1963, the rise in bank advances may have been over £50 million less.

The analysis now turns to the component groups of the private sector : persons, industrial and commercial companies, and financial institutions.

Persons[a]

In the March issue of this *Bulletin* it was suggested that at some stage of a cyclical upswing the financial surplus of persons was likely to rise relatively to that of companies, and the view was advanced that this might have begun to occur during the fourth quarter of 1963. An attempted sub-division of the private sector surplus so soon after the end of the period is always hazardous, and this is particularly true of first quarters with their very large seasonal movements. It must be admitted, however, that there is little evidence that persons continued to increase their share of the private sector surplus during the quarter under review. It may be that they did so, but that this is concealed by seasonal influences and inadequacies of the data; it may be that the process will not begin until later in the cycle; it may be that the expectation of it was misplaced. Judgment between these possibilities cannot be attempted until at least one more quarter's figures become available.

Net claims by persons on the banks probably fell by nearly £180 million during the quarter, little less than the previous quarter's rise. Current and deposit accounts of persons fell by £73 million. However, if the rise in transit items is divided between persons and companies roughly in proportion to the change in their current and deposit accounts, then net deposits of persons fell by about £100 million. Meanwhile bank borrowing by persons rose by £78 million.

Persons' claims on the public sector, by contrast, probably rose during the quarter. The increases in note holdings and National Savings, which are probably largely due to persons, have already been mentioned; these will have been only partly offset by the decline in persons' holdings of Tax Reserve Certificates. No precise information is yet available concerning personal lending to local authorities.

Industrial and commercial companies

For the reasons outlined above, it is difficult to estimate the underlying position of industrial and commercial companies in the quarter. They were probably in substantial deficit for seasonal reasons; but the underlying rise in their earnings probably exceeded the increase in expenditure on fixed investment and stocks. If this view is correct, companies' underlying surplus would have risen.

Net claims by industrial and commercial companies on the banks, like those of persons, decreased substantially. On the same basis as that used for persons, their net deposits probably fell by about £200 million, while their advances rose by £260 million.

Companies' claims on the public sector probably also fell during the quarter; the absence at present of information about changes in local authority debt holdings and about transactions of some of the groups of financial institutions makes it impossible to be certain. It is true that private sector holdings of Treasury Bills rose by £32 million, and that a large part of this

[a] This term includes not only individuals but also partnerships, unincorporated businesses, etc.

increase may have been due to companies. Holdings of Tax Reserve Certificates other than by persons, however, fell by £145 million, and these are largely holdings of companies.

Company calls on the capital market rose substantially compared with the previous quarter. As mentioned earlier in the Commentary, the quarterly total was the highest since the third quarter of 1961, and the proportion of equity issues to the total also increased.

Financial institutions The main groups included here are insurance companies, pension funds, hire purchase finance companies, building societies, the Special Investment Departments of Trustee Savings Banks, and investment and unit trusts. First quarter figures are not yet available for all these groups.

Taken together, the institutions reduced their net claims on the banks during the quarter. Current and deposit accounts fell by £39 million, and borrowing by bank advances rose by £3 million. It is not yet possible to make a reliable estimate of their transactions with the public sector, though their claims almost certainly increased.

Total hire purchase debt outstanding continued to rise strongly during the quarter, whereas during the first quarter of 1963 there was a substantial fall. The increase was in debt owed to finance houses, mainly to finance purchases of cars by persons. Debt owed to household-goods shops fell, but by less than usual.

Building societies' net receipts on shares and deposits reached £131 million, £11 million more than the previous record level in the fourth quarter. Their net advances on mortgage, which were also at a record level in the fourth quarter, fell by rather more than might have been expected on seasonal grounds.

Net sales of units by unit trusts reached the record total of £20 million; these funds were, as usual, invested very largely in equities.

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, which includes transactions both in sterling and in other currencies.[a] Further detail is given in Table 9 of the Statistical Annex.

£ millions	**1963 IV**	**1964[1] I**
Current and deposit accounts	+494	−124
Adjustment for transit items	− 30	−111
Net deposits	+464	−235
Claims on:		
Public sector:		
Notes and coin ...	+136	− 98
Treasury Bills	+171	−481
Government stocks ...	+ 44	−112
Advances	+ 3	+ 72
Bank of England, Banking Department, net claims on Exchequer	− 15	+ 35
Private and overseas sectors:		
Advances: to private sector ...	+ 93	+341
to overseas sector ...	− 13	+ 10
Miscellaneous claims[2]...	+ 58	+ 36

(1) The changes in the first quarter of 1964 cover only those banks contributing at both the 31st December 1963 and the 31st March 1964. The new contributors at March 1964, however, have been treated by the other contributors as members of the banking sector at that date, whereas previously they were treated as part of the private sector, *viz.*, companies. For consistency with the figures at December 1963, therefore, current and deposit accounts at March 1964 have been increased by £26 million and advances to the private sector by £55 million; these amounts were reported at that date by the new contributors as "claims on U.K. banks and the discount market" and "liabilities to U.K. banks" respectively.

(2) Call money, commercial bills discounted and securities other than gilt-edged.

The fall in claims on the public sector greatly exceeded the fall in net deposits, and was associated with a substantial increase in claims on other sectors, notably the private sector. It is probable that a large part of this movement was due to persons and companies using bank advances to make tax payments to the Exchequer.

Comparing the positions of the separate groups of banks, it may be noted that the fall in deposit liabilities of the whole sector con-

(a) Some detail of transactions in currencies other than sterling by the accepting houses and overseas banks in London is given in a new Table 14 of the Statistical Annex. Currency transactions by the rest of the banking sector—the domestic banks and the discount market—form a relatively unimportant part of total banking sector transactions.

ceals the fact that deposits with the overseas banks continued to rise sharply; indeed the rise was much greater than in the previous quarter, though less than that of the third quarter of 1963. While current and deposit accounts with the domestic banks fell by over £200 million, those with the overseas banks rose by about £100 million. The overseas banks' advances, however, increased by much the same amount as their deposits, while the domestic banks increased their advances by about £300 million despite the fall in their deposits. For both groups of banks the rise in advances was larger than any in recent quarters.

Public sector The Exchequer Group had a cash surplus of £628 million in the quarter, made up as follows :

	£ millions
Budget: above the line	+696
below the line	− 68
overall	+628
Internal extra-budgetary funds ...	− 4
Exchange Equalisation Account ...	+ 4
Other external items	—
Cash surplus	+628

The overall budget surplus was £336 million smaller than in the corresponding quarter of 1963. But departmental and other balances were run down less in this quarter than a year ago; consequently internal extra-budgetary funds showed a deficit of only £4 million, compared with £116 million a year earlier. The surplus, taking budgetary and extra-budgetary funds together, therefore, was £224 million smaller. (External items, net, were very small in both years and the overall cash surplus was £217 million lower)

Earlier figures had shown a marked increase in the Exchequer deficit on budgetary and extra-budgetary account between the second and third quarters of 1963 but broad stability between the third and fourth quarters (each comparison being with the corresponding quarter of 1962). It is now seen that this slowing-down in the growth of the deficit was only temporary. The figure of £224 million quoted above compares with a total rise in the deficit during the three previous quarters of only £130 million. A small part of this acceleration in the Exchequer's net spending can be attributed to a decline in revenue; a change of trend in revenue is always possible in the first quarter because its composition differs substantially from that in other quarters. Even so, gross expenditure increased much more quickly than it had done earlier in the financial year.

The disposition of the Exchequer surplus was as follows :

£ millions	**Banking sector**	**Private sector**(1)	**Overseas sector**	**Total financing**
Net Exchequer indebtedness to Bank of England, Banking Department	+ 35			+ 35
Bank of England notes	− 98	+ 56		− 42
Non-marketable debt:				
National Savings		+ 85		+ 85
Tax Reserve Certificates ...		−172		−172
Marketable debt:				
Stocks	−112	+ 27	+22	− 63
Treasury Bills ...	−481	+ 32	−22	−471
	−656	+ 28	—	−628

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

There was no net change in overseas holdings of government debt, following a very substantial increase in the fourth quarter of 1963. But the Exchequer borrowed a modest amount from the private sector, to which it had repaid debt in the previous quarter, and the proceeds, together with the Exchequer Group's cash surplus, were used to retire public debt held by the banks.

Net official stock purchases totalled £63 million compared with £32 million in the previous quarter : there were net purchases of £95 million of stocks maturing within 5 years (reflecting, as indicated earlier in the Commentary, the purchase of the stocks due to mature in May); and net sales of £6 million maturing within 5 to 15 years and of £26 million in the over-15 year range. As the net result of these operations and of the passage of time, the average maturity of the market's holdings decreased by rather less than two months during the quarter.

Little is yet known concerning transactions between the rest of the public sector and other sectors during the first quarter, except for transactions with the banks. There was no change in the deposits of public corporations, while their bank advances rose by £5 million. Deposits of local authorities fell by £14 million, and their borrowing from the banks (including temporary money) rose by £69 million. Bank borrowing does not, however, normally finance a substantial proportion of local authorities' total requirements from outside the public sector; borrowing from the private sector is usually much more important.

Prospects It is likely that in the months immediately ahead the public sector's deficit will continue to grow, though more slowly than recently, and that the overseas sector will remain in surplus. This points towards continued growth of the private sector's surplus, though the rise may be less rapid than of late. Within the total—with company profits probably increasing less rapidly and expenditure on fixed investment rising—some increase in the proportion of the surplus accruing to persons rather than companies is still to be expected.

The implications of these prospective developments for financing patterns are particularly difficult to discern in view of the uncertainties associated with the General Election. It seems clear, however, that both the public sector and companies are likely to be heavy borrowers, with persons (via financial institutions including, perhaps, the banks) and the overseas sector being the main sources of the required finance.

Within the public sector, there is likely to be an increase in the proportion of borrowing undertaken by the Exchequer, if only as a result of the new local authority borrowing arrangements. There are several reasons, however, why a substantial proportion of the Exchequer's borrowing may be covered without recourse to sales of marketable debt: for example, as incomes rise there is likely to be a sizable increase in the note issue and in National Savings (the latter being assisted by the improved terms recently introduced); and should there be a fall in the external reserves, this will provide the Exchequer with sterling finance. While residual sales of marketable debt may still be large, the financial surpluses which are the counterpart of the public deficit will be available for lending. In the months immediately ahead there is little reason to expect market forces to exert sustained upward pressure on interest rates unless—which is unlikely—a strong preference for equities should lead those with surpluses at their disposal to divert an unusually large proportion of them towards company securities.