# COMMENTARY

Since the last issue of this *Bulletin* in June, evidence has accumulated that the pace of expansion of the economy, both in output and in demand, has slowed down this year, as had been expected. Rising expenditure on fixed investment, by both the public and the private sectors, may now be the main expansionary force, although consumption and stock accumulation continue at a high level.

Towards the end of May, sterling weakened. This was not due to a loss of confidence, but was mainly a consequence of the continuing deficit in the United Kingdom's balance of payments and of tighter money conditions on the Continent. The export figures have been disappointing : their erratic movement from month to month makes assessment unusually difficult, but their behaviour, notwithstanding encouraging reports of the state of export order books, has not fulfilled earlier hopes. The reserves rose in the second quarter as a whole, though they fell in June. There were further falls in July and August.

At home there has been no shortage of credit. But the external situation aroused some expectations of a further rise in Bank Rate; and as a result most market rates of interest have moved up a little. Wages and other incomes are probably growing a little faster than before, and most increases are well above the ' guiding light ' of 3% to 3½% a year.

The notes which follow deal mainly with developments since the beginning of the year, particularly in the three months May to July. They continue into August where it seems appropriate.

**Domestic economy** The extent of the slackening in the growth of the economy this year is not easily assessed, especially as some of the official statistics carry a rather different emphasis—implying a slightly more pronounced slowing down—than do reports from industry direct.

Industrialists in general, for example, seem confident that expansion continues. Yet the index of industrial production, after rising by around 10% last year, has not altered, seasonally adjusted, throughout January to June this year. The change of trend seems abrupt, although some slackening in growth this year is readily understandable. In manufacturing, some industries—textiles, clothing, and furniture are examples—have fallen back a little from the very high levels of production reached at the beginning of the year, while some others, such as bricks and other building materials, cars, and much general engineering, which have been working at or near capacity for some time, are finding it difficult to increase production further. In many fields order books are still lengthening, including those for machine tools which are now beginning to benefit increasingly from home industry's plans for capital re-equipment. Only for some consumer goods does it appear that the flow of orders may be slowing down.

Except in building, there is no evidence that shortages of materials are hindering output. But shortages of labour, especially skilled workers, continue and are now affecting production in some industries, particularly in the London area and the Midlands. Unemployment continued to fall during May to July, when—at what is usually the year's low point—the total out of work was 318,000 or 1·4% of all employees. The equivalent ratios were 0·8% in London and the South-East and 0·7% in the Midlands. There was a rise in August to 368,000 (1·6%), mainly on account of school-leavers.

Imports are discussed in some detail later. After a sharp rise towards the end of 1963, associated with the surge in stockbuilding, they have in total stayed close to January's high level.

Among the main categories of demand, exports, which are also discussed more fully later, were only about 1½% higher in the first half-year, after seasonal adjustment, than in the second half of 1963; and there was another poor figure in July. Yet conditions abroad and the state of order books would appear to have offered scope for a larger increase; and here again exporters' reports, though not necessarily conclusive, give a more buoyant impression than the actual trade figures. Personal spending, while still high compared with a year ago, is not markedly expanding: although the number of new cars registered continues to be very large, it fell a little during May to July from the peak reached in April; moreover, sales in the shops, after allowing for seasonal factors, were rather smaller in volume in the second quarter than in the first, although higher in value because of higher prices. Stockbuilding, too, appears to have added little to the growth of demand in the first half of this year after the sharp increase at the end of 1963: manufacturers have continued to build up stocks, including work in progress, but wholesalers' and retailers' stocks have changed little.

Expenditure on fixed investment, on the other hand, continued to increase strongly, and in the building industry shortages of bricks and other materials are intensifying. The main indications—new orders for machinery, approvals of industrial development certificates, housing starts, surveys of manufacturers' intentions, and the large public investment programmes—all suggest that investment will continue for some time to claim an increasing share of resources. As a precautionary measure, the Chancellor of the Exchequer asked the nationalised industries in June to examine their investment programmes for 1965/66 so as to establish in advance whether there were marginal items which could if necessary be postponed or cut without damage to their main plans.

After rather large increases in the second half of last year, there has been little change this year in the prices of imports as a whole, or in the prices paid by manufacturers for materials and fuel. On the other hand, between December and July wholesale prices rose by 2½% and retail prices by 3%; about one-third of these increases was due to the higher duties on drink and tobacco imposed in the Budget. Personal incomes are still growing faster than the trend rate of increase in productivity. For example, wage settlements so far this year have added on average the equivalent of 4½% a year to hourly rates of pay, while earnings have no doubt risen more than basic rates. Recent awards have given substantially more than the average to some groups for whom a special case had been made out. It is important that these should not set a new norm.

**Balance of payments**

Owing to a marked deterioration in overseas trade, a substantial deficit developed in the current account of the balance of payments during the first quarter. As compared with the fourth quarter of 1963, imports, seasonally adjusted, were over 7% higher, mainly because of a rise at the turn of the year in imports of semi-processed materials and finished goods; whereas exports were scarcely changed. As a result, the deficit recorded on trade increased from £33 million to £107 million.

Judging by the trade figures, the current account deficit in the second quarter will again have been large. Allowing for seasonal factors, imports rose about 2%—an appreciably smaller increase than in the first quarter—but exports were slightly lower. The more moderate growth of imports was due partly to a fall in purchases of food and tobacco. But there was also a less rapid increase in imports of industrial materials—associated presumably with a slower expansion of both stocks and output—and of finished manufactures, especially capital goods.

A disappointing feature in the performance of exports was a fall in shipments of machinery and transport equipment (although exports of cars were maintained). These goods, which account for about 45% of all U.K. exports, have contributed little to their total growth in the past eighteen months despite a steady improvement in the engineering industries' export order books. Sales of other manufactured goods, notably textiles and metals, were expanding in the second quarter, as were those of food, fuels and basic materials. Geographically, the main growth in total exports was to Western Europe, Canada and South Africa. In Europe there were gains in both the large trading areas: in the European Economic Community there was a particularly marked rise in exports to Western Germany, though shipments to Italy and, to a lesser extent, France were down. Otherwise there were falls to most countries both in and out of the sterling area, including the United States.

**Foreign exchange market** Sterling, having been quite firm for several months, began to weaken at the end of May. The spot rate against the U.S. dollar then fell steadily, except for a brief period of stability around the middle of June, from \$2·79$\frac{15}{16}$ to \$2·78$\frac{23}{32}$ by the 20th July. Although it subsequently improved slightly, and finished the month at \$2·78$\frac{13}{16}$, it fell further in the last two weeks of August, to around \$2·78$\frac{3}{8}$. The authorities intervened from time to time in order to moderate the fall, but they did not seek to arrest the movement by drawing unduly on the reserves.

Although sterling might have been more resilient but for economic and political uncertainties at home, there was no evidence of a loss of confidence abroad during this period. The behaviour of forward rates, for instance, which moved steadily in favour of sterling throughout June and much of July, suggested that speculative positions were not being taken up.

The easier tone of sterling seems rather to have been associated with other circumstances. There was the continuing sizable deficit in the U.K. balance of payments; moreover, around the middle of the year the trading position of the overseas sterling area as well as the United Kingdom's was moving into a less favourable seasonal phase. Another cause was the development of tighter monetary conditions in Western Europe. As usual during June some foreign commercial banks repatriated funds held abroad in order to show a more liquid position in domestic currency in their half-yearly balance-sheets. But more important than this seasonal phenomenon was an underlying tightening in a number of continental centres as monetary measures taken to combat inflationary pressures exerted increasing influence. The effect of this tightness was also felt in the Euro-dollar market. The widespread move towards dearer credit was signalled during June and July by higher rediscount rates in a number of West European countries. In all these circumstances it was not surprising that the easier tone of sterling persisted throughout most of these months.

Allowing for the cost of forward cover, there was little to choose during May to July between the rates for three months' dollar deposits in London and deposits with local authorities. Rates for local authority deposits were little changed; there was a small increase in the rates for dollar deposits, but this was broadly offset by the narrowing discount on forward sterling. Rising yields on U.K. Treasury Bills, on the other hand, coupled with the reduced cost of forward cover, made them a more profitable investment than their U.S. counterpart. The covered advantage rose briefly to a little over $\frac{1}{2}$% a year in July, but there was no market evidence that this prompted an inflow. The general stringency on the Continent no doubt reduced the volume of funds available for such investment; and it is possible, too, that some potential investors were held back by expectations of a further rise in U.K. short-term rates. It may be added that, although the Treasury Bill comparison continues to have considerable significance, especially for official holders, the growth of the Euro-dollar market has increased the relative importance attaching to the dollar deposit/local authority interest rate comparison.

**Reserves and liabilities** After increasing by £17 million in May, the reserves fell by £30 million in the next two months. There was a further fall of £33 million in August, of which £10 million represented the annual debt payment to Western Germany arising from the liquidation of the European Payments Union and some £4 million the annual repayment to Portugal of war-time bonded debt. On the 8th August the standby facility with the International Monetary Fund, under which the equivalent of \$1,000 million (£357 million) is available to be drawn immediately if required, was renewed for a further year. Earlier, in May, the \$500 million swap agreement with the United States was extended for a further year. The U.K. authorities made a small drawing of \$15 million under this facility at the end of June; it was repaid within a fortnight, in July.

In the second quarter as a whole, the reserves rose by £16 million; so it seems that the balance of payments deficit was, broadly, financed by an increase in net liabilities in both sterling and foreign currencies. As might be expected at this time of year, the overseas sterling area countries further increased their net sterling holdings, by £70 million. Net sterling liabilities to other countries rose by £17 million (and gross liabilities by £29 million), which reinforces the impression that the weakness of sterling towards the end of the quarter did not arise from a lack of confidence. Net external liabilities in foreign currencies, as may be seen from Table 25 of the Statistical Annex, increased by £61 million. This change occurred partly because the banks switched foreign currency deposits into sterling and partly because certain foreign currency balances held for U.K. customers were drawn down to finance direct investments abroad.[a] After being little changed over the previous two quarters, there was a rise in gross foreign currency liabilities in the second quarter of £114 million. These funds, which came largely from North America, were partly on-lent to Western Europe.

**Gold market** There was for the most part a fairly active demand for bar gold during May to July. The market in coins, too, was at times particularly active, mainly owing to a demand for sovereigns for Italian and, to a lesser extent, Greek account. The heavy Soviet sales of March and April were not repeated, but the official buying syndicate was able to acquire a modest amount of gold from the regular flow of new production. The daily fixing price rose from around 250*s.* 6*d.* per fine ounce at the beginning of May to over 251*s.* 7*d.* at times in July as the rate for sterling progressively eased. The dollar equivalent moved within a narrow range either side of $35·08.

**Bill rates** At the end of February, following the increase in Bank Rate, the discount market had raised its agreed tender rate for Treasury Bills to $4\frac{5}{16}$%; and the houses maintained this rate without change each week until the 8th May. Then, in order to regain the initiative against outside tenderers after this unusually long period of stability, the discount houses changed their bid on the 15th May, bringing the rate up to just over $4\frac{3}{8}$%. Thereafter, during June and July, the houses varied their bid several times, increasing the rate to a little over $4\frac{5}{8}$% by the end of July. In doing this, they were concerned to maintain the initiative they had regained at the tender, but they were also influenced by the weakness of sterling and the disappointing trade returns which aroused expectations in some quarters of an early rise in Bank Rate. As against this, the houses had no wish to raise the rate too quickly and contribute unnecessarily to a general increase in interest rates and the cost to themselves of the money they borrow.

The authorities for their part were content to see the Bill rate become flexible again and also, in the developing circumstances (including the tendency towards tighter money abroad), to see it rise moderately. They would not, however, have wished it to increase rapidly or to a point at which it was again very close to Bank Rate, as it had been at the beginning of the year. Consequently, except on one occasion, on the 30th June, the market was not required to borrow at the Bank; and on that occasion there were special considerations. Money is often short at the end of June, when the market is disturbed by the temporary increase in bank deposits needed by the banks' customers for their mid-year accounts, and by the banks' corresponding need for cash to preserve their 8% cash ratio. The Bank were, as usual, unwilling to meet the full demand by open market operations. This was the first time the market had borrowed at the Bank since January.

Other money rates tended as usual to follow the Bill rate. There was some increase, though probably a rather smaller one, in the average cost of the market's borrowing, and commercial bill rates also moved up. Between the middle of May and the end of July, for example, the market raised its buying rate for three months' prime bank bills from $4\frac{1}{2}$% to $4\frac{13}{16}$%.

**Other short-term money rates** In contrast to the rise in bill rates, there was little change in the deposit rates offered by the larger hire purchase finance houses during May to July. These rates were already quite high,

[a] Currency liabilities to U.K. residents, which account for only a small part of the banks' total currency liabilities, are not included in Table 25 which is concerned with external liabilities; but the banks' corresponding assets generally take the form of external claims, which are included in the table. This table was described in an article in the *Bulletin* for June 1964.

however, and the houses did not lack for funds. The total of deposits with members of the Finance Houses Association rose from nearly £400 million at the end of April to a new record of £427 million in June, and there was little change in July. At the same time the demand for new credit, which is mainly for cars, eased slightly.

The short-term rates offered by local authorities were also little changed during this period: three months' money, for instance, remained around 5%. No doubt this partly reflected a seasonal fall in requirements, as receipts from ratepayers will have been high; but in addition local authorities were borrowing a fair amount in the capital markets and from the Public Works Loan Board.

It seems likely that both the finance houses and the local authorities benefited during this time from temporary deposits of institutional funds ultimately destined for the stock market, but held back owing to its uncertain tone.

**Gilt-edged market** The gilt-edged market was quiet and fairly firm during May, but inclined to be dull on any disappointing news. The new issue of stock and the redemptions in that month were recorded in the June *Bulletin*. When the spot rate for sterling began to fall at the end of the month prices weakened, particularly for the shorter-dated stocks. Throughout June and July there was recurrent speculation, associated with the external situation, concerning a possible rise in Bank Rate, and buyers remained hesitant. The authorities were content to see a moderate rise in short-dated yields, in line with the Treasury Bill rate. At the longer end of the market, they had no wish to see yields move markedly in either direction; accordingly, they played their usual role of seeking to cushion short-term fluctuations and responded to such demand for stock as developed.

Some support was given to steady the market in June and, more particularly, in July. Official purchases were concentrated on the short stocks—which the discount houses, in particular, were selling heavily—and especially on the two stocks due to mature next year, namely 4% Treasury Stock 1965 and 3% Savings Bonds 1955/65. At the longer end, yields around 6% were still attractive to some institutional investors, and official sales continued in June and July, including amounts of the two stocks issued earlier this year, namely 5¼% Funding Loan 1978/80 and 5¾% Funding Loan 1987/91.

Over the three months to the end of July, there were only small net increases in yields on long-dated stocks, while medium-dated rose by up to ¼% and short-dated by up to ½%; the increases took place predominantly in the second half of July.

**Debenture and equity markets** The market for industrial debentures was, as usual, influenced by the state of the gilt-edged market and here, too, prices weakened a little. For example, the average yield on a group of stocks with about twenty years to maturity, which was already around 6½% at the end of April, had risen about $\frac{1}{16}$% by the end of July. Most of the increase occurred in July. But the flow of new issues at these high rates remained very substantial.

Movements in the equity market were somewhat erratic. Roughly, prices were falling in May, rising in June, and little changed in July. The approach of the General Election made for hesitancy, so too at times did the economic outlook, or some assessments of it: whereas in general (apart from the trade gap) current economic activity and company reports both continued to be encouraging. In spite of the uneven tone of the market, new equity issues, which continued to come forward in quantity, were absorbed readily enough. The F.T.-Actuaries index of industrial share prices fell from 117 at the end of April to 110 early in June. It rose to around 115 during June, 117 during July, and to a new record of 119 in the middle of August.

**Local authority capital borrowing** Rates for local authority mortgages were marked up slightly in May and early June, when they settled at 6%-6⅛% for up to ten years and 6⅛% for longer terms. That rates did not rise further may have reflected the ability (or the prospect) local authorities now have of borrowing more in other and cheaper ways. The comparable rates at this time for their borrowing from the Public Works Loan Board within their quotas[a] ranged from 5⅝% to 6%.

Reference was made in June to four issues of short-term bonds, totalling £3 million, which had recently been placed by Manchester Corporation with the discount houses. These were the first of their kind; but the power to issue such bonds, previously confined to a few local authorities, was extended to all in England and Wales on the 8th July when regulations made under the Local Government (Financial Provisions) Act, 1963, came into force. Bonds, being more easily transferable, are a more attractive investment and thus a cheaper form of borrowing than mortgages of comparable maturity, and it had earlier become evident that a very large number of local authorities were anxious to place substantial amounts of them. Accordingly, in order to ensure their orderly marketing, an amended General Consent under the Control of Borrowing Order, 1958, was also brought into force on the 8th July which requires the terms and timing of bonds issued " to or through the agency of any bank, discount house, issuing house, or broker " to be agreed with the Bank of England, acting on behalf of H.M. Treasury. (There is no such restriction on bonds issued direct to investors from council offices)

The new arrangement will enable the Bank to control the flow of new bond issues to the market in much the same way as it already does the issue of local authority stocks. A large volume of such issues might well disturb the gilt-edged market in short-term stocks. The bonds will not be acceptable as security for loans to the discount market by the Bank of England, and they are unlikely to be taken to any great extent by the clearing banks as collateral for call money lent to the discount market. If this were to happen, it could lead to an increase in the banks' liquidity, which would not necessarily be desirable.

The bonds may be issued with maturities of from one to five years. The pace at which issues can be brought forward will depend very much upon the way in which demand for this new instrument develops. It is hoped that the fact that some of these issues enjoy a stock exchange quotation will help to hasten the growth of the market for them. In marshalling the queue of borrowers some preference is being given to those prepared to issue bonds with maturities longer than one year, as it is not desired that the restrictions which have recently been imposed on temporary borrowing by local authorities for periods up to one year should be accompanied by a large rise in borrowing for a fractionally longer period. At the same time, in view of the maximum term of five years which is being applied to bonds issued in this way, it is intended to allow local authorities to issue stocks, if they wish, with a minimum life of five years instead of ten years as previously. These too are a cheaper form of borrowing than mortgages of similar term.

During July, bonds totalling £6½ million were issued through the Stock Exchange on behalf of seven local authorities; these were at par, with coupons ranging from 5% for one-year bonds to 5¾% for four-year. A further £4½ million of one-year bonds—all issued at a discount to yield 5%—were placed in the discount market on behalf of nine other authorities. Issues in August totalled £14½ million.

**London clearing banks**

Government spending in recent months has increased rather more slowly than might have been expected from the budget estimates; and the Exchequer's need for finance has also been somewhat reduced by the receipt of the sterling counterpart to the fall in the reserves. A large part of the Exchequer's remaining requirements has been financed by the seasonal summer rise in the note circulation and by a fairly high level of subscriptions to National Savings securities and Tax Reserve Certificates. In consequence comparatively little finance has been required from marketable debt, though much of what has been required has come from the clearing banks. Between the middle of May and August their holdings of stocks and Treasury Bills rose by £95 million, a rise partly offset by a fall in their money at call with the discount houses (which is mostly invested in government debt).

The postal dispute, and the delays which it caused in the settlement of all kinds of personal

[a] The new arrangements for borrowing from the Public Works Loan Board are described on page 90 of the June 1964 issue of this *Bulletin.*

and commercial transactions, affected the clearing banks' figures of deposits and advances in July and August, and makes their interpretation particularly difficult. Taking the three months from May to August together, advances rose by £187 million: advances to the nationalised industries rose by £28 million and those to other borrowers by £159 million. Little seasonal change is expected during these months and the underlying increase, averaging about £50 million a month, has clearly quickened compared with earlier in the year. It is not yet possible to be sure which classes of borrower are increasing their demand for advances, but it seems likely that an increasing proportion of the demand is coming from companies. Their expenditure on fixed investment is rising, whereas the growth in their earnings has probably slowed and capital issues—though still high—may be past their peak.

Net deposits rose by £276 million in the three months. This was appreciably more than expected on seasonal grounds, and the underlying increase broadly matched that in advances. The combined liquidity ratio in August was 30%, rather lower than might have been expected at this time. The comparable advances ratio was as high as 51½%.

**General assessment**

The economy is probably still expanding, although no longer so fast as last year when there were appreciable unused resources of men and machines available to be brought into use. It is difficult, however, to say to what extent the change may be due to a slackening in the growth of demand as against possible difficulties on the supply side, such as the shortage of labour.

In the first half of the year, it is clear that the balance of payments was in substantial deficit, both as a result of a deterioration in the visible trade balance and of an unusually large net outflow of long-term capital. Some deterioration in the trade balance was foreseen at this stage, as it was to be expected that the rise in imports needed to sustain a higher level of industrial activity would outstrip the rise in exports. The outflow of long-term capital in the early part of this year was chiefly on private account, and this is unlikely to be maintained. But at the end of the year there will be large repayments of government debt to North America and Switzerland, and the payment of interest on these debts will affect the invisible account as well. It is unlikely, if only for seasonal reasons, that the balance of payments deficit in the second half of the year will be financed to the same extent as in the first half by increases in net external liabilities in sterling and other currencies; and some loss to the reserves must be expected.

A renewed rise in exports is essential if expansion is to be sustained. How soon this can be expected depends on the reasons, which are not yet clear, for their poor performance in recent months. Export orders on hand for engineering goods have been rising sharply since the second quarter of 1963. To the extent that this is due to a natural time lag between orders and deliveries, the expansion in exports looked for in recent issues of this *Bulletin* should yet materialise. But if it reflects difficulties of supply, due, it may be, to conflicting demand from the home market, the implications are more serious. Some increase may be expected in imports, but their growth could well be moderate, assuming that there is no considerable rise in the rate—already high—at which stocks are being built up.

In these circumstances, two points may be emphasised. One is that the recent figures of overseas trade, liable though such figures are to erratic movements over short periods, are a sharp reminder that the United Kingdom cannot afford a rise in costs and prices which weakens its position in export markets. The need for an effective national incomes policy therefore remains as clear as ever, whatever shortcomings there may have been in practice. The other is the need, becoming increasingly evident, to make the most efficient use of all our industrial resources. There is no place for the wasteful use of labour, whether resulting from restrictive practices or shortcomings in management, any more than for the wasteful use of machinery or imported materials (for example, through holding excessive stocks). The bid for sustained expansion, and persistence with this bid through balance of payments difficulties, can only succeed if the best use is made of all the country's resources.

# QUARTERLY ANALYSIS OF FINANCIAL STATISTICS

## 1st April to 30th June 1964

In this analysis, the main trend depicted over the past year or so in the financial position of the various sectors,[a] after making rough adjustment for seasonal influences, has been a rise in the public sector's financial deficit balanced by increases in the surpluses[b] of both the private and the overseas sectors. It has generally been difficult to uncover any clear pattern in these changes from quarter to quarter, but it did appear that around the turn of the year the rate of increase in the public sector's deficit and the overseas sector's surplus may have been speeding up after relatively slow movements in the preceding quarters.

In June it was tentatively suggested that during the first quarter the public sector's position changed somewhat faster than the overseas sector's, implying some addition to the underlying surplus of the private sector; the national income figures now published for that quarter appear to confirm that suggestion. However, this does not seem to have continued; early indications for the second quarter point to changes for the domestic sectors fairly similar to those in the fourth quarter of 1963. So very probably the figures for the intervening first quarter of the year, with their very large seasonal swings, should be regarded with special caution in trying to discern trends.

In the second quarter, allowing for seasonal movements, the public sector's deficit appears to have reverted to a relatively slow rate of growth, and the private sector's surplus probably fell. The overseas surplus, which had already risen substantially in the first quarter, was probably rather larger.

**Overseas sector** Even without allowing for seasonal movements, it seems certain that the overseas sector had a large surplus in the second quarter, possibly similar in total to that in the first. Although the sector will have continued to be a net borrower from the British Government on long-term capital account, owing mainly to drawings on development loans, overall (in contrast with the previous quarter) its net claims on the public sector rose strongly. For example, as the table on page 184 shows, there was a net increase of £87 million in its holdings of marketable government debt.

There was also a substantial rise in the sector's net claims on the banks, its deposits rising by £169 million while its borrowing (advances, money at call and commercial bills combined) increased only by about £60 million. This is the first quarter since at least the beginning of 1962 in which both overseas holdings of marketable government debt and overseas net claims on the banks have increased substantially. In the main this reflects the recent growth of the sector's surplus, and particularly that of overseas sterling countries.

As against this, it seems likely that there was a large increase in overseas net liabilities to the private sector, arising from substantial investment abroad by U.K. companies and comparatively little net private investment in this country from overseas.

**Private sector** During the second half of 1963 the private sector's surplus tended to be held in the form of increased claims on the banks rather than of increased holdings of public sector debt. It is difficult to say whether this continued in the first quarter, because interpretation is complicated by the big seasonal swing in the Exchequer's position in that quarter. In the second quarter, however, it clearly did not continue: the increase in the private sector's claims on the banks was negligible—a rise in its net

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[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). The financial surplus of the overseas sector is the counterpart of the deficit on current account in the U.K. balance of payments.

deposits of £295 million[a] being largely offset by an increase of about £270 million in its borrowing.

It follows from this that the private sector, besides increasing its overseas assets, must also have added substantially to its claims on the public sector. Little of this shows up in its claims on the Central Government which, as may be seen in the table on page 184, rose only by £48 million. There is little reason to expect much change in the sector's claims on the public corporations, and it is probable that its claims on local authorities again rose substantially.

The rise in the sector's claims on the Central Government was the net result of an unusually large take-up (£114 million) of non-marketable debt, a rise (£16 million) in holdings of Bank of England notes, and a resumed decline (£82 million) in holdings of marketable debt. Government sales of non-marketable debt benefited from the introduction on the 15th May of the more attractive National Development Bonds in place of Defence Bonds; from the raised limits on holdings of National Savings Certificates and Premium Savings Bonds; and from the higher return offered from the 28th March on Tax Reserve Certificates. The reduction in holdings of marketable debt may be partly due to this higher return on Tax Reserve Certificates, which perhaps encouraged companies to switch out of Treasury Bills. Certainly total private sector holdings of Bills fell by £44 million. The gilt-edged market was uncertain during the quarter and the sector sold a net £38 million of stocks. The increase of £16 million in its holdings of Bank notes may be compared with an increase of £37 million during the same quarter last year. The difference is probably due to the early incidence of Easter, which fell at the end of March this year, but in the middle of April last year.

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

**Persons**[b] In developing a study of this kind, much interest attaches to the division of the private sector's surplus between persons and companies, because a better understanding of the cyclical pattern of their surpluses would help in analysing developments in the capital markets, where many of the capital flows are between persons and companies.

It was suggested in the March issue of this *Bulletin* that the share of persons in the private sector's surplus probably rose during the fourth quarter last year. In June, on the strength of some early and incomplete figures for net changes in financial claims, doubt was expressed whether the rise had continued during the first quarter of this year. The publication of national income figures for the first quarter makes possible a re-assessment by the alternative, and probably more secure, method of estimating the difference between saving and investment in physical assets.

The new evidence suggests that the underlying financial surplus of persons did in fact rise during the first quarter; their saving rose (seasonally adjusted) but their investment was little changed. The surplus of companies, by contrast, was probably fairly stable. It is unlikely that companies' saving changed much: after seasonal adjustment their gross trading profits are estimated to have fallen, but they had rather less tax to pay than in the revenue quarter last year. Investment in physical assets was probably also broadly maintained: stockbuilding may have fallen (though it was still substantial) but, if so, there will have been an offset in the rise in fixed investment.

During the second quarter, as has been suggested, it looks as if there was a reduction in the underlying surplus of the private sector. Within this reduced surplus, it is probable that the share of persons continued to rise; indeed it is likely that their surplus rose absolutely as well as relatively. Their saving remained high, as the increase in current spending apparently lagged behind the growth of incomes; while their investment and stockbuilding probably increased little. The surplus of companies, by contrast, may well have fallen somewhat : profit margins were probably falling, whereas fixed investment was rising and stockbuilding was still substantial.

The increase in the surplus of persons seems to have been used largely to increase their

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(a) The whole of the fall in transit items is here allocated to the private sector.

(b) This term includes partnerships, unincorporated businesses, etc., as well as individuals.

bank deposits and as a result, in contrast to the private sector as a whole, they added substantially to their net claims on the banks; their net deposits rose by some £350 million,[a] while their borrowing increased by only about £80 million.

There was also an increase in persons' identified claims on the Central Government. Their net take-up of National Savings totalled £46 million (compared with £14 million a year earlier); and they added £10 million to their holdings of Tax Reserve Certificates. As information about the amount persons lent to local authorities is lacking, it is not possible to estimate the change in their position vis-à-vis the public sector as a whole.

Persons' transactions with financial institutions, so far as they are known, are discussed later in the section on these institutions.

**Industrial and commercial companies** Just as the increase in the underlying surplus of persons seems to be reflected in a rise in their net claims on the banks, so the apparent reduction in the surplus of companies was accompanied by a run-down in their claims on banks; their net deposits[a] fell by about £90 million, and their borrowing rose by about £170 million.

It has thus been shown that, taking both deposits and borrowing into account, companies were net borrowers from the banks while persons were substantial net lenders. This is not surprising considering the economic circumstances of these two sectors; but it may be noted that it contrasts with the impression obtained by looking only at the analysis of advances by the British Bankers' Association,[b] namely, that bank lending to industry remained low.

Although companies' deposits with banks fell, their deposits with hire purchase finance houses rose sharply from £164 million to £195 million. There are indications too of a small increase in their claims on the Central Government, notably the rise of £58 million (compared with £28 million a year earlier) in holdings of Tax Reserve Certificates other than by persons.[c] However, as noted earlier, some part of the fall in private sector Treasury Bill holdings may have been due to companies.

Companies' calls on the capital market were somewhat lower than in the previous quarter, though substantially higher than a year earlier. The high rate of capital issues in the first half of this year supports other evidence that further increases in fixed capital expenditure are to come.

**Financial institutions** The main groups included here are insurance companies, pension funds, hire purchase finance companies, building societies, the Special Investment Departments of the Trustee Savings Banks, and investment and unit trusts.

Statistics for the second quarter are not yet complete. So far, they show that these institutions, taken together, continued to invest a large part (probably over £200 million) of their new funds in company securities. Their holdings of government debt increased by about £30 million, including net purchases of stocks amounting to some £35 million (compared with only £8 million in the previous quarter) and a net reduction of about £5 million in Treasury Bills. Their holdings of local authority debt, which had increased sharply by over £100 million in the previous quarter, rose by some £25 million only. The lower figure reflects a small reduction, as against a rise of over £50 million, in holdings of temporary money. Their net claims on the banks increased by much the same amount as a year earlier: their current and deposit accounts rose by £36 million and their advances by only £19 million.

In the peak season for car buying, hire purchase debt due to finance houses rose by £59 million, compared with £27 million a year earlier. Finance during the quarter was obtained partly from the banks and partly from deposits by the private sector, especially industrial and commercial companies.

Although building societies' net receipts on shares and deposits (including accrued interest) were below the record levels of the two preceding quarters, they were still, at £121 million,

(a) The fall in transit items has been divided between persons and companies roughly in proportion to the change in their current and deposit accounts.

(b) See Table 13 of the Statistical Annex.

(c) See Table 4 of the Statistical Annex.

higher than a year earlier. These receipts are mainly from persons, and the reduction no doubt reflects the greater competitiveness of Exchequer non-marketable debt. On the other hand, their net advances on mortgage, also largely to persons, reached a record of £144 million.

Net receipts by unit trusts from the sale of units (which they invest largely in company securities) were again large; at a record £21 million they were slightly greater than in the first quarter and half as much again as a year earlier. Net deposits with the Special Investment Departments (which largely hold public sector debt) rose by something over £30 million.

**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 in other currencies as well as in sterling. Now that a sufficient run of figures is available, the changes in the corresponding quarter of last year are given for comparison.

*£ millions*

| | 1963 II | 1964(1) II |
|---|---|---|
| Current and deposit accounts | +394 | +337 |
| Adjustment for transit items | + 73 | +135 |
| Net deposits ... ... ... | +467 | +472 |
| Claims on: | | |
| Public sector: | | |
| Notes and coin ... | + 28 | + 37 |
| Treasury Bills ... ... | +204 | +129 |
| Government stocks ... | + 18 | − 76 |
| Advances ... ... | − 10 | + 41 |
| Bank of England, Banking Department, net claims on Exchequer | + 43 | + 13 |
| Private and overseas sectors: | | |
| Advances: to private sector ... | +207 | +290 |
| to overseas sector ... | + 51 | + 30 |
| Miscellaneous claims(2)... | + 53 | + 31 |

(1) There were ten additional contributors from the first quarter of 1964. See Table 9 of the Statistical Annex.

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

The increase in net deposits was much the same in the two quarters, but the rise in the banks' net claims on the public sector was only half that in 1963. This was not because the Exchequer needed less finance this year, but because its needs were met to a greater extent by the other sectors, particularly the overseas sector. At the same time, the banks' claims on the other sectors rose by some £40 million more than in 1963, which meant there was greater pressure on advances ratios.

This pressure was felt mainly by the domestic banks, whose advances in the second quarter rose by £170 million and deposits by only £98 million. By contrast, the accepting houses' and overseas banks' advances grew by £189 million and their deposits by as much as £237 million. Since March 1963 (the first date for which comprehensive statistics are available) deposits with accepting houses and overseas banks have grown by some 30%; most of the increase has come from overseas residents, but there has also been a rise (of over 50%) in deposits of U.K. companies and financial institutions taken together. During the same period total deposits with domestic banks grew by only about 10%. (These banking sector figures are set out in detail in Table 9 of the Statistical Annex)

**Public sector** The Exchequer Group had a cash deficit of £238 million in the quarter, made up as follows:

*£ millions*

| | 1963 II | 1964 II |
|---|---|---|
| Budget: above the line ... | −219 | −138 |
| below the line ... | − 46 | −120 |
| overall ... ... | −265 | −258 |
| Internal extra-budgetary funds ... ... ... | − 2 | + 40 |
| | −267 | −218 |
| Exchange Equalisation Account ... ... ... | + 40 | − 12 |
| Other external items ... | + 1 | − 8 |
| Cash deficit ... ... ... | −226 | −238 |

The overall budget deficit was slightly smaller this year than last year. If the extra-budgetary funds, which consist largely of departmental balances, are taken into account, the deficit on internal items was £218 million,

£49 million smaller than a year ago. Although this seems out of line with the estimated increase of £313 million in the budget deficit during the financial year 1964/65, the experience of the first quarter of a financial year is often a poor guide to the final out-turn. External items, which brought in funds last year, cost £20 million, and the total cash deficit was in fact a little larger than last year.

The contributions of the various sectors to financing this deficit were as follows:

*£ millions*

| | Banking sector | Private sector[1] | Overseas sector | Total financing |
|---|---|---|---|---|
| Net Exchequer indebtedness to Bank of England, Banking Department ... ... | + 13 | | | + 13 |
| Bank of England notes ... ... | + 37 | +16 | | + 53 |
| Non-marketable debt: | | | | |
| National Savings | | +46 | | + 46 |
| Tax Reserve Certificates ... | | +68 | | + 68 |
| Marketable debt: | | | | |
| Stocks ... ... | − 76 | −38 | − 9 | −123 |
| Treasury Bills ... | +129 | −44 | +96 | +181 |
| | +103 | +48 | +87 | +238 |

(1) Including government debt held by local authorities and public corporations.

A much smaller proportion of the deficit was financed by the banks than in the last three quarters of 1963, when the Exchequer was also in deficit. This was because, as noted earlier, the overseas sector was lending heavily to the Exchequer, largely through purchases of Treasury Bills by central monetary institutions (particularly in the sterling area); and because the private sector was making unusually large purchases of non-marketable debt.

Net official purchases of stocks amounted to £123 million in the second quarter compared with £63 million in the first. In both periods there were heavy purchases (or redemptions) of short-dated stocks, partly offset by sales of longer maturities. In the second quarter net purchases of stocks maturing within five years, together with the redemption of market holdings of 2½% Exchequer Stock 1963/64 and 4½% Conversion Stock 1964, amounted to £210 million. There was no net change in official holdings of 5 to 15-year stocks, while net sales of longer-dated stocks brought in £87 million.

Complete details of local authority borrowing are not available beyond the first quarter, when the total (excluding net borrowing from the Exchequer) was £216 million, compared with £188 million in the same quarter last year. Most of this borrowing was in the form of temporary money. Under the new arrangements which came into effect in April local authorities will borrow progressively more of their requirements from the Exchequer. In the second quarter they borrowed £28 million net, compared with a small net repayment a year earlier; but this will have left a substantial amount still to be found elsewhere.

**Prospects** On a broad view of trends in recent quarters, there has been a slower rate of growth in the private sector's surplus, accompanied by a rise in the surplus of the overseas sector. Although the overseas surplus may have been larger in the second quarter than in the first, it seems reasonable to expect that it will not grow much, if at all, during the second half of the year. If this proves right, and if the public sector's deficit increases as is to be expected, it follows that the surplus of the private sector must then grow more rapidly.

It is not easy, however, to judge which part of the private sector—persons or companies—is the more likely to gain. Personal incomes and savings appear to have risen in the first half of this year. It could be that the surplus will show up in a continued increase in personal savings, in which case—even after allowing for the likelihood of a further rise in their investment, notably in house building—persons could have more available for lending to the other sectors, either direct or through an increase in bank deposits.

On the other hand, persons may increase their spending on consumption. In this event, and assuming that this did not lead to an increase in imports which materially enlarged the overseas sector's surplus, persons could thereby contribute to an improvement in the financial position of companies. Companies might also benefit directly from public sector spending. Were either of these developments to occur, companies should be able to finance their capital expenditure with less resort to borrowing, including borrowing from the banks. Failing such developments, an increase in the financial surplus of companies does not, on the face of it, seem very likely. As suggested earlier in the Commentary, companies' earnings may not actually be falling (because some growth could result from rising turnover, even if margins were under pressure), but they are probably no longer rising very quickly. At the same time fixed investment is likely to go on expanding, and fast enough, perhaps, to offset any slackening which may occur in the rate of stock accumulation.