# Commentary

**Introduction**

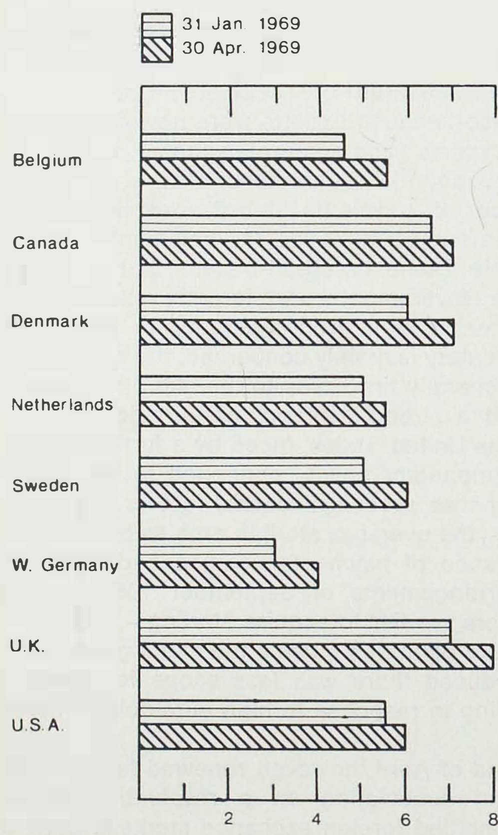
Output in the domestic economy taken as a whole probably grew no further during the first quarter of 1969. This was primarily because consumer spending declined, largely in response to the measures of restraint introduced last November, but also because exports were no longer rising. The flatness of exports (and some exceptional official payments on capital account) brought about another substantial identified balance of payments deficit, despite a large improvement in invisibles; however, the balancing item was strongly favourable. Domestic credit became tighter, mainly as a result of the Government's very large revenue surplus.

During the three months from February to April, with which this Commentary is mainly concerned, the appearance of sterling was generally firm, despite the still disappointing trade figures and a strong demand for euro-dollars – for which banks in the United States, faced by a further tightening of domestic monetary policy, continued to bid heavily through their branches abroad. Seasonal factors had begun to assist sterling – the overseas sterling area as a whole had a favourable balance of payments position and, following the guarantee arrangements of September 1968, sterling area countries were readier to acquire sterling – and as the sterling balances of countries outside the sterling area were already much reduced there was less scope for funds to move out of sterling in response to high euro-dollar interest rates.

Towards the end of April, however, renewed fears for the French franc and speculation on a revaluation of the Deutschemark unsettled foreign exchange markets. Early in May there was a substantial movement of funds from other centres into Western Germany, and sterling fell to its lowest point since November. Although the exchanges became less disturbed after the West German Government announced their intention not to revalue, sterling did not recover all of the lost ground, partly because the trade figures continued to be discouraging.

The Budget introduced on 15th April is designed to produce a large central government surplus during the current financial year and also a surplus for the public sector as a whole. The major revenue proposals were for increases in corporation tax and selective employment tax; thus, the greater part of the tax burden will initially fall on companies. The Government expect total demand to rise by about 3% in the course of the next twelve months, with output increasing moderately during the second half of this year and accelerating in the first half of 1970. Legislation will be introduced on industrial relations but the Government's present statutory powers to delay pay and price increases for twelve months will be allowed to lapse; some powers of delay will remain, however.

In his Budget speech, the Chancellor of the Exchequer pointed out that the rise in money supply in 1968 had been




accompanied by a large balance of payments deficit, and that the implied extension of credit to the domestic economy was greater than could be afforded in the circumstances. It was therefore essential that in 1969 bank lending to the private and public sectors be restrained.

The clearing banks had been asked in February to intensify their efforts to restrict their less essential lending. Though their advances fell substantially in the period up to mid-April, the progress which they had made as a group in complying with the ceiling on their restricted lending was sharply reversed in the following month. Accordingly, the Bank of England stressed once more the importance which the authorities attach to achieving full and early compliance with the ceiling and informed the clearing banks that the rate of interest payable on Special Deposits made by them would be halved with effect from 2nd June. The press announcement is reproduced after this Commentary.[1]

As noted in the last Commentary,[2] Bank rate was raised on 27th February from 7% to 8%. During February and March, domestic interest rates rose swiftly and large borrowers such as the building societies found it difficult to meet their requirements. Because of the tight monetary conditions in the United States, key international interest rates generally continued to rise and a number of other central banks increased their discount rates. Though some domestic interest rates eased in April, the trend in May was still clearly upwards.

**Domestic economy**

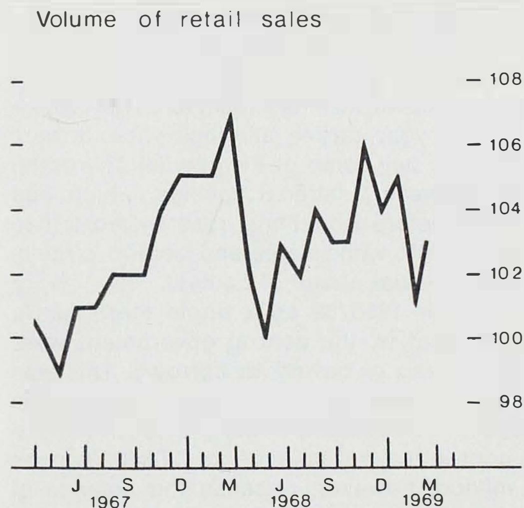
Allowing for seasonal factors, aggregate demand continued to expand in the fourth quarter of 1968; but the pattern altered: the rise in exports slowed down and consumer spending seems to have increased a little less rapidly than in the third quarter. On the other hand, new fixed capital investment rose faster, and manufacturers and others added more to their stocks of raw materials and finished goods.

It seems unlikely that total demand expanded any further in the first quarter: exports ceased to rise and consumer spending turned down. Indeed, the available evidence points to a fall of about 1% in consumer spending, mainly, it seems, because of the measures taken in November:[3] the volume of retail sales, seasonally adjusted, was about 1½% less than in the fourth quarter and registrations of new cars were reduced by as much as one fifth. Real earnings were probably no longer rising: average weekly earnings, restrained to some extent by industrial disputes, were 1½% higher in the first quarter than in the fourth, but retail prices, reflecting the higher rates of purchase tax and excise duties imposed in November, increased by as much as 2%. Consumers may, too, have increased their rate of saving, which had fallen in the latter part of 1968. It seems that in general there was little or no anticipatory buying before the Budget; however, car registrations rose a little in April.

Information about the recent course of other forms of domestic demand is more scanty. Fixed investment by private industry seems to have grown more strongly in 1968

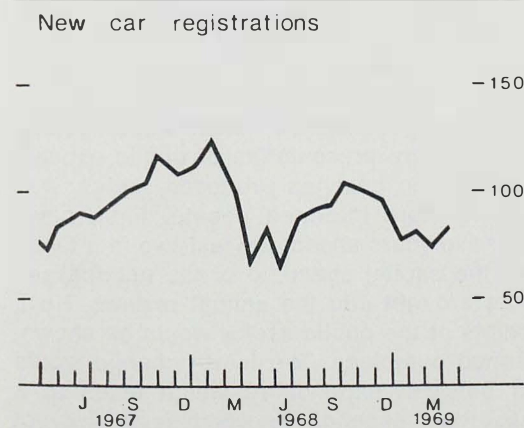
1 See page 145.
2 March *Bulletin*, page 4.
3 December 1968 *Bulletin*, pages 342 and 350.

Seasonally adjusted Average 1966=100




*Retail sales fell steeply in February and were lower in the first quarter than in the fourth.*

Seasonally adjusted
latest month provisional Thousands




*Registrations of new cars were sharply lower in the first quarter but recovered a little in April.*

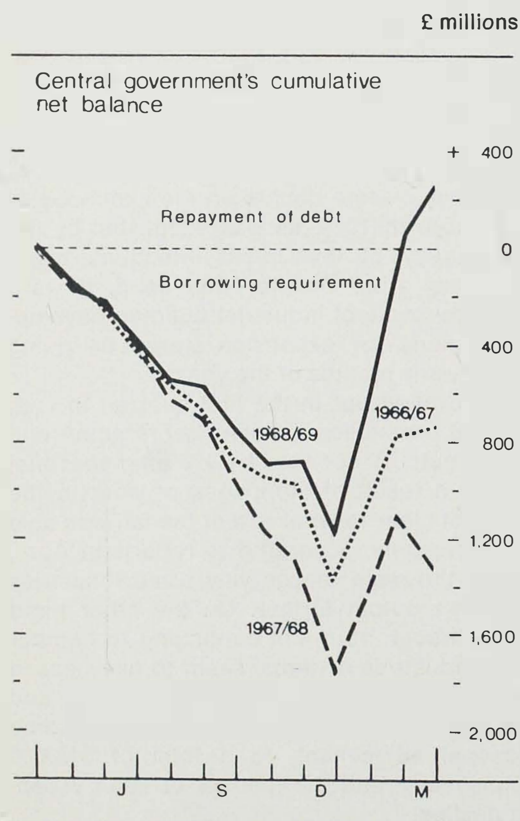
than earlier evidence suggested but until the fourth quarter the growth was mainly in the shipping and service industries. Capital spending by manufacturers, which had been sluggish, then increased by about 8%, but this may have owed something to the fact that smaller investment grants would be received for expenditure on plant and machinery after 31st December. How strongly manufacturing investment has risen since the end of 1968 is still uncertain. The additional restrictions placed on consumer spending last November, the general tightness of monetary conditions, and the extra taxes which industry must meet as a result of the Budget must now cast some doubts on the likelihood of an increase of 10%-15% in 1969, as was suggested by the Board of Trade's survey of investment intentions taken towards the end of last year. On the other hand, forward indicators, such as approvals of industrial building development, suggest that plans for expansion were still going ahead strongly in the early months of the year.

Output may have levelled out in the first quarter: in fact, the index of industrial production (which covers about one half of total domestic output) declined by ¾% after seasonal adjustment, partly as a result of stoppages of work in the motor industry. It is not clear to what extent the fall was also due to shortages of capacity; according to reports in April, lack of capacity was the main reason why some industries could not expand their output further. On the other hand shortages of labour, though no doubt continuing to hamper output in particular industries or firms, seem to have eased a little for the economy as a whole. Between February and May the number of wholly unemployed rose by some 31,000, after seasonal adjustment, to a total of 518,000 (2¼% of total employees); and the number of adult vacancies continued to decline.

**Central government finance**

The central government's surplus (net balance) of £1,454 million in the first quarter – the main revenue season – was very substantially greater than in the same period of any previous year. Although expenditure was larger than a year earlier, revenue was much larger – mainly because of import deposits and the higher rates of purchase tax and excise duties imposed last November, but also because of the increased rate of corporation tax and the special charge on investment income introduced in the 1968 Budget. The net amount lent by the central government was less than half as much as a year earlier, reflecting a big reduction in the drawings of both local authorities and the nationalised industries.

Thus, although external transactions in the first quarter required financing to the extent of £218 million – for there was an inflow of foreign exchange, in sharp contrast to the substantial loss in the previous quarter – the Government were able to repay £1,236 million of domestic borrowing. Investors other than banks reduced their holdings of government debt by £241 million, so that the holdings of the banks and discount houses declined by £995 million. Notes and coin with the banks fell by £154 million and the Banking Department's net claims on the Government by £86 million.




*The net balance moved into substantial surplus in the first quarter of 1969. Compared with the previous financial year the improvement in 1968/69 was as much as £1,604 million.*

Moreover, the banks and, on a smaller scale, the discount houses, again sold gilt-edged. So much so, that the reduction in Treasury bills held by the banks and discount houses, at £443 million, was not particularly large for the time of year; indeed it was a good deal smaller than a year earlier.

Investors outside the banks also reduced their holdings of gilt-edged and they ran down their tax reserve certificates – but by little more than a year earlier, although persons were now using certificates to pay some of the special charge on investment income. However, national savings, which had declined in the period before Christmas, rose by more than in the first quarter of 1968, while notes and coin in circulation increased much as usual ahead of Easter.

Over the financial year 1968/69 as a whole there was a positive net balance (that is, the central government were able to repay debt instead of having to borrow). This was the first surplus since 1962/63, and, at £273 million, the largest since 1950/51.[1] Compared with the previous financial year the improvement in the net balance in 1968/69 was as much as £1,604 million; however, because the balance of payments improved, external transactions provided £1,006 million less sterling finance, so that the repayment of domestic borrowing, at £729 million, was in fact £598 million more than in the previous year.

**Public expenditure**

On 20th February the Chancellor announced that the growth of public expenditure in 1968/69 was likely to have been slightly below the figure of 4¾% (in real terms) which had been forecast in January 1968.[2] Moreover, he still expected that the rise in 1969/70 would be no more than 1% above the 1968/69 target. For 1970/71 an increase of 2% was planned, with an additional margin of 1% for contingencies. The Government were therefore confident of fulfilling their intention of holding the growth of public expenditure to an average of 3% per annum from 1967/68 to 1970/71.

In April the Government published a 'Green Paper' setting out proposals for the future presentation of public expenditure.[3] There are five main changes proposed, which, it is believed, will lead to more informed debate. First, plans would be shown for five years ahead, the last two in a tentative form. Second, the capital spending of the nationalised industries would be brought into the annual reviews. Next, the projected receipts of the public sector would be shown, as well as its planned outgoings. The fourth change would be to distinguish between expenditure which leads to a direct use of resources, expenditure which is by way of transfer payments, and expenditure which is for the purchase of existing assets. Finally, expenditure would continue to be shown at constant prices but allowance would be made for the likely increase in the real cost of purchasing labour for the public sector.

1 In 1950/51 the surplus was £313 million but the central government were lending only comparatively small amounts to the nationalised industries. And in 1962/63, when the Government repaid only £14 million of debt, they were making very few loans to local authorities, requiring them to raise their capital finance in the market other than in exceptional circumstances.

2 If payments of investment grants and regional employment premiums and refunds of selective employment tax are excluded, so that the comparison between 1967/68 and 1968/69 is not distorted, the forecast increase was 3¾% rather than 4¾%.

3 Cmnd.4017. The proposals are for consideration by the Select Committee on Procedure.

**The Budget**

The Chancellor proposed to raise some £270 million of net additional revenue in 1969/70 (about £340 million in a full year), the bulk of it through an increase of 28% in most rates of selective employment tax and a rise in the rate of corporation tax from 42½% to 45%. Among other tax changes, Customs and Excise duties on petrol and oils used as road fuels and on wines were increased and purchase tax was applied to a number of goods previously exempt, such as furnishing materials and household linen.

It is estimated that the tax measures, taken together with the natural growth of revenue on the one hand and some rise in the Government's expenditure on the other, will increase the central government's surplus (the amount available for the repayment or redemption of debt) from £273 million in 1968/69 to over £800 million. The public sector as a whole will also probably be in surplus in 1969/70; thus, despite the improvement forecast by the Government in the balance of payments, the private sector is likely to become a net borrower rather than a net lender, with a marked deterioration in the liquid position of companies.

The Government envisage that the Budget measures as a whole will, directly or indirectly, provide a brake on consumer demand. Taking the measures into account, the latest official economic forecasts are for a growth in domestic output of some £450 million (about 3%) in real terms[1] between the first half of 1969 and the first half of 1970. Over one fifth (£100 million) of these additional resources is expected to be absorbed by an improvement in the balance of payments, with exports of goods and services growing more rapidly (by 6%) than imports (3½%). Consumer spending is forecast as taking an additional £110 million or so – a growth of little more than 1% – while increases in private fixed investment and in public spending each account for a similar amount, growing by 6% and 2½% respectively. Output is expected to rise fairly slowly in the first half of 1969 and to accelerate thereafter.

In his Budget speech the Chancellor stated that the Government would legislate during the present Parliamentary session so as to implement some of the main provisions in the White Paper on industrial relations issued in January.[2] He also announced that the present statutory powers to delay pay awards and price increases on which the National Board for Prices and Incomes had reported would be allowed to expire at the end of 1969 – when the Government, under part two of the Prices and Incomes Act 1966, would once more confine themselves to deferring settlements which are referred to the Board for a maximum of three months. Retirement pensions would be raised in November; national insurance contributions would be increased by more than enough to provide for the extra benefits.

Among other measures announced by the Chancellor was a scheme for contractual savings; this is expected to start towards the end of 1969. Under the scheme savings will yield a return, in the form of a tax-free bonus, equivalent to about 12% per annum to a taxpayer at the standard rate

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*1* At 1958 prices.
*2* "In Place of Strife: a policy for Industrial Relations" (Cmnd.3888).

if he makes regular contributions over five years, or almost 13% if he does not encash his savings for a further two years. The contract will be limited to savings of up to £10 a month. The Chancellor also raised the limit on individual holdings of the current issue of national savings certificates from £1,000 to £1,500, and the limits on amounts deposited in ordinary and special investment accounts with the Post Office Savings Bank and with trustee savings banks from £5,000 to £10,000. A new issue of British savings bonds from 28th April bears interest at 7% instead of 6% as with the previous issue.

**Banks and discount houses**

Between their make-up dates in January and April, the *London clearing banks* reduced their advances, other than to the nationalised industries, by about £60 million, after seasonal adjustment. As noted in the last *Bulletin*, their advances rose sharply in the month to mid-February, making it unlikely that they could bring their restricted lending within the required ceiling (namely 98% of the mid-November 1967 figure) by mid-March. At this point, therefore, while the need for more time was accepted, they were reminded by the Chancellor of his determination that they should get within the ceiling without undue delay. The banks undertook to intensify their efforts, despite the difficulties. In the two months up to mid-April their total advances other than to the nationalised industries fell by some £110 million, after seasonal adjustment, and their restricted lending by more than this.

However, in the month to mid-May progress was sharply reversed: their advances rose by almost £160 million and though a large part of the increase was in lending to local authorities and other exempt categories, restricted lending increased substantially. Moreover, a sizable loss of funds by the banks in the month to mid-May led to a sharp reduction in their combined liquidity ratio – two of the banks falling below the required minimum ratio of 28%.

Between mid-January and mid-April the clearing banks' holdings of gilt-edged fell by nearly £200 million, reflecting the drain on their funds in an unusually severe revenue quarter. Although their Treasury bill holdings also fell sharply, the reduction in call money with the discount market was less marked.

Over these three months, net deposits with the clearing banks fell by some £85 million more than the seasonal expectation even though investors were reducing their holdings of gilt-edged: tax payments were much heavier than usual and bank lending to the private sector was falling at this time.

During the first calendar quarter, the *accepting houses, overseas banks and other banks* increased their sterling advances to the U.K. private sector but lent less in sterling to overseas residents. Their restricted lending fell, and collectively they remained some way below the ceiling set in November (102% of the total just before devaluation). Sterling acceptances – which are subject to a separate ceiling – were also reduced during the quarter and the banks were in aggregate within this ceiling too by the end of March.

The banks' more liquid sterling assets rose in total – loans to local authorities through the temporary money market increased substantially although call money declined – but their holdings of gilt-edged fell (by £47 million) from an already low figure.

Sterling deposits with these banks rose substantially during the quarter. Surprisingly, in view of the large central government surplus, domestic deposits (excluding those by other banks) rose by about £100 million, exceeding £2,000 million for the first time. And sterling certificates of deposit increased by more than £95 million, even though some of the early issues of this new instrument matured during the quarter; however, only £30 million of the increase was taken up outside the banking sector. On the other hand sterling deposits by overseas residents fell by some £20 million. Activity in the sterling inter-bank market continued to increase, against the normal seasonal trend: deposits by banks in this market rose by over £140 million.

Not unexpectedly, the *discount market's* borrowed funds declined over the quarter – by some £300 million – as banks withdrew call money to meet the run-down of customers' deposits resulting from the central government's very large revenue surplus. Most of the fall in the houses' assets was accounted for by Treasury bills, but they also further reduced their holdings of short-dated gilts.

**Bill markets**

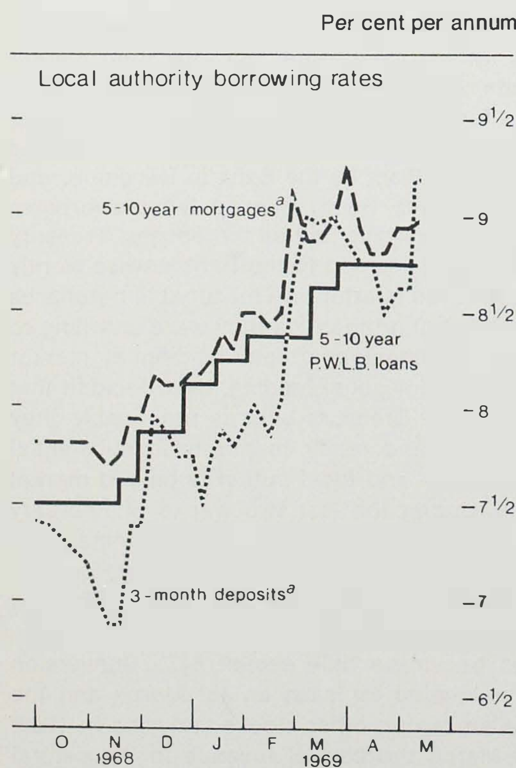
In February the seasonal flow of revenue to the central government was at its peak and the discount houses were short of funds on most days, despite the small number of Treasury bills offered at the weekly tenders and the large sums which accrued to the houses as the bills matured which had been sold to them by the Bank in December and early January. At first the Bank relieved these shortages wholly by buying Treasury bills; but as the houses' Treasury bill holdings dwindled, it seemed to the Bank unwise to rely for the rest of the revenue quarter on Treasury bill purchases alone to relieve market shortages. As they were unwilling to resume large and persistent overnight lending at market rates, and saw no need for penal lending, they decided that besides buying as many Treasury bills as practicable they would, exceptionally, stand ready to purchase substantial quantities of commercial and local authority bills at market rates. Accordingly, during the last two weeks of February and the first week of March, the Bank bought prime bank bills on several occasions. This did not, however, prevent the Treasury bill holdings of the banks and discount houses from becoming exceptionally low.

Conditions then became a little easier: 3½% Conversion Stock 1969 was redeemed for cash on 1st March and the authorities were also buying other stocks maturing in 1969; by the middle of March the flow of revenue to the central government was smaller and foreign exchange settlements were also, on balance, in the market's favour. During the second half of March and through most of April conditions varied from day to day with the Bank intervening – mostly on a moderate scale – in both directions. The average cost of

the houses' borrowed funds remained at around $6\frac{9}{16}$% until Bank rate was raised on 27th February, after which it rose to $7\frac{3}{8}$%. During March, as money taken for fixed periods fell due and was renewed at higher rates, the cost rose a little further; by the beginning of April it had reached $7\frac{7}{16}$%.

Until the rise in Bank rate the discount houses had seen more reason to reduce their tender rate than to increase it, but on 28th February they dropped their bid sufficiently to raise the rate by a full 1% – to a little over $7\frac{11}{16}$%. They also dropped their bids at the next two tenders in view of the unsettled conditions in foreign exchange markets and the disappointing trade figures for February, and by the middle of March the rate had risen to a little over $7\frac{13}{16}$%. As outside competition was not strong the houses generally secured enough bills during this period to begin to rebuild their portfolios, but towards the end of March a number of them who would shortly be making up their accounts became keen to secure more bills. The market therefore increased its bid, the tender rate easing to a little over $7\frac{3}{4}$%. By mid-April, however, the rate had edged up again to just under $7\frac{13}{16}$%, as the market became apprehensive about the continued rise in interest rates abroad.

During the period the houses still had difficulty in reducing their commercial bills to conform with credit restrictions. The clearing banks who were close to, or over, their ceilings on restricted lending (which includes commercial bills), preferred to cut their bill purchases from the houses rather than call in loans from their customers. After the increase in Bank rate, the houses raised their buying rate for three months' prime bank bills by 1%, to $8\frac{1}{4}$%-$8\frac{5}{16}$%, and by the middle of March the rate has risen to $8\frac{3}{8}$%-$8\frac{7}{16}$%. By this time the Bank had resumed their normal practice of making only limited purchases of commercial bills for sampling purposes.




*The cost of local authority borrowing went up very sharply between November and March.*

a Weekly, Fridays.

**Local authorities**

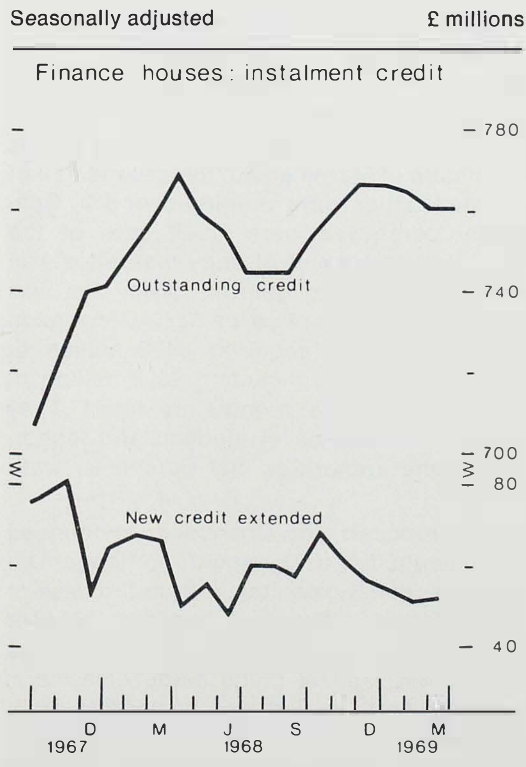
Although revenue is seasonally low during the three months under review, local authority borrowing from the Public Works Loan Board was substantially less than in the previous three – when there had been an acceleration of drawings after new rules governing access to quota loans had been introduced.[1] P.W.L.B. lending rates were raised on three occasions, so that borrowers who took the view that very high rates would not last would have become increasingly unwilling to commit themselves for long periods; this probably contributed to the falling away of drawings at the beginning of the new financial year.

Other forms of local authority borrowing also became more costly. Nevertheless, mortgages remained a relatively popular form of finance and some £70 million a month was probably raised in this fashion; mortgage rates, which were in the range $8\frac{3}{8}$%-$8\frac{5}{8}$% at the end of January, rose to more than 9% at the end of March but had eased to $8\frac{3}{4}$%-$8\frac{7}{8}$% by the middle of April. As noted earlier, local authority borrowing from the accepting houses, overseas banks and other banks – most of which is through the temporary money market – increased sharply in the first quarter. Rates for three months' deposits rose from just under 8% to 9% in

1 March *Bulletin*, page 14.

the middle of March, but they, too, fell back (to $8\frac{3}{4}\%$) in April. Rates for shorter-term money remained below the three months' rate throughout. Other bank borrowing by local authorities declined, possibly because overdraft rates were generally above temporary money rates during the latter part of March and in April.

The net amount raised by local authorities through marketable bonds in February was rather more than the average in the previous three months; but after the rise in Bank rate authorities were obliged to concede as much as $9\frac{3}{8}\%$ on one-year issues and there were net redemptions of bonds during March and April. High and still rising interest rates continued to hold back new stock issues.




*New credit extended by hire purchase finance houses fell between November (when terms control was tightened) and February. However, the total of debt outstanding did not turn down until January.*

**Hire purchase finance houses**

During January and February new credit extended by the finance houses fell sufficiently to reduce somewhat the total of debt outstanding; but there was little further change in March and by the end of the quarter the houses collectively, like the clearing banks, had not quite got down to their ceiling (98% of the figure at the end of October 1967). In February the Bank wrote to a number of the houses, asking them to report what measures they were taking to bring their lending down to the required level.

Although their financing requirements were now somewhat reduced, the general scarcity of funds obliged the houses to raise the interest rates which they offered for deposits. The rate for three months' deposits increased very sharply after the rise in Bank rate, and though it tended to ease in April – along with other short-term rates – it rose by about $\frac{3}{4}\%$ on balance over the three months, standing at $8\frac{3}{4}\%$-$8\frac{7}{8}\%$ at the end of April.

**Building societies**

In the closing months of 1968 the net receipts of the societies, after seasonal adjustment, had improved greatly, thanks mainly to the reduction in Bank rate in September and to the more uncertain course of equities. By the end of the year the societies' combined liquidity ratio had recovered to 15·7%, compared with little more than 15% three months earlier.

Even by December, however, the rising trend in competing interest rates had served to reduce the inflow of funds to the societies, and the position became worse in the new year as large amounts of revenue accrued to the central government. The increase in Bank rate at the end of February seemed bound to add to the societies' difficulties – a good many had begun to ration mortgages in face of the continuing heavy demand – and it was announced on 14th March that the recommended rate of interest paid to share investors would be raised from $4\frac{1}{2}\%$ (tax paid) to 5% from 1st April, while new mortgages would cost $8\frac{1}{2}\%$ instead of $7\frac{5}{8}\%$; existing borrowers would begin paying the new rate later in the year. The wider margin between the societies' borrowing and lending rates would go some way to offset increases in corporation tax, in selective employment tax and in the amount of income tax payable by the societies at the composite rate of tax – which would go up with the increased rate of interest.

For the financial year 1968/69 the composite rate was 6*s*. 5*d*. in the pound – an increase of 2*d*. over the previous year.

In March and April the inflow to the societies improved, but it was not clear how far the recovery would go, so long as the trend in other interest rates still seemed upwards. In his Budget statement the Chancellor said that he was ready to extend the tax reliefs which would be embodied in the new scheme for contractual savings to a similar scheme run by the building societies; the details of such a scheme remain to be worked out.

**Gilt-edged**

The upward pressure on interest rates continued throughout the period almost without interruption, as a result of tighter monetary conditions, renewed misgivings about the economy, continuing uncertainties about the international monetary system, and the rise in key international interest rates. The gilt-edged market reacted accordingly.

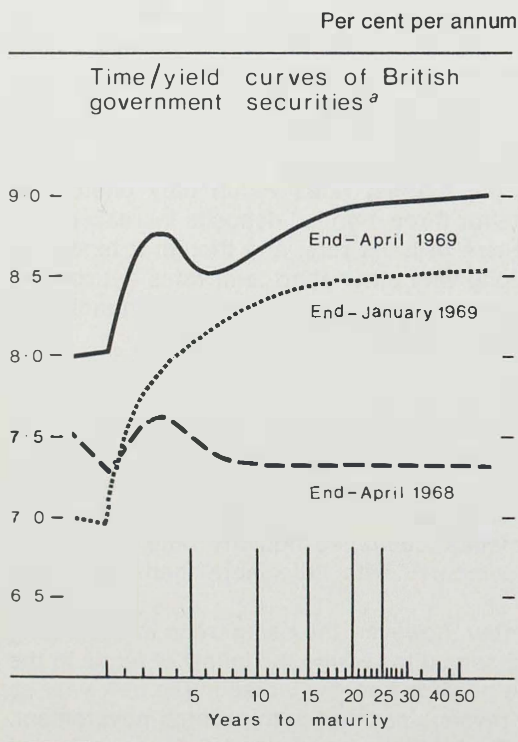
During the period the authorities generally allowed yields to rise: those on long and medium-dated stocks rose on balance by about ⅜%, and those on shorter-dated issues by still more. In the middle of March and in the second half of April some longer-dated issues were yielding over 9%. Consequently net official purchases were small save at the shorter end where a sizable amount of early maturities was taken in. During the first calendar quarter £53 million was paid to the market on the redemption of 3½% Conversion Stock 1969 and the authorities acquired £430 million of short-dated stocks in the market, including £303 million of stocks due to mature in twelve months or less.[1] They acquired no more than £23 million of medium and longer-dated stocks. In April the authorities' net purchases were small.

Among his Budget proposals, the Chancellor announced that disposals of gilt-edged stocks would no longer be chargeable to long-term capital gains tax, nor, in the case of companies, to corporation tax if the stock had been held for more than twelve months; as a corollary, realised losses could no longer be offset against gains made elsewhere. On the day after the Budget, trading was heavy and there were widespread price gains, some of as much as 2½ points, as dealers adjusted prices in the expectation that different classes of investors would rearrange their portfolios to take advantage of the new opportunities created by the tax concession. Stocks with low coupons and little or no 'neutral zone',[2] stood to gain most in yield from the measure and were much in demand. There was also some switching into gilts from company fixed interest securities and local authority stocks, neither of which benefit from the Chancellor's proposal. To ensure that the market adjusted as smoothly as possible to the changed conditions, the authorities made known before dealings started the yield basis on which they were prepared to deal in the tap stocks, moderate amounts of which were sold.

The rally did not long survive these initial readjustments;

Per cent per annum

Time/yield curves of British government securities[a]




a The lines begin at Bank rate and continue through the yield on 91-day Treasury bills to those on British government stocks.

1 See Table 3(1) of the annex.

2 The band between the lowest price of issue and the redemption price in which a stock could appreciate without attracting capital gains tax.

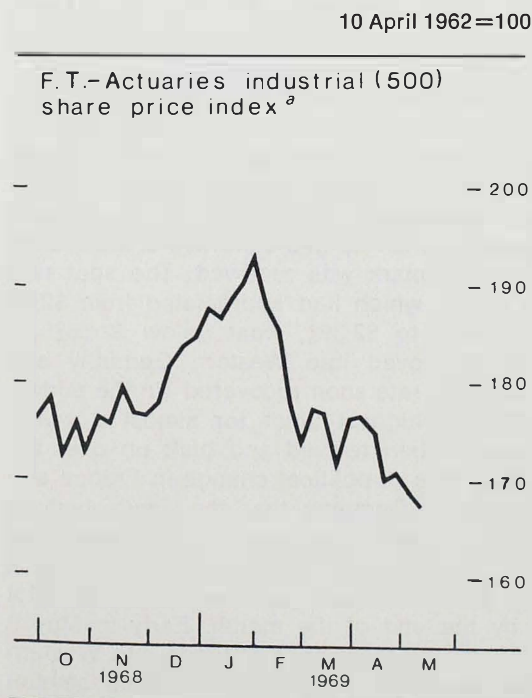
official sales dried up as the market reached the view that the Budget as a whole would do little directly to improve the balance of payments, and as fears of international currency instability were renewed. However, the authorities acquired relatively little stock, allowing yields on medium and longer-dated issues to rise. At the very end of the month the tone became a little better, partly because U.S. Treasury bill rates had fallen, and early in May the authorities were able to sell stock, mainly the shorter-dated issues.

**Equities and debentures**

At the end of January the F.T.-Actuaries industrial share price index stood at 193·7, having risen by almost 45% since sterling was devalued. This, however, proved to be the peak: in February prices fell and during the next two months the index generally fluctuated between 170 and 178. Take-over activity was considerably reduced and this accounted in part for the lower turnover in equities compared with the previous three months.

The fall in prices was in part a result of profit-taking, for shares acquired shortly after devaluation could be resold without liability to short-term capital gains tax, and there were no doubt many investors able to match realised gains on equities with losses on gilt-edged; but it seemed also that investors had paused to reassess prospects both for the economy and for companies. Subsequently, the tightening of credit and large tax payments, may, together, have obliged some investors to sell.

The Budget added to the market's weakness, partly because of a proposal that the interest on personal borrowing, other than for the purchase or improvement of land or buildings should cease to qualify for relief from income tax and surtax – which seemed bound to reduce equity buying – but also because companies were most directly affected by the increases in taxation. Despite some improvement in the latter part of April, the index stood no higher than 168·0 at the end of the month.




*From its peak at the end of January the share price index had fallen about 13% by the end of April.*

a Weekly, Fridays.

Yields on *debenture and loan stocks* continued to rise: according to the F.T.-Actuaries calculation[1] the redemption yield on 20-year debentures and loan stocks rose from a little below 9½% at the end of January to 10⅛% at the end of April; and in April first class industrial borrowers were obliged to offer as much as 9¾% on coupons of issues at par. Meanwhile, the margin between the calculated redemption yield on 20-year debenture and loan stocks and that on government stocks of a similar term widened over the three months from 1% to 1¼% – increasing particularly sharply after the Budget, as investors liable to capital gains tax moved out of company stocks into gilt-edged.[2]

There were fewer issues of ordinary shares than in the previous three months, but more of company fixed interest stocks – the latter included a large number of convertible debentures. Fixed interest issues in total were very large in

1 This calculation is based on representative stocks bearing various coupons, but giving a yield somewhat above that obtainable on high coupon stocks issued recently.

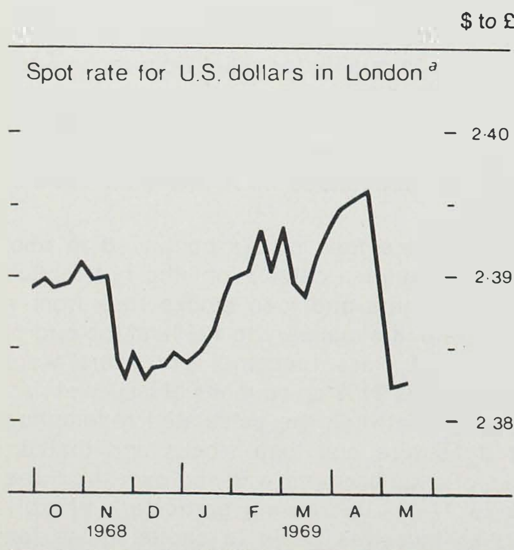
2 However, some groups of financial institutions which were not liable to capital gains tax sold gilt-edged and bought higher yielding company fixed interest securities instead.

February and still sizable in March. However, underwriters were on several occasions left with large lines of stock; seldom in recent years can the market have been as unready to assimilate new issues, despite the high yields offered.

**Foreign exchange and gold markets**

Sterling was quite buoyant for much of the three months under review and the Bank were able to take in a substantial amount of foreign exchange, most of which was used to repay medium and short-term debt rather than to increase the published total of reserves. Towards the end of April, however, spot and forward rates weakened as expectations of possible parity changes revived.

This was a seasonally favourable period for sterling, largely because the earnings of overseas sterling area countries were at a peak; moreover, some of these countries were increasing the sterling element of their reserves following the arrangements of September 1968 under which the United Kingdom guarantees the greater part of their officially held sterling balances. So far as the U.K. balance of payments was concerned, identified transactions continued in deficit, but this was outweighed by a large favourable balancing item, probably indicating some reversal of leads and lags on commercial payments from November 1968 and an inflow of other short-term funds. There is a more detailed discussion of the balance of payments below.




*Sterling remained fairly buoyant until speculation on changes in currency parities became intense at the end of April.*

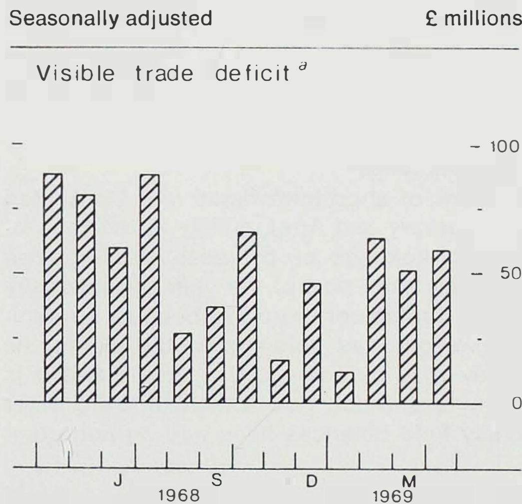
a Middle closing rate: weekly, Fridays.

However, though the pound was able to withstand some unfavourable developments such as industrial strikes or the persistant threat of them, as well as the adverse trade figures, the fragility of its recovery became apparent in early March, and more particularly at the end of April, when speculation on possible changes in the parities of the French franc and the Deutschemark was renewed. The spot rate against the U.S. dollar, which had appreciated from $2·39 at the end of January to $2·39⅝, went below $2·38¾ on 7th March as funds moved into Western Germany and Switzerland. Though the rate soon recovered (in the middle of April it touched its highest point for almost a year), currency uncertainties then revived and built up over the last week in April in face of political change in France and suggestions in Western Germany that the Deutschemark might be revalued as part of a general readjustment of currency parities. The strain on sterling was initially taken by the spot rate, which fell from just over $2·39½ on 21st April to $2·38½ by the end of the month. Early in May it dropped to $2·38¼, as the movement of funds into Western Germany became very large, and a considerable amount of support was necessary.

Forward sterling also reacted nervously to the re-emergence of speculation in foreign exchange markets. The cost of three months' cover, expressed as an annual rate, fell to 1⅞% before the increase in Bank rate on 27th February; but it went as high as 3⅞% at one point in early March and by the end of April had widened again to 5¾%, indicating that recovery of confidence had still a long way to go.

The gold market was fairly quiet, although the price was very firm throughout. Demand predictably increased in early March when the franc weakened – but otherwise remained

fairly modest even in late April and the first few days of May. The London free market fixing price rose from $42·50 per fine ounce at the beginning of February to $43·82½ on 10th March. It fell away thereafter, dropping to $42·85 at one point, but by the end of April had recovered to $43·60.




*The deficit on visible trade showed no improvement in the first quarter, nor in April.*

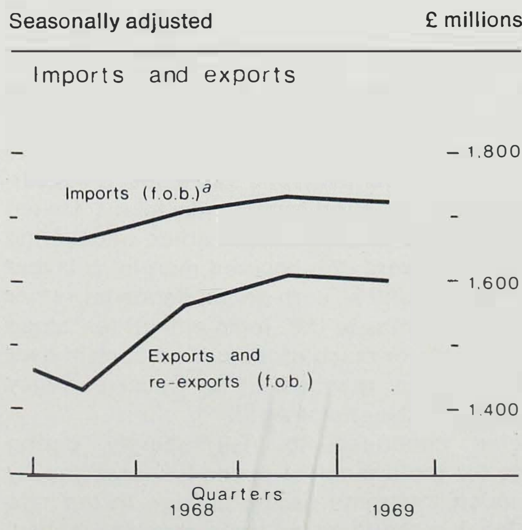
a Excluding deliveries of, and payments for, military aircraft and missiles purchased from the United States.

## Balance of payments

The balance of payments estimates for the first quarter of 1969 will be published soon after this *Bulletin*. The indications are that there was a substantial identified deficit on current and long-term capital account, after seasonal adjustment, though a smaller one than in the fourth quarter; the improvement was wholly in the invisible account. The balancing item seems to have been large and positive: among the unidentified receipts was, no doubt, a good deal of credit extended from overseas to companies in the United Kingdom to counter tight monetary conditions generally and to finance import deposits in particular; and, as suggested earlier, there may have been some unwinding of the leads and lags which built up in the previous quarter.

The deficit on visible trade, after seasonal adjustment, was the same as in the fourth quarter (£128 million), a small deficit in January giving way to much larger ones in the following two months. The value of imports, as recorded in the trade accounts and seasonally adjusted, was slightly less than in the fourth quarter, but this was probably due to delays caused by the strikes in U.S. east coast ports, which ended in February; the April figures provided evidence that these arrears were being cleared. It is difficult to determine how much effect import deposits have had in restraining imports; however, most categories of goods which are not subject to deposits have increased recently, while imports of finished goods, which are subject, have been lower.

Exports, too, after seasonal adjustment, were slightly lower in the first quarter – also probably as a result of the strikes in U.S. ports. However, there was little recovery in April, perhaps because any acceleration of shipments after U.S. ports reopened was cancelled out by the loss of exports through stoppages at Ford Motor Company plants in early March. At this stage the rising trend which had persisted since the early months of 1968 had clearly levelled out.




*Both imports and exports fell slightly in the first quarter, possibly as a result of the strikes in U.S. ports.*

a Excluding deliveries of, and payments for, military aircraft and missiles purchased from the United States.

The invisible account was probably in considerably larger surplus in the first quarter than in the fourth, but the long-term capital account deteriorated as a result of some large official payments, including an additional subscription to the International Development Association and a repayment to the Export-Import Bank of borrowing to finance purchases of military aircraft which have now been cancelled.

In his Budget speech the Chancellor announced that the programme of voluntary restraint of investment in certain overseas sterling area countries would generally continue. However, the standing request to financial institutions not to increase their portfolio holdings of foreign currency securities would be withdrawn – though such investment remains limited in total by the availability of investment currency, except where financed, with exchange control permission, by foreign currency borrowing. After the Budget the investment currency premium rose sharply, though it later fell back.

The official forecasts point to a substantial improvement in the balance of payments as between calendar years 1968 and 1969. The visible trade balance is expected to improve as the growth of exports is resumed and as imports are held down by the various measures to restrain home demand; the invisible surplus should benefit from an increase in oil companies' earnings and some reduction in Government overseas expenditure (other than debt service); and though the net outflow of official long-term capital will probably be greater than in 1968, overseas borrowing by the nationalised industries and local authorities is expected to help to redress the balance.[1]

**Movements of short-term funds**

There was a net inflow of short-term funds into the United Kingdom between February and April, mainly in the form of a rise in the sterling holdings of overseas sterling area countries, for whom the early part of the year is seasonally favourable. Since last September there has been an appreciable increase in these countries' holdings (in the six months ended in March they rose by some £250 million) and it is clear that the guarantees which now attach to the greater part of their officially held balances have had an important stabilising effect.

During the three months under review there was a slight fall, on balance, in the net sterling holdings of countries outside the sterling area, if the counterpart of drawings on central bank facilities is excluded: their balances had already been substantially reduced and did not decline much further, but sterling claims upon them by U.K. banks continued to rise, suggesting that more export credit was being extended.

The net external position in foreign currencies of banks in the United Kingdom changed in the first calendar quarter from a liability of £22 million to a claim of £21 million: in gross terms, claims rose by £1,105 million while liabilities increased by £1,062 million: the banks switched foreign currency deposits into sterling during January but switched funds out of sterling in March. There was probably some further, though small, switch out of sterling in April. The normal interest arbitrage comparisons remained unfavourable to the employment of short-term funds in the United Kingdom mainly owing to the cost, noted earlier, of covering investment in sterling forward; the covered margin in favour of investment in three months' euro-dollar deposits, rather than in loans for three months to U.K. local authorities, stood at the equivalent of 2½% for much of the period; it went over 3% in early March, and reached 5¾% when currency speculation developed at the end of April.

Euro-dollar rates continued to rise sharply during February, the rate for three months' deposits increasing by just over ¾% – much the same as the change in the rate offered by U.K. local authorities for three months' money. In March euro-dollar rates rose only marginally; and they

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1 H.M. Government have decided that the nationalised industries, and in certain cases local authorities, should be encouraged to raise medium and long-term finance in overseas capital markets. The Treasury will be prepared to make special arrangements, where appropriate, to relieve the borrowers of the exchange risks. In March the Gas Council issued bearer bonds in Western Germany totalling DM 300 million – two thirds through a public issue, the rest by private placing. This borrowing will affect the balance of payments figures for the second quarter.

declined in the early part of April, hardening, however, at the end of the month. Throughout much of the period U.S. banks were bidding strongly for funds through their branches in London, and several Western European countries – who have been the market's main source of funds – were taking measures to discourage short-term outflows.

**Reserves and special facilities**

In the first quarter of 1969 the United Kingdom's official gold and convertible currency reserves increased by the equivalent of £20 million, having fallen by £123 million in the previous quarter; the rise in reserves was after repayments of medium-term assistance totalling the equivalent of £168 million – £141 million to the International Monetary Fund and Switzerland[1] and £27 million (in three monthly instalments) to the Bank for International Settlements.

There was a net reduction during the quarter of the outstanding short-term assistance taken by the United Kingdom under special facilities: $50 million (£21 million) was repaid of the Federal Reserve $2,000 million reciprocal swap facility – leaving $1,100 million still outstanding; and some repayment was made of other short-term facilities. Part of the amount that had been drawn under the $2,000 million medium-term facility agreed at Basle in September 1968 was also repaid – because of the increase in the sterling balances of sterling area countries during the fourth quarter of 1968.

**Conclusion**

Over the months ahead companies face considerably increased pressures on their liquid assets and on their access to credit: the financial stringency which was already in prospect before the Budget will be intensified by the larger surplus of the public sector now envisaged. It remains to be seen how companies will react.

They are unlikely to find outside funds readily available. The banks offer little scope, for the clearing banks are collectively in excess of the required ceiling on their restricted lending and will be making strenuous efforts to reduce their advances. Nor, to judge from the recent behaviour of the capital market, will that be a ready source of finance for the time being. If companies react by cutting back or postponing part of the planned increase in fixed investment – which, indeed, the prospect of more sluggish home demand might induce them to do – or by raising their prices, the outlook for total demand could become distinctly less buoyant. And though a rise in prices would reinforce present measures to curb consumer spending, it might also have undesirable repercussions on the further expansion of exports.

There are other uncertainties, notably the trends in exports and in consumer spending. The rise in exports has recently levelled out and it is not clear how far this is due to the strikes a few months ago in U.S. ports, and how far it reflects inadequacies of productive capacity. Reports of capacity shortages persist, but the position will no doubt

1 £83 million was repaid to the I.M.F. in February and £7 million to Switzerland, being the third of eight repayments of the United Kingdom's drawings in May 1965. The balance of £51 million repaid to the I.M.F. (in March) was in respect of the drawing in 1966 to finance the United Kingdom's increased gold subscription to the Fund.

become easier in some cases as the measures which were taken last November have more effect. The trend of export orders looks to be satisfactory – particularly in certain industries where longer production periods have hitherto concealed any benefits from devaluation – and there is little evidence that the United Kingdom has recently suffered a loss of competitiveness.

Consumer spending appears to have been sharply reduced in the early part of this year and there is the prospect that prices will rise in the second half, thus damping down the volume of spending. Nevertheless, the danger of still faster rises in money incomes is strong – particularly as official powers to delay settlements are to be diminished – and this could lead to a revival of spending, so that it claims a larger share of productive capacity than is tolerable or draws in additional imports.

The balance of payments recovery has still a long way to go. Recently, the revival of speculative movements across the foreign exchanges has shown that sterling, though stronger, continues to be little more than convalescent. Confidence is unlikely to strengthen until there are signs that the United Kingdom is moving faster than at present towards an acceptable external surplus.

Meanwhile, the problems which have given rise to speculation may not quickly be resolved, and, with the prospect of an unsettled period in foreign exchange markets, it is essential that policy manifestly continues to give priority to obtaining the necessary improvement in the balance of payments.