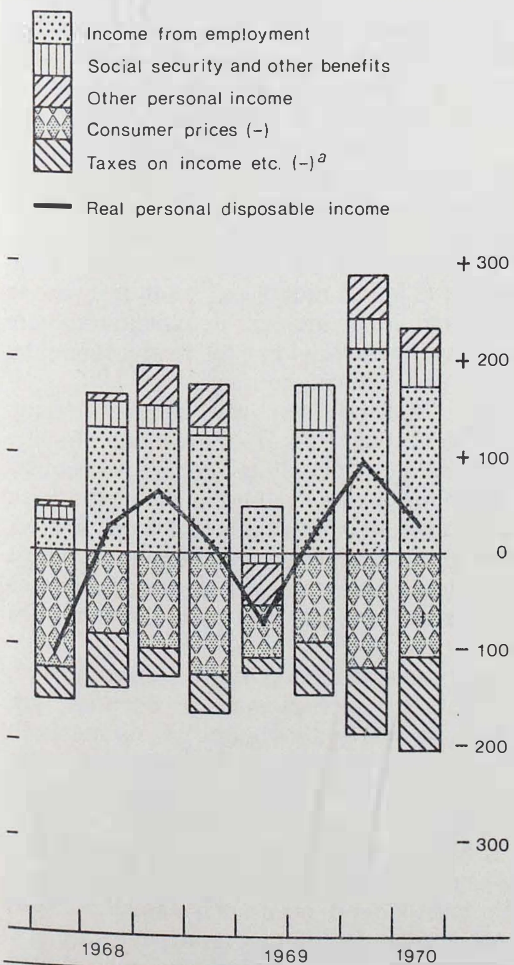
Commentary

In the main, this Commentary reviews developments in the three months from May to July. Up to the middle of the year, the economy seems to have been growing only slowly, while industrial costs and prices were increasing very fast; consumers' expenditure began to rise appreciably in the June quarter, however. There was an appreciable increase in domestic credit and in the money supply in those three months; but industrial and commercial companies again raised very little capital by way of new issues, and in July redemptions outweighed new issues. The balance of payments surplus on current account was rather modest in the June quarter, but there were further repayments of overseas debt; and sterling stood up reasonably well to the dock strike in July.

Seasonally adjusted £ millions

Changes in spending power

attributable to:



Large increases in personal incomes in the six months to last March outweighed increased tax payments and higher prices . . .

a U.K. taxes on income, transfers abroad (net) and taxes paid abroad, national insurance and health contributions.

The domestic economy

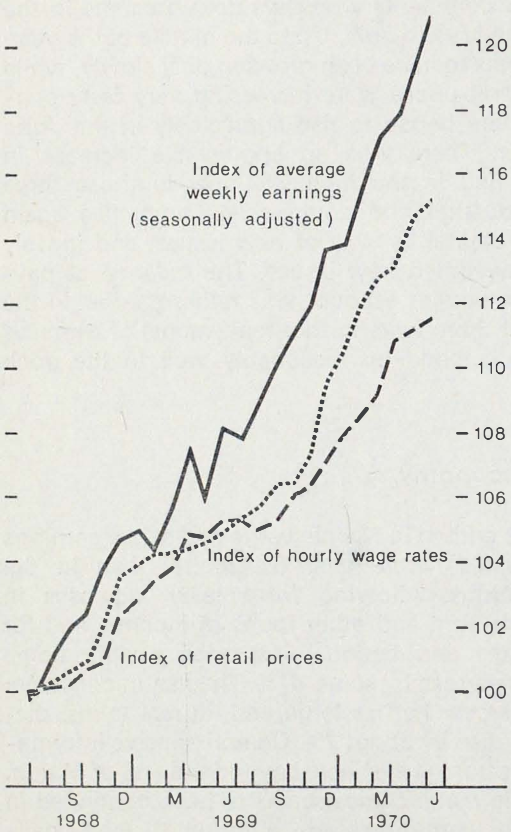
In the six months ending in March, wage and salary earnings (seasonally adjusted) were over 5% higher than in the previous six months. Allowing for smaller increases in interest, dividends, rent and other forms of income, and for payments of taxes and national insurance contributions, disposable incomes rose by some $4\frac{1}{2}$%. The rise in consumer prices was rather over half as large and, in real terms, disposable incomes rose by about 2%. Comprehensive information in this form is not yet available beyond the end of March, but the increase in real incomes seems to have continued in the second quarter. Earnings rose by a further 3% (seasonally adjusted) in this period and, although prices were also rising quickly, they probably increased less than earnings.[1] The indications are that earnings and prices again rose sharply in July. The pace of these recent increases can be judged from the fact that, over the twelve months to June, earnings rose by about 12% and retail prices by nearly 6%; both increases were about double the annual rate in the last ten years.

The growth in real incomes since last autumn was not at first reflected in a corresponding rise in consumer spending. The inference is that the additional income was, for a time, saved (or used to repay debt); part may, for example, have been lent to building societies, whose receipts have been rising strongly. In the second quarter, however, it seems that rising incomes began to encourage a marked growth in personal consumption. Preliminary estimates indicate that consumers' expenditure in this period may have risen quite quickly, perhaps by about 1%. Little is yet known about developments since June, but reports suggest that retail sales have remained high; and there was a sharp increase in the number of new cars registered in July.

1 The rise of $2\frac{1}{2}$% in the index of retail prices between the first and second quarters is not seasonally adjusted; as there seem to have been some seasonal increases, the underlying movement was probably rather smaller.

July 1968 = 100

Wages, earnings and prices



. . . and in the June quarter too, earnings rose rather faster than prices.

There are few indications as yet that other forms ot demand increased in the second quarter although there may have been some additions to stocks, which were unchanged in the early months of the year. The volume of exports was slightly lower than in the first quarter. Home engineering orders and deliveries do not suggest any marked upturn in fixed investment by private manufacturing industry which, in the first quarter, was about the same as in the second half of last year A survey of manufacturers' investment intentions published by the Ministry of Technology in May suggested that industrialists' views had not changed greatly since an earlier survey taken at the end of last year, when companies had been expecting to increase the volume of their investment by about 10% this year compared with 1969.[1] But this would require some acceleration in investment from the second quarter onwards, after a period of broad stability since the middle of last year, and the Ministry have expressed doubts about these findings. A survey of industrial trends taken by the Confederation of British Industry in June showed that about half the firms surveyed were already working below capacity, and that – as in January – rather more firms were expecting to reduce than to increase their expenditure on plant and machinery over the next twelve months. The Engineering Employers Federation judged, on the basis of surveys conducted in May and June, that capital expenditure authorised this year by member firms may at best be very little larger than last year and that, if recent trends continue, there could be some fall in investment in the medium-term. The distributive and service industries and shipping companies reported to the Board of Trade that, on balance, they intended to invest broadly as much this year as last. This again would require an increase in expenditure from the second quarter onwards, following a fall in investment by these industries in the previous six months.

Investment in new housing has been generally falling since the middle of 1968, but there are indications of some recent improvement, perhaps reflecting the steady recovery in building society lending since the beginning of the year. In the three months to July, the amount of work started, and the number of houses completed, had recovered almost to the levels in the middle of last year; and more work was under construction at the end of July than three months previously.

In total, demand probably increased in the second quarter, after falling in the first. But such increase as occurred was accompanied by a strong rise in the volume of imports, both of industrial materials and of finished manufactures. This suggests that there was probably little change in domestic output, and the available indicators point to the same conclusion. A slow rise in the index of industrial production between October and March was checked in the second quarter, when there may, indeed, have been a small decline; and, within the total, manufacturing output followed the same pattern. Similarly, the numbers wholly unemployed

1 If a fall in investment in the first quarter of last year is roughly adjusted to allow for projects which had been accelerated in order to qualify for the higher investment grants ruling until the end of 1968, the increase expected this year over last becomes about 7½%.

(excluding school-leavers and others temporarily out of work) rose sharply in the month to mid-July, after adjustment for seasonal influences, having previously changed little since the beginning of the year. The Department of Employment and Productivity suggested that this sudden increase might in part have been caused by an abnormal number of students registering as unemployed before taking up work either for the holidays or permanently. There was no further change to mid-August, when the figure stood at 593,000, or rather over $2\frac{1}{2}$% of all employees. Notified vacancies for adult workers fell gradually over the first eight months of the year.

There was a very significant increase in the number of working days lost as a result of industrial disputes in the first seven months of this year. These losses had already risen quite sharply in 1968 and 1969, and last year's total of $6\frac{3}{4}$ million was the highest since 1957. During the first seven months of this year, 6 million working days were lost, or nearly double the already high figure in the same period of last year. These totals measure only days lost in the plants in which stoppages occur, and do not include workers laid off in other works because of the disruption of supplies. However, some of the production lost in the course of disputes is made good by subsequent overtime working. The stoppages in the first half of the year were spread among a wide range of industries, especially engineering (including manufacturers of car components). Disruption of domestic supplies probably contributed to a sharp increase in the second quarter of the year in the share of the new car market which was met from imported cars.

All in all, the expansion of output envisaged at the time of the Budget has been slow to appear, but there are prospects of some resumed growth before very long.

Balance of payments

There has been an important change in the official presentation of the balance of payments accounts. The current account remains as before, but most of the items previously included as 'monetary' have been grouped with those included as 'long-term capital transactions' under a new heading 'investment and other capital flows'. These, together with the current balance and the unidentified movements which give rise to the 'balancing item', provide a total of currency flows affecting official financing.[1] (Under the new

1 The new presentation is intended to take account of developments, since the concept of the 'basic balance' was introduced in 1959, which have made the previous distinctions between long-term and short-term transactions, and between transactions requiring finance and the related financing, seem increasingly unrealistic and arbitrary. For example, the movements of funds across intra-company accounts – which have been large in recent quarters – were, under the old presentation, included in the long-term capital account (as part of direct investment) although the term of these arrangements must vary from one company to another. Again, growing amounts of medium and long-term trade credit were grouped (with other banking items) among short-term ('monetary') movements. The inclusion of intra-company flows in the long-term capital account also illustrates the difficulty of distinguishing between transactions and the related financing, for many of these flows presumably fell into the latter category. On the other hand, some monetary movements required financing themselves – for example, fluctuations in balances because of changes in interest rates or confidence. These questions were discussed more fully in the March 1970 issue of *Economic Trends*. The new presentation is described in the *United Kingdom Balance of Payments 1970* (H.M.S.O., September 1970), and is summarised in Table 18 of the statistical annex.

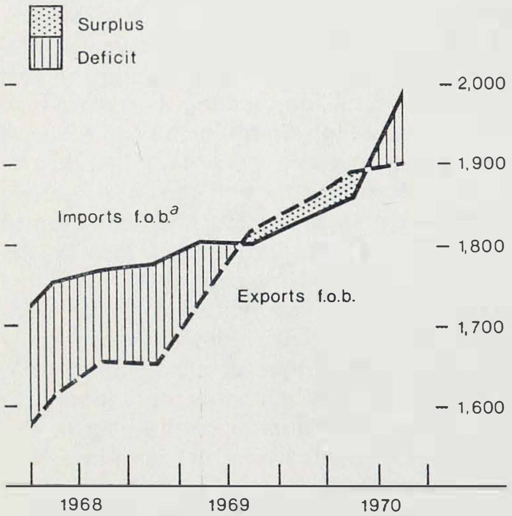
presentation, changes in sterling balances of non-sterling countries are divided between 'official financing' and 'investment and other capital flows' according to whether they represent the sterling counterpart of swap assistance or other movements.)

The current balance remained in surplus during the second quarter, although the surplus was the smallest for over a year. The favourable balance on visible trade since last summer was replaced by a deficit of over £80 million, but invisible earnings recovered somewhat after the set-back in the first quarter.

About one third of the trade deficit was attributable to the delivery of three Boeing 747 aircraft, which are being financed by long-term borrowing (in 'investment and other capital flows') and so did not directly affect the reserves during the quarter. But the value of other imports rose very sharply, by about 5%, mainly because of an increase in volume. There were larger arrivals both of industrial materials, especially steel and other metals, and of machinery and other finished manufactures. The Government announced on 22nd July that the rate of import deposits would be reduced from 30% to 20% as from 1st September, and that deposits would no longer be payable after 4th December, at the end of the scheme's second year. Exports continued to rise in the second quarter, but the increase was less than 1% and was entirely attributable to higher prices; the volume of shipments fell slightly. Sales to West European countries continued to rise, and those to overseas sterling countries were also higher, but there was another sharp fall in shipments to North America following a brief recovery in the first quarter.

Seasonally adjusted £ millions

Balance of U.K. visible trade



Imports rose sharply in the June quarter, and visible trade moved back into deficit.

a Including payments for military aircraft and missiles purchased from the United States.

The trade figures for July were heavily distorted by the U.K. dock strike which lasted from the middle of that month until 2nd August, and those for August will also have been badly affected. Quite apart from the interruption to the movement of goods while the strike lasted, and the subsequent clearance of the backlog, stoppages have a different impact on the recorded figures of exports and imports in the month in which they occur.[1] On this occasion, the effect was to make the trade balance for July much more favourable than it would otherwise have been, and the balance for August is likely to be severely distorted in the opposite direction. It is improbable that even a rough indication of the trend of overseas trade will emerge until the early autumn.

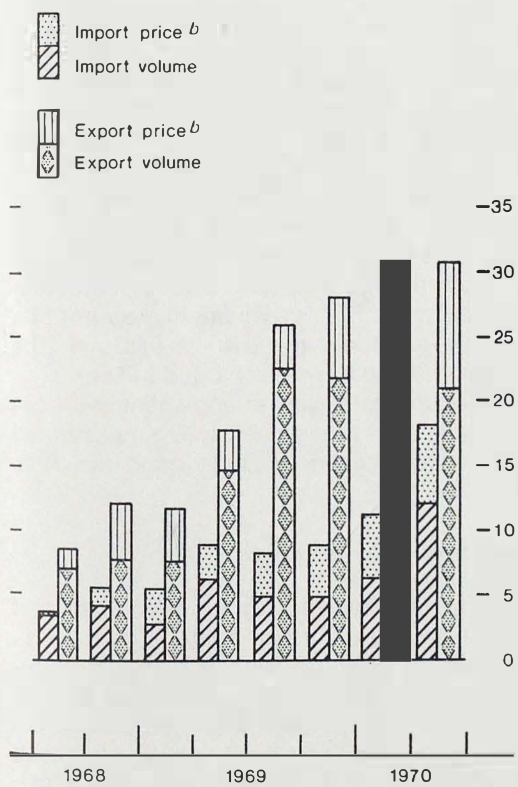
As well as the current surplus, there was a substantial net inflow of investment and other capital funds in the second quarter, although it was very much smaller than the exceptional inflow between January and March. Private investment transactions contributed to the net inflow in the June quarter. Overseas direct investment in U.K. concerns was smaller than in the previous three months, because the large

1 This is because the receipt of import documents is fairly closely related to the movement of goods to which they refer, whereas export documents are normally presented after shipment, with a time lag between then and their inclusion in the figures which may on average be about two weeks. Thus the interruption in trade during the second half of July was quickly reflected in the import figures for that month, whereas the corresponding export figures were probably not greatly affected; the main impact on the export figures is likely to appear in the total for August, when imports will be reflecting the resumption in trade.

Seasonally adjusted

Cumulative changes per cent since 1968 second quarter

Value and volume of overseas trade [a]



Although exports in the June quarter were worth some 30% more than two years ago, recent growth has depended entirely on higher prices. Imports, however, have been rising in volume too.

a Imports c.i.f., including deliveries of military aircraft and missiles purchased from the United States.

b Derived from value figures and volume indices, ignoring any small discrepancies in coverage.

inward movement of funds recorded over intra-company accounts to ease liquidity shortages in the first quarter did not continue. But U.K. portfolio investment in overseas securities fell away, reflecting the renewed weakness in overseas stock markets; and U.K. companies increased their borrowing abroad, both for use in the United Kingdom and to finance overseas investment. There was some outflow of official capital, and a large amount of export credit was extended. On the other hand, overseas sterling countries added a further £170 million to their gross sterling holdings, reflecting favourable seasonal influences on the balance of payments position of these countries taken as a group; during this quarter, their holdings reached a new peak. Non-sterling countries' holdings (excluding the counterpart of swap assistance) were not greatly changed in the second quarter and, though larger than throughout last year, were still modest by most earlier standards.

In addition to these movements, banks in the United Kingdom had a larger amount of their foreign currency assets converted into sterling at the end of June than at the end of March. Although this represented a switch into sterling during the quarter, the inflow was temporary; it occurred mainly in the latter part of June and was reversed early in July. The usual covered interest comparisons with euro-dollars were, in fact, unfavourable to sterling throughout the period. Over and above the borrowing abroad already noted, some U.K. companies which had exchange control permission to do so borrowed sizable amounts of euro-dollars from banks in London for conversion into sterling in the second quarter, in order to use the proceeds in the United Kingdom.[1] Such borrowing was comparatively rare in the past, but increased during the first half of this year, when it was no doubt encouraged by pressures on company liquidity and the high cost of borrowing on U.K. capital markets.

The unrecorded receipts which had given rise to the exceptionally large favourable balancing item in the estimates for the previous six months did not continue in the June quarter. Taken together, the recorded surplus on current transactions and the identified capital inflows broadly accounted for the total of £227 million which became available during the quarter to reduce outstanding borrowing on special facilities or to add to the offical reserves. This followed an inflow of some £1,350 million over the previous six months, before including the £171 million received at the beginning of January as the first allocation of I.M.F. Special Drawing Rights.

Reserves and special facilities

The accruals in the second quarter were again used mainly to reduce outstanding borrowing on special facilities. £193 million was used in this way, so that the reserves rose by £34 million, to a total of £1,163 million at the end of June.

1 This is in addition to euro-dollar borrowing of some £30 million by companies in order to finance investment abroad.

The reduction in borrowing was made up as follows:

£ millions

	Outstanding drawings on: I.M.F.	Central bank and related facilities	Total
End-March 1970	1,000	654	1,654
End-June 1970	992	469	1,461
Reduction in June quarter	8	185	193
$ millions equivalent	*19*	*444*	*463*

Repayments on the outstanding drawings from the I.M.F. are not due to begin until June 1971. The reduction of £8 million ($19 million) in these liabilities in the second quarter occurred as a result of the Fund's use of sterling in transactions with other countries in May. The repayment of other facilities included £31 million ($75 million) as the fifth of eight quarterly instalments on the Basle arrangements of June 1966, which had been arranged to finance fluctuations in the sterling balances.[1] This instalment was not due until September, but was repaid in advance in June (the repayment due in June having been discharged in February). The $2,000 million reciprocal swap arrangement with the Federal Reserve System, which had been fully reconstituted by the end of February, remained unused during the June quarter.

Foreign exchange and gold markets

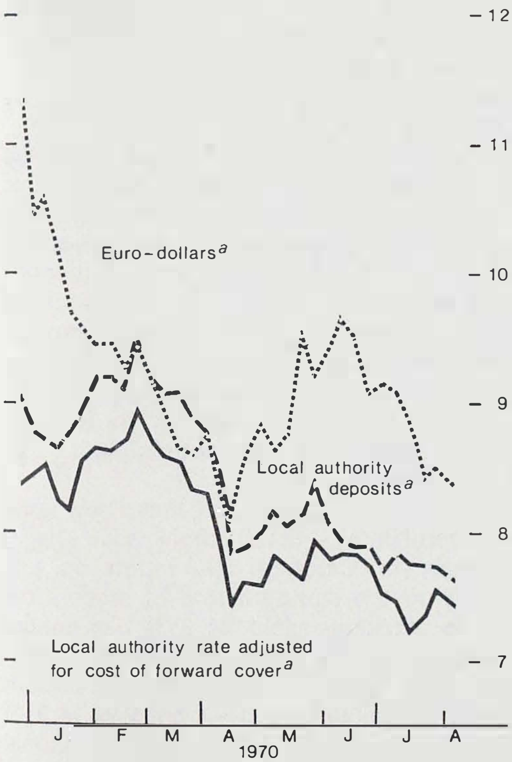
Most of the inflow into the reserves in the second quarter occurred in April. There were further gains, especially in June, but sterling had to contend with a number of unfavourable factors at times during the period from May to July. In these circumstances the spot rate was allowed to fall from about $2·40\frac{5}{8}$ at the end of April to a low point of $2·38\frac{7}{8}$, before it rose at the end of July to about $2·39\frac{1}{8}$. There was, however, a further, and more pronounced, fall in August.

Fluctuations in the demand for euro-dollars were the most important single influence on sterling between May and July. For most of the period there was a persistent and fairly heavy demand from West European countries, especially Western Germany and Italy; and in June, some Continental holders withdrew funds from the euro-dollar market for balance sheet purposes over the end of the half year. There was also some borrowing for conversion into deutschemarks to take advantage of the very high short-term interest rates in Western Germany; and, at times, speculative borrowing for conversion into deutschemarks and other currencies. This renewed speculation about exchange rates followed the announcement on 31st May that the Canadian authorities had decided to suspend their official buying and selling rates for the Canadian dollar, which would henceforth be allowed to find its own level in the exchange markets. Although U.S. banks were not, on balance, the largest borrowers of euro-dollars during these three months, their changing requirements were an important influence on the

1 See September 1966 *Bulletin*, page 209.

Per cent per annum

Short-term interest rates in London



Euro-dollar rates rose sharply from April until the middle of June; they then eased over the period to the end of July, but remained appreciably higher than comparable domestic rates, even without allowing for the cost of forward cover.

a Rate on 3 months' deposits; weekly, Fridays.

course of the market. Their increased borrowing to meet domestic demands for funds in mid-May and mid-June reinforced Continental demand and intensified the movement in rates. By the middle of June, the three months' rate had risen from nearly $8\frac{3}{4}$% at the end of April to nearly $9\frac{3}{4}$%. After 24th June, however, when the Federal Reserve Board modified their regulations governing the rates which U.S. banks can pay on deposits,[7] these banks repaid large amounts of euro-dollar borrowing; and the repayments continued in July. Rates fell by $\frac{1}{2}$% initially, but then levelled off before falling fairly steadily from early July onwards.

The rise in euro-dollar rates to mid-June was not matched by comparable U.K. rates. Although the cost of forward cover fell, as operators converted sterling into dollars to invest in the euro-dollar market and covered themselves by buying sterling forward, covered comparisons became markedly unfavourable to sterling. One month forward sterling was at a premium for almost the whole of June. There was also an occasional premium on three months' sterling for the first time since 1963; the premium momentarily rose to rather over $\frac{9}{16}$% per annum at one point early in July, before disappearing as euro-dollars became more plentiful.

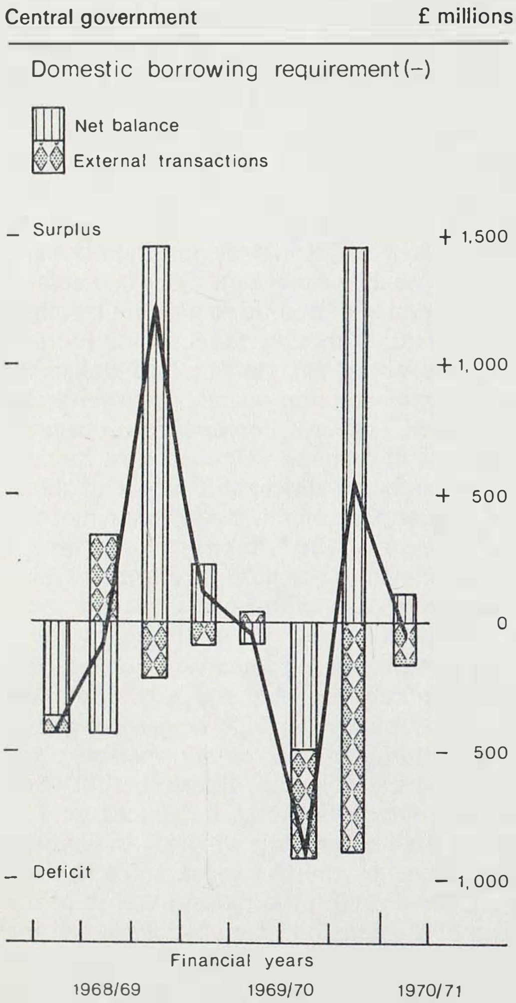
The pattern of short-term interest rates was not the only factor adverse to sterling between May and July. Sentiment was affected at times by rapidly rising U.K. wages and prices, fluctuations in the gilt-edged and equity markets, and disappointment with the trade figures; the general election was another unsettling factor. Seasonal influences tend to become unfavourable after the middle of the year and the market was also disturbed by the U.K. dock strike in July. But sterling was sheltered during the closing weeks of the period by the easing of the demand for euro-dollars, and the weaker tendency for U.S. dollars; the $\frac{1}{2}$% reduction in the West German discount rate announced on 15th July was also helpful. The settlement of the dock strike at the end of the month encouraged substantial buying of sterling at this time, particularly by overseas oil companies with royalty and tax payments to make to producing countries.

Prices in the London gold market were fairly firm early in May, approaching $\$36\frac{1}{4}$ per fine ounce at one point. But steady sales by producing countries and a seasonal weakening of demand brought the price down to about $\$35\frac{1}{4}$. There was a temporary recovery early in June as a result of the widespread discussion of inflationary trends following the publication of the annual report of the Bank for International Settlements. Thereafter, however, the price reverted to $\$35\frac{1}{4}$, and it stayed in this region, in generally quiet conditions, over the remainder of the period to the end of July.

Central government financing

The central government's net balance was in surplus by just over £100 million during the June quarter. There was also a

7 The Board suspended the limitation on rates which the banks can pay on 30 to 89-day time deposits and certificates of deposit in denominations of $100,000 and over.



Although the central government was again in surplus in the June quarter, the continued inflow from abroad resulted in a small borrowing requirement . . .

surplus in this period last year, but it is nevertheless a very unusual occurrence in the first quarter of a financial year. The favourable balance would have been larger this year than last had it not been for import deposits, which are no longer resulting in net payments to the Exchequer. Otherwise, revenue increased much more steeply than expenditure between the two years. Lending to local authorities and nationalised industries increased, but the amount taken by the latter was, as last year, quite small.

Because of the continued inflow of foreign exchange during the quarter, the sterling cost of external transactions was larger than the Exchequer surplus, so that some £50 million of domestic borrowing was needed. The gilt-edged market was weak for much of the quarter and the authorities purchased large amounts of stock from the discount houses, banks, and other domestic holders. There were also further withdrawals from national savings; and seasonal increases in the public's holdings of tax reserve certificates and of notes and coin were by no means sufficient to offset these movements. The banking sector was thus required to take up £225 million of Treasury bills.

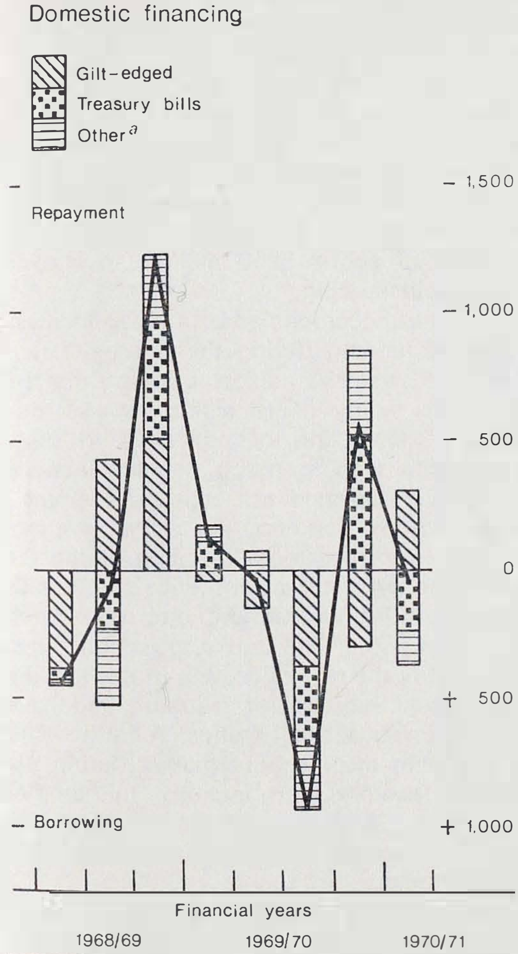
It was announced towards the end of July that a new issue of national savings certificates – the Decimal Issue – is to become available early in October. The return on this issue to a holder paying the standard rate of income tax will be equivalent to a taxable yield of $9\frac{3}{4}\%$ per annum if certificates are held for the full four years, compared with the return of about $7\frac{3}{4}\%$ over five years on the present (twelfth) issue. There is also to be a rise from $2\frac{1}{2}\%$ to $3\frac{1}{2}\%$ in the interest paid on ordinary accounts at the National Savings Bank from 1st January next, and the same increase on deposits in the ordinary departments of trustee savings banks from 21st November. This is the first increase in the rate of interest paid on these accounts since the Post Office Savings Bank was established in 1861.

Banks and discount houses

The banking sector's sterling advances and deposits both rose sharply in the June quarter. The increase in lending was in part associated with companies' reluctance to raise funds by way of new capital issues during this period, as described later in the Commentary. Additions to deposits, though no doubt mainly the accompaniment of the rise in lending, will also have reflected the public's net sales of gilt-edged stocks, in place of earlier substantial purchases. The inflow of funds from abroad and tax payments to the Exchequer were both much smaller than in the previous quarter, and their influence on deposits must have been correspondingly less.

Advances by the *London clearing banks*, other than lending to nationalised industries, rose by £210 million (seasonally adjusted) between mid-April and mid-July. The rise in restricted lending, which includes holdings of commercial bills, was even larger. Part of this rise in restricted business was attributable to a marked recovery

Central government £ millions



... which was financed largely through the take-up of Treasury bills by the banks.

a Net indebtedness to Bank of England, Banking Department; notes and coin in circulation; non-marketable debt.

in personal lending (leaving aside 'bridging' loans in connection with house purchases); until mid-April, the total of such lending had changed little for several months, following a fall in the latter part of last year. Nevertheless, restricted lending was, up to mid-June, growing at a rate which was broadly consistent with the guidance which the banks had been asked to observe in April – a gradual increase of not more than about 5% over the twelve months to mid-March 1971.[1] In the month to mid-July, however, restricted lending rose very sharply, and it was clear that the degree of restraint which had been requested would not be achieved if lending continued to increase at that rate. The Bank therefore reminded the clearing banks – and the Scottish banks whose lending had also risen quite sharply in the month to mid-July – that the request to restrain their lending remained in force. The banks were asked to take all possible steps to reduce the rate of growth in their lending in the months immediately ahead, and to continue to press their customers to arrange long-term funding of their indebtedness where appropriate. The Bank's notice is reproduced on page 327.

Among their other lending, the clearing banks' advances to local authorities had begun to fall in the month to mid-April. They continued to do so until the middle of June, by which time the amount remaining outstanding was unusually small; there was little further change in the following month. A reduction in temporary money rates encouraged local authorities to borrow heavily from the accepting houses, overseas and other banks during much of this period and, together with a seasonal increase in revenues, made them less dependent on their clearing bank facilities.

The clearing banks sold about £30 million of gilt-edged stocks over the three months to mid-July. Holdings of liquid assets were substantially reduced in May, when the additional £50 million of Special Deposits which the Bank had called for at the time of the Budget became payable. The fall was reversed over the next two months, but there were some sizable changes in the composition of liquid assets over the period as a whole: a large fall in the amount of call money lent to the discount market and (more particularly) to other borrowers was offset by a seasonal rise in cash holdings and by an increase in commercial bills.

Net deposits with the clearing banks rose steeply – by almost £200 million after seasonal adjustment – over these three months. At mid-July, the combined liquidity ratio stood at 29·8%, which is fairly normal at this time of the year; however, the ratios of three of the larger banks were below 29%.

In the month to mid-August, there was a comparatively small rise, of some £30 million seasonally adjusted, in the clearing banks' advances (leaving aside lending to nationalised industries). The rise in restricted lending, including commercial bills, was modest. Net deposits rose by about £65 million after seasonal adjustment. The clearing banks sold a further £30 million of gilt-edged stocks, but added

1 The notice which the Bank issued to banks and finance houses on 14th April is reproduced on pages 136–7 of the June 1970 *Bulletin.*

nearly £120 million to their liquid assets; this mainly took the form of additional lending at call to the discount market, but there was also a sizable increase in Treasury bill holdings. As a result, the combined liquidity ratio rose to 30·9%, a relatively comfortable figure for August.

Leaving aside inter-bank funds, domestic sterling deposits with *accepting houses, overseas and other banks* rose by about £175 million in the June calendar quarter, more than reversing the fall over the previous six months. Overseas residents added further substantial amounts to their sterling deposits with these banks during the quarter; and there was a very large increase, of about £250 million, in sterling certificates of deposit outstanding.

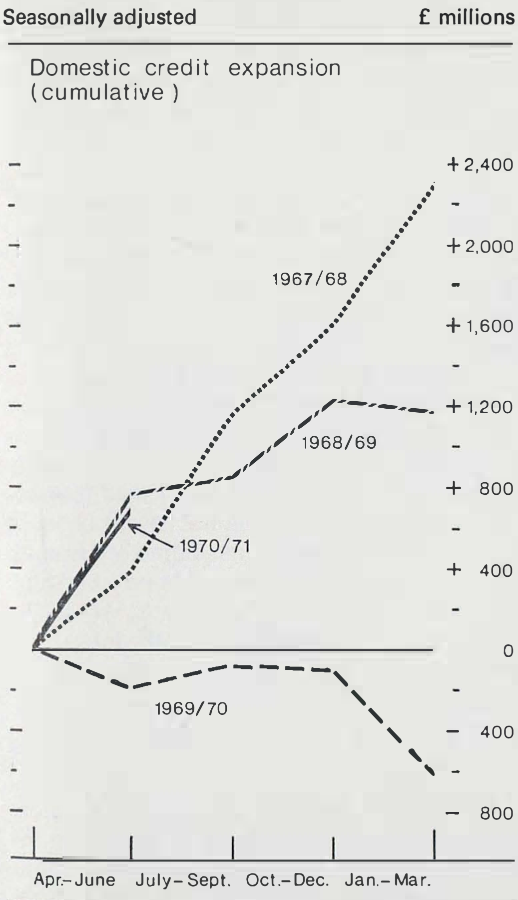
The rise in deposits was accompanied by a sharp increase in all forms of sterling lending during the quarter. Loans to local authorities rose by £150 million, bringing the rise since last September to nearly £450 million, or over one third. An additional £90 million of advances to other U.K. residents, together with a much smaller increase in sterling lending to overseas residents, caused an appreciable expansion of restricted lending. For some of these banks, the rate of increase in restricted lending during the quarter was faster than was consistent with the Bank's request that the rise over the twelve months to next March should be kept to within 7%.[1] The banks most concerned have been asked to justify the rate of growth in this lending in relation to the current request for restraint, and have been reminded that the request still stands. A further £80 million was lent at call to the discount market during the quarter, and there was another sharp increase, this time of more than £150 million, in the banks' own holdings of sterling certificates of deposit; but they sold over £50 million of gilt-edged stocks.

The *discount market* took additional call money from all sources during the June quarter and, in total, borrowed funds rose by £225 million. The houses were also heavy sellers of gilt-edged stocks (£135 million). They were thus able to replenish their holdings of Treasury bills by £160 million, almost doubling them during the quarter. Holdings of commercial bills also increased (partly because of a fall in the amount of bills the houses had on-sold); and there were substantial additions to other assets, notably local authority bonds.

Domestic credit and money supply

The strong rise in bank lending to the private sector was the main reason for a large expansion of domestic credit during the June quarter. The figures for calendar quarters must, however, be interpreted with caution. As explained in the December 1969 *Bulletin* (page 415), the totals both of bank lending and of deposits are subject to considerable fluctuations towards the end of each quarter, which tend to be

1 The reason these banks were asked to keep the increase in their restricted lending within 7% over the year, whereas the figure for the clearing banks and Scottish banks was 5%, was explained on page 126 of the June 1970 *Bulletin*.



There was an appreciable increase in domestic credit in the June quarter, mainly reflecting the rise in bank lending.

largely reversed before the make-up day in the middle of the following month. These end-quarter influences seem to have been particularly marked in the June quarter. Over the calendar period, domestic credit expanded by some £830 million or, seasonally adjusted, by about £700 million. The expansion indicated by the mid-monthly figures – whether from mid-March to mid-June or from mid-April to mid-July – although still large, was noticeably less marked; on a seasonally adjusted basis, the increase in the 'banking' quarter (whether to mid-June or to mid-July) was less than two-thirds of the increase in the calendar period.

The rise in domestic bank deposits, largely the counterpart of the increase in advances, was reflected in a growth in the money supply, but the end-quarter distortions already referred to make the movement on this occasion particularly difficult to assess. During the calendar quarter, the money supply as conventionally defined[1] rose by £870 million which, after seasonal adjustment, represents an increase of some £700 million, or more than 4%. But the increase measured from mid-month data was likewise smaller.

Bill markets

The discount houses were often short of funds during the three months to July. In the first half of the period, the shortages were eased as a result of large official purchases of gilt-edged stocks and the sterling generated by exchange inflows. Even so, conditions were difficult at times because of the Exchequer surplus and the need for the London clearing banks and the Scottish banks to meet the call for additional Special Deposits. From mid-June onwards, renewed investment by the public in gilt-edged stocks, a seasonal increase in the note issue, and some requirement for funds over the end of the half year, all contributed to frequent shortages in the market. The Bank's assistance included overnight lending at Bank rate on a few occasions, but was mainly through purchases of Treasury bills; some commercial and local authority bills were also bought.

Uncertainty about trends in the gilt-edged market caused the houses to reduce their bids for Treasury bills at the tenders in the second half of May and by the end of the month the tender rate had risen from just over $6\frac{3}{4}$% to $6\frac{7}{8}$%. The rate then remained virtually unchanged over the remainder of the period to the end of July. Outside competition dwindled and the amounts of bills offered rose from the very low totals of the previous three months. The houses were thus able to achieve more satisfactory allotments than in the earlier period. The average cost of borrowed funds remained at around $6\frac{7}{8}$%.

Hire purchase finance houses

After a check in the previous three months, there was another moderate increase in the amount of new credit extended by the finance houses in the June quarter, when allowance is made for seasonal factors. Repayments were

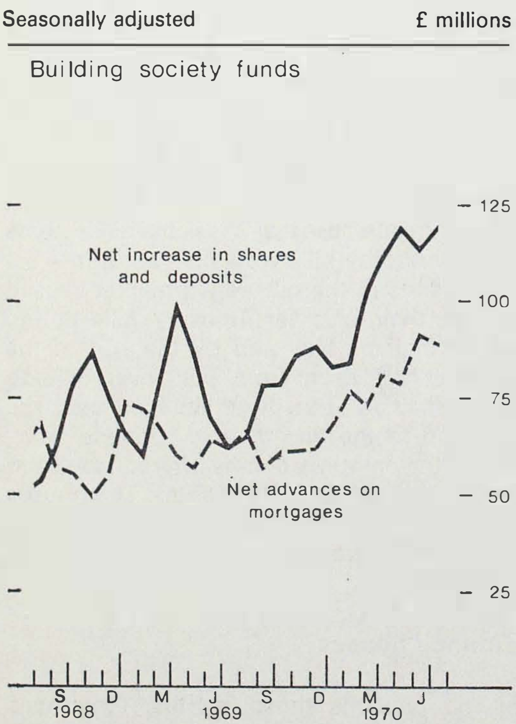
1 A note discussing various alternative definitions of the money supply and presenting the relevant figures follows on page 320.

little changed, and the total of debt outstanding rose by £12 million during the period – the largest increase since the end of 1968. This rate of growth was, however, broadly consistent with the guidance given to the houses in April (an increase of not more than 5% during the year to next March). A small part of the rise in lending in April was attributable to a change in the tax treatment of interest due on loans, as a result of which tax was no longer deductible.[1]

The houses' deposit rates had fallen in March and April by more than the reductions in Bank rate in those months, but changed little between May and July. A slight upwards movement in May was subsequently reversed; and at the end of July, the three months' rate was a little lower than at the end of April, at about 8¼%. In August the Finance Houses Association announced that, from 1st September, a Finance House base rate would be established as a basis which could be used in place of Bank rate to calculate charges for long-term industrial and commercial lending. The announcement stated that this change had become necessary because the cost of money to the finance houses had ceased to follow the broad trend of Bank rate, making some long-term lending relatively unprofitable. The base rate would be calculated each month from the three-month inter-bank rate, and published in the press daily.

Building societies

After allowing for seasonal factors, the societies' gross receipts rose strongly in the early months of this year. In the three months to July, they were higher than ever before. Although withdrawals also accelerated in May and June, net receipts were very large, and probably included some funds previously invested in the stock market. Net lending was the highest since the beginning of 1968, and new lending commitments continued to increase. The combined liquidity ratio rose from 16·1% at the end of April to 16·7% at the end of July.



The sharp rise in building societies' funds since February has been accompanied by a substantial increase in their lending.

Local authorities

Longer-term borrowing by local authorities remained quite large in the three months to July. Rather less was raised on market mortgages than in the previous three months, but borrowing from the Public Works Loan Board increased. There were few new stock issues between May and July, and calls on earlier issues brought in only small amounts. Net borrowing on bonds, taking new issues and maturities together, was also very small. As in the earlier months of this year, no stocks or bonds were issued on overseas markets. On balance, longer-term rates rose a little, by amounts in the region of ⅜%, over the three months; larger increases in May were partly offset by reductions towards the end of July. At that time, mortgage rates stood at a little under 9%, P.W.L.B. rates for 10–15-year loans at 9⅜%, and one-year bonds at 8⅜%.

1 See March 1970 *Bulletin*, page 12.

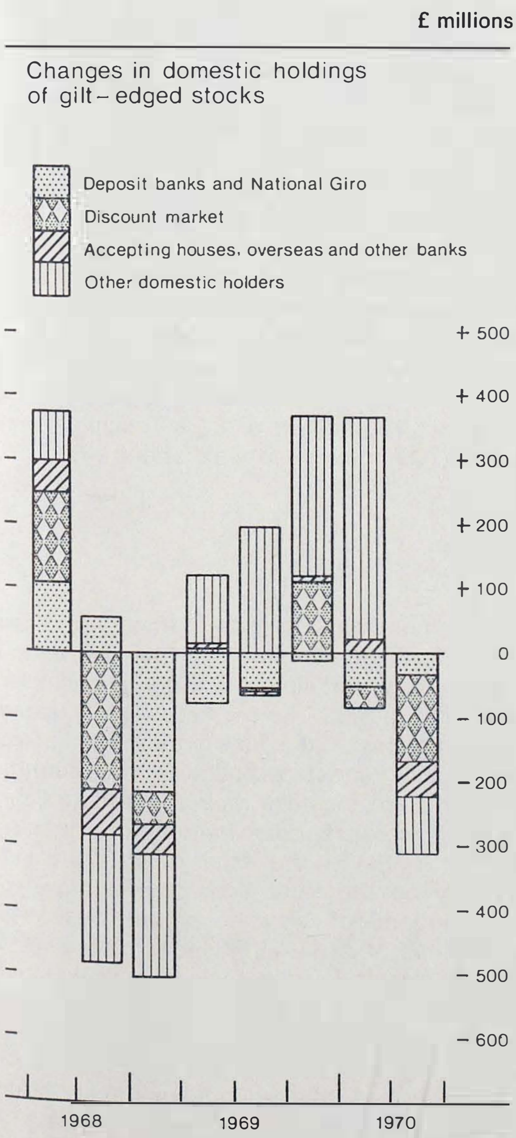
The fall in temporary money rates which began early in March was checked for a time during May, but rates then began to edge downwards a little during June and July. By the end of July the rate for three months' deposits stood a little below 7¾%, a fall of rather more than ¼% compared with the end of April; seven-day rates, however, ended the period little changed, at about 7¼%. As already noted, local authorities borrowed very large amounts of temporary money during the June quarter, but repaid some of their borrowing from the clearing banks.

Gilt-edged market

After the bout of very heavy selling by holders of gilt-edged stocks in the latter part of April, and the accompanying steep rise in yields, the market steadied at the beginning of May. Towards the middle of the month, however, there was renewed (though much more modest) selling, which increased in the first half of June. Concern about the situation in the Middle East affected confidence throughout this period, and the market was also disturbed in June by the approach of the general election, continuing discussion of wage and price inflation, and the trend of the trade figures. When the May figures were announced on 15th June, long yields rose to nearly 10%, or ¼% above the previous highest figure in June last year. In the second half of the month, the market was significantly stronger. The recovery began from the belief that the previous selling had been overdone; following the election, the trend was reinforced, and the market remained generally firm – particularly in medium and long-dated issues – over the remainder of June.

The authorities purchased some £280 million of stock on balance during the June quarter, largely as a result of the heavy selling pressure at the end of April. The total included about £210 million of issues maturing within the next year and about £75 million of other short-dated stocks. Although net sales of medium-dated issues totalled £105 million, official purchases of long-dated stocks were nearly as large.[1] The total of stock bought by the authorities in the June quarter was thus almost as large as the amount which had been sold in the previous three months (about £310 million); but whereas the earlier sales reflected a heavy demand from domestic investors outside the banking sector, the purchases in the June quarter were mainly attributable to disposals of stock by the banks and discount houses. Over the six months, these institutions disposed of some £280 million of stock, but their sales were almost matched by net purchases of £260 million by other domestic investors. Identified overseas holdings increased by a total of about £50 million – spread fairly evenly between the two quarters – because of purchases by central banks and other official monetary institutions.

Early in July, fears of the approaching dock strike provoked some scattered selling, which became heavier at the middle of the month in response to the June trade figures and the failure of attempts to avert the strike. This selling

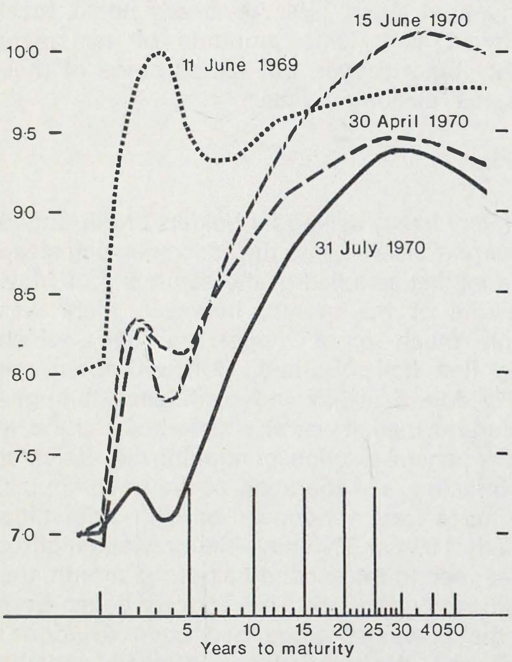


Both the banking sector and other domestic holders sold substantial amounts of gilt-edged stocks in the June quarter.

1 See Table 3 (1) of the annex.

Per cent per annum

Time/yield curves of British government securities [a]



Yields on longer-dated government securities rose sharply in the middle of June, but by the end of July they had fallen back again; on shorter maturities, yields at the end of July were about 1% lower than at the end of April.

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

proved to be short-lived, however, and the market later became quite firm, partly because of an active demand for short and medium-dated stocks from holders switching out of 3% Savings Bonds 1960/70. This stock matured on 1st September, and a considerable number of holders wished to dispose of their stock before 27th July, because there was a tax advantage to them in selling at a price which included accrued interest rather than receiving the final dividend.[7] In the last few days of the month, a more general demand for stock developed following the settlement of the dock strike. The market strengthened considerably, and the authorities were able to sell substantial amounts of stock. By the end of July, yields were generally about $\frac{3}{4}$%–$\frac{7}{8}$% below the high point in mid-June. Those on short-dated stocks at 7%–7$\frac{1}{2}$%, were up to 1$\frac{1}{4}$% lower than they had been at the end of April. Yields on most medium-dated stocks were also substantially lower than three months earlier, but long yields – which ranged up to 9$\frac{1}{4}$% at the end of July – fell by only about $\frac{1}{4}$% over the three months.

The revival of demand for gilt-edged securities after settlement of the dock strike, including the reinvestment demand from holders of Savings Bonds 1960/70, reduced official holdings of short-dated stocks to a low figure, and also made it necessary for the authorities to issue a new stock on which to base their operations at the longer end of the market. Accordingly, two new issues were announced on 6th August: £300 million of 6$\frac{3}{4}$% Treasury Stock 1974 was issued at £98 : 5 : – per £100 nominal, to yield almost 7$\frac{1}{4}$% to maturity; and £600 million of 8$\frac{1}{2}$% Treasury Loan 1984/86 at £95 per £100 nominal, to yield about 9$\frac{1}{8}$%.

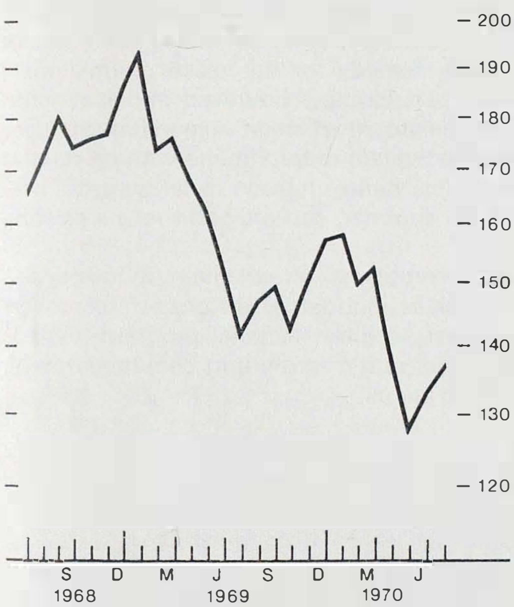
Company securities

A sharp fall in equity prices in the latter part of April was checked for a time at the beginning of May. Thereafter, however, prices fell steadily, and almost without respite, until towards the end of that month. The market was depressed by further large falls in prices on the New York stock market. It was also thought that monetary policy in this country might require companies to increase their demands on the capital market, and that it might become harder for companies to maintain profit margins in the face of rising costs. Although a brief rally on the New York market provided encouragement at the end of May, sentiment weakened again during the first half of June – influenced by the same developments as were depressing the gilt-edged market and also by the renewed weakness in New York. Once the election was over, however, prices recovered, and held the gain in the wake of a steady improvement on Wall Street. At the end of July, the F.T.–Actuaries industrial share price index stood at 136·8. This was slightly lower than it had been at the end of April, but represented a recovery of fifteen points from the low point on 27th May.

7 It was the registered holders on 27th July who received the dividend due some five weeks later; sellers before that date received a price which was adjusted to include accrued interest since the date of the previous dividend.

Logarithmic scale 10 April 1962 = 100

F.T.—Actuaries industrial (500) share price index[a]



There was some recovery in share prices after mid-June and by the end of July they were only a little lower than at the end of April.

a Monthly, last working day.

The yield on first-class high coupon debentures of about 25 years' maturity rose to a peak of nearly 11% in mid-June, but then fell back to stand at about $10\frac{1}{4}$% at the end of July. The margin over government stocks of similar date then stood at about 1%, rather larger than at the end of April.

The amount of cash which companies raised on new issues, which had been very low since the middle of 1969, fell further in the three months from May to July, to a net total of less than £60 million. Conditions in the new issue market were particularly difficult at times during these three months, because of the unsettling factors already referred to. Rather than attempt to raise capital on new issues in these circumstances, many companies borrowed instead from their banks, thus contributing to the large demand for bank advances. Almost the whole of the net £60 million raised on new issues was attributable to issues by financial companies, predominantly in July. Industrial and commercial companies raised a negligible amount – some £8 million – during these three months, compared with sums ranging between £150 million and £200 million a quarter between mid-1968 and mid-1969; indeed in July, redemptions of earlier issues by these companies exceeded the amount of new cash raised. Equity issues were particularly small in all three months. Although the queue of prospective borrowers lengthened somewhat over the period, the increase in the cost of borrowing – coupons of $10\frac{3}{4}$% and 11% were offered in July – again led to some issues being withdrawn or postponed.

The increased demand for unit trust units in the first quarter did not persist and, reflecting the weakness in the equity market, sales were lower in the second quarter. Gross sales amounted to £48 million, compared with £55 million in the March quarter; but as repurchases were also lower, the difference in net sales was smaller. Sales continued to fall in July and, whether measured gross or net, were the lowest recorded this year.

Conclusion

The economy has recently been growing only slowly; but there is a prospect of some recovery in output before very long. Consumers' expenditure is now clearly rising and, to judge from the recent and prospective growth in real incomes, seems likely to increase further.

The course of domestic output depends not only on consumption but also upon the way in which other forms of expenditure – notably exports and fixed investment – develop, and upon the ability of home production to compete with imports. To the extent that production and supplies are disrupted by industrial disputes, additions to demand may be reflected in increased imports rather than domestic output. A gradual and sustained growth of output, if achieveable, should foster improvements in productivity, and create conditions favourable to some moderation of the rise in industrial costs. In contrast, an unduly rapid rise in output would bring only temporary benefits; as the limits of existing capacity were reached, and shortages of manpower and supplies emerged, a new element would be added to the existing inflationary pressures.

Whatever the prospects for output, the very rapid increase in incomes and prices since the latter part of last year remains a cause for great concern. It has been accompanied by a sharp acceleration in the incidence of industrial disputes, which have impaired the productive potential in a number of important sectors of industry. Monetary policy alone cannot provide an acceptable remedy for the existing inflationary pressures. It has its part to play, however, and it remains important to restrain the growth of credit. A moderate increase in lending can help to sustain output in line with productive potential. But an unduly rapid increase in lending, such as occurred earlier in the summer, can only add to the existing inflation.

Not until the root problems of spiralling incomes and prices and the associated industrial dislocation are overcome will it be possible to make material progress towards the objectives of a faster rate of growth in conjunction with a sound balance of payments.