Commentary

Exchange rates were still floating at the beginning of the three months November 1971 to January 1972 with which this Commentary is mainly concerned. On 18th December a general international realignment of rates was agreed in Washington, all the main currencies being revalued against the U.S. dollar. As part of this, sterling was revalued by just over 8½%, the new middle rate being $2·6057, compared with the old par value of $2·40. Beforehand, the movement of funds into the United Kingdom had been heavy. Afterwards the outflow was modest and there was also a continuing demand for sterling arising from the surplus on the current account of the balance of payments. Sterling appreciated against the dollar compared with its opening price after the agreement. The inflow from abroad in the December quarter and more importantly a continued sharp increase in bank lending led to a much faster rate of increase in the money stock. The increase would have been even greater but for substantial official sales of gilt-edged stocks.

In the domestic economy, demand – led by consumers' expenditure – continued to grow quite strongly until the coal miners' strike disrupted power supplies in February. Before then, the slowing down in the rate of growth in prices and earnings was becoming more pronounced. Domestic output, however, was still subdued, a lot of plant remained idle and unemployment went on rising. The recorded total for Great Britain and Northern Ireland exceeded one million in January 1972.

International currency realignment

A general realignment of the main exchange rates was agreed at the ministerial meeting of the Group of Ten countries and Switzerland held in Washington on 17th and 18th December. The United States abolished the 10% surcharge which had been imposed in August on dutiable imports not subject to quantitative restrictions and withdrew the discriminatory tax allowances on capital goods bought at home. They also undertook to seek Congressional authority to raise the dollar value of monetary gold from $35 to $38 per fine ounce. The present dollar value of gold was fixed in 1934. The proposed change represents an 8·57% increase in the dollar value of gold and a 7·89% devaluation of the dollar in terms of gold. For the time being, the convertibility of the dollar into gold or other reserve currencies remains suspended.[1]

Under the settlement, the United Kingdom has kept unchanged the par value of sterling in terms of gold notified to the International Monetary Fund. A new middle rate for sterling against the dollar of $2·6057 was announced after the Washington meeting. As part of the agreement, the Fund announced that member countries would temporarily be permitted to allow their exchange rates to move within margins of 2¼% against their intervention currency – in the

1 See September 1971 *Bulletin*, page 295.

case of the United Kingdom, the U.S. dollar – and 4½% against other currencies. It was decided that the United Kingdom should take advantage of this dispensation, and accordingly the Bank announced new selling and buying rates for U.S. dollars, with effect from 21st December of \$2·5471 and \$2·6643. These compared with the former official selling rate of \$2·38, which had remained in force until the Washington agreement, and the buying rate of \$2·42, which had been withdrawn on 23rd August. Members of the Fund whose exchange rate in terms of gold had been changed under the realignment were able to notify central rates under the temporary regime of wider margins, if they did not wish immediately to propose a new par value. Since the par value for sterling against gold remained unchanged, it was not necessary for the United Kingdom to notify a central rate. Changes in the main currencies against gold and against the dollar, comparing new middle or central rates with par values before 5th May 1971 (when the deutschemark and guilder began to float) were as follows:

	Against gold	**Against U.S. dollars**
	(Percentage change)	
Italy, Sweden	−1·0	+ 7·5
United Kingdom, France	—	+ 8·6
Belgium, Netherlands	+2·8	+11·6
Western Germany	+4·6	+13·6
Switzerland	+7·1[a]	+13·9
Japan	+7·7	+16·9

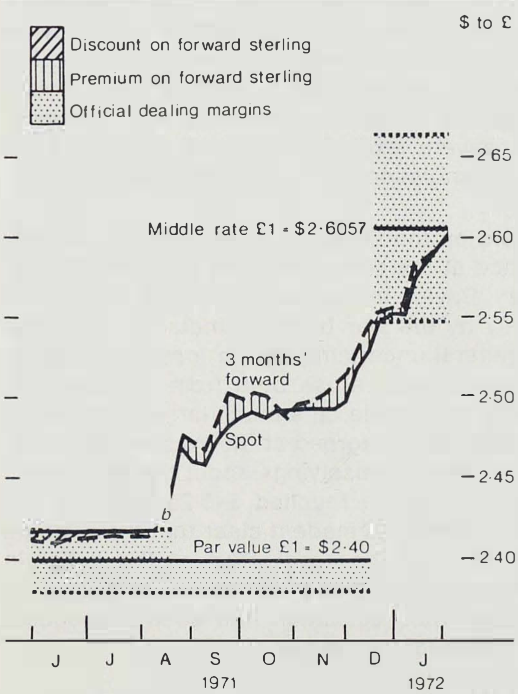
a The Swiss franc was officially revalued by 7·1% against gold on 10th May, giving a middle rate for the U.S. dollar of Sw. fr. 4·0841. In the December realignment its gold parity remained unchanged but the middle rate against the U.S. dollar was fixed at Sw. fr. 3·84.

Canada continued with a floating exchange rate.

The total effective change in the exchange value of sterling under the realignment was very small. Calculations of the change, which are generally confined to the visible trade balance, depend on the base date used, on the choice of the unit of measurement (*e.g.* gold/Special Drawing Rights or U.S. dollars) in which the effects are calculated and on the treatment adopted for the Canadian dollar which has been floating since May 1970. A number of estimates have compared the new middle and central rates of all currencies with par values in January 1971, using S.D.R.s as the unit of measurement and assuming a middle rate for the Canadian dollar of Can. \$1 = U.S. \$1. Even on this basis no precise and definitive calculation is possible, because alternative assumptions can be made about the effect of price changes on the volume and direction of trade and about the policy reactions of countries to changes in their trade balances brought about by the realignment. Using slightly different assumptions on these points the various estimates produce an effective outcome for sterling ranging from no change to a revaluation of about 1%. Any effect of so small a move on the U.K. trade balance will be offset by the benefits to be gained from the removal of the U.S. surcharge and the discriminatory tax allowance on capital investment.

Immediately after the agreement, the U.K. authorities removed the exchange control restrictions against inflows from abroad which had been introduced in August 1971 and reinforced in October.[1] Most other countries which had introduced similar measures also relaxed them.

Spot and 3 months' forward rates for U.S. dollars in London[a]



Sterling continued to appreciate against the dollar and was close to its new middle rate by the end of January.

a Middle closing rates; weekly, Fridays.
b No quotations are available for the period 16th to 22nd August when the London foreign exchange market was closed.

Foreign exchange and gold markets

Foreign exchange markets were quiet during the first half of November. On the 19th, however, it was announced that the next Group of Ten meeting, which had already been postponed once, was to be held in Rome at the end of the month; and that a bill had been introduced into the U.S. Congress which would empower the President to make limited changes in the price of gold. These events led to heavy sales of U.S. dollars against other major currencies, which continued with only brief interruptions through the Rome meeting – which was inconclusive – and up to the realignment in mid-December. Sterling was kept below $2·49½ during the second half of November; but selling of dollars increased early in December and the pound was allowed to go above $2·50 on the 7th. It subsequently rose rapidly to close in London at $2·5291 (and at $2·5325 in New York) on Friday the 17th, before the realignment. This represented an appreciation of 5⅜% over parity.

The foreign exchange markets in London and some other centres were closed on Monday, 20th December, the first working day after the Washington agreement. When dealings resumed next day, there was no immediate rush to take revaluation profits and sterling soon settled between $2·55–$2·56. Later, international demand for funds over the end of the year caused euro-dollar interest rates to rise and produced some selling of sterling, the rate falling below $2·55 on 24th December. There was only a modest movement of funds back into the dollar, however, and the rate soon recovered to over $2·55 when normal usance took settlements into January. During the first part of January, the supply and demand for sterling were well balanced at a rate of around $2·55. A continuing U.K. balance of payments surplus and buying by oil companies offset any modest outflow of funds which took place. Towards the middle of the month, however, the dollar weakened against most currencies. There were some misgivings about the durability of the Washington realignment; and holders of currencies other than dollars were still feeling no urgency to realise their revaluation profits – U.S. interest rates were falling and there seemed to be scope for larger profits within the wider exchange rate margins. The pound rose by approximately 2 cents in one day on the 14th and, after touching $2·60 on the 17th, settled around $2·59 for the remainder of January. Early in February, it rose briefly above $2·61 and, in common with all other major currencies except the lira and Swiss franc, was above its new middle rate against the dollar. However, by the time that the U.S. bill to increase the monetary value of gold to $38 was published, most markets were somewhat calmer. Sterling settled around its new middle rate and was subsequently only temporarily affected by the domestic power crisis; but funds continued to flow into

1 See September 1971 *Bulletin*, page 296, and December 1971 *Bulletin*, page 436.

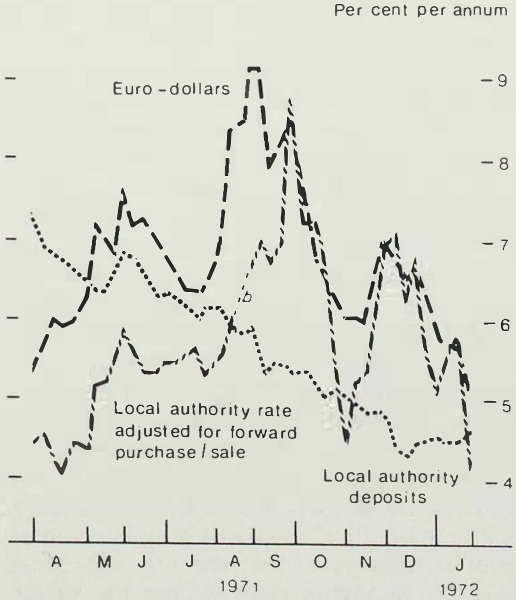
Western Germany and Japan where restrictive measures were announced on 24th February.

From November to January, forward sterling for periods up to six months was almost continuously at a premium. In early December, as the foreign exchange market's expectations of a dollar devaluation increased, forward premiums for sterling against the dollar were particularly large: on the 6th, one month forward sterling reached a premium equivalent to $8\frac{1}{8}$% per annum and three months' forward sterling a premium of $3\frac{3}{4}$% per annum. During the period under review forward exchange markets generally operated smoothly. The only serious difficulties experienced by traders in the United Kingdom were in those currencies where, to limit inflows of funds, new and severe exchange restrictions had been placed on the accumulation of foreign balances by non-residents.

The price of gold on the London market rose from nearly $\$42\frac{1}{2}$ per fine ounce at the end of October to around $47 at the end of January. Buying in the first part of this period was encouraged mainly by the war between India and Pakistan but also by the general uncertainty in the foreign exchange markets. Later, the demand arose both from rumours that the United States might decide on a much larger increase in the official price than the $3 agreed at the Washington meeting and from some general misgivings about the settlement. By early February, the price reached $49·25 but then fell back after the U.S. authorities made it clear that the rumours were unfounded and that the devaluation of the dollar in terms of gold would be no more than the 7·89% agreed in December. Once the U.S. legislation had been introduced, the market price steadied around $48.

Short-term interest rates in London[a]

Per cent per annum



Both domestic and international interest rates continued to fall between November and January.

a Rates on 3-month deposits; weekly, Fridays.
b No adjusted rate is available for the period 16th to 22nd August because of the closing of the London foreign exchange market.

Short-term interest rates

Short-term interest rates in the United Kingdom were lower than at any time since 1964. Until the second half of January, they were generally below those available on comparable euro-dollar investments. Euro-dollar rates changed little during the first half of November. They started to rise in the second half because of demand for dollars to finance speculative movements into other currencies. The three months' rate, which had been steady at about 6% during the first half of the month, reached 7% towards the end of November when end-month pressures augmented the effects of speculative borrowing. By 1st December the rate had fallen back to $6\frac{7}{16}$% and it did not again move above $6\frac{3}{4}$% before the Washington agreement. The rise in euro-dollar rates during this period was surprisingly small in comparison with the steep increases experienced in previous foreign exchange crises. The reason may have been that a considerable proportion of the selling pressure came from the United States. Also, many holders of other currencies whose authorities were no longer permitting the payment of interest to foreigners were swapping these holdings back into dollars. They thus obtained at least some return on their funds by temporarily lending them in the euro-dollar market.

Immediately after the Washington agreement euro-dollar rates eased and the three months' rate had fallen to $5\frac{1}{16}$% by the end of January. This fall was helped by a decline in U.S.

domestic interest rates: on 13th December the U.S. discount rate was cut from 4¾% to 4½% and between mid-December and mid-January the three months' Treasury bill rate fell from about 4% to a little below 3⅛%. U.S. commercial banks also lowered their prime lending rates by ¼% to 5¼% in mid-December and by a further ½–¾% early in 1972. Towards the end of January, the U.S. Treasury bill rate rose again slightly but it was back to a little less than 3⅛% by mid-February.

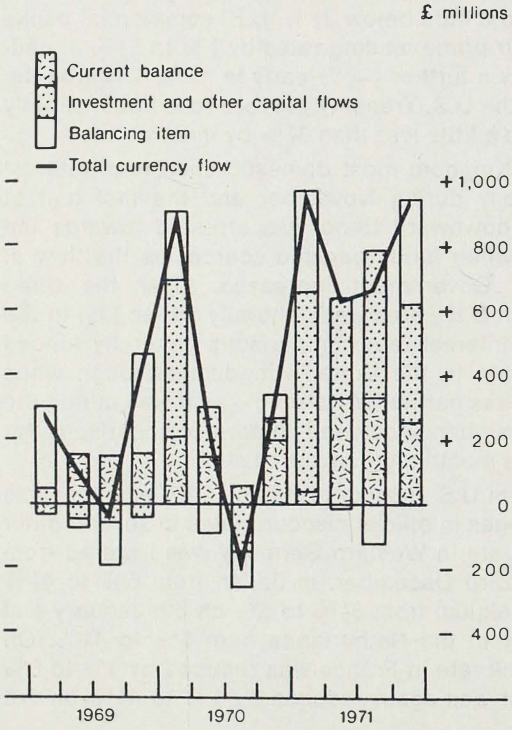
In the United Kingdom most domestic short-term interest rates fell gradually during November and the first half of December. The downward trend was arrested towards the end of January when funds became scarcer as the flow of revenue to the Government increased. Over the three months, the fall in U.K. rates was generally under ¼%. In the period, covered interest rate comparisons generally tended to be unfavourable to the United Kingdom although when forward sterling was particularly strong – as it was during the first half of December – covered interest comparisons for periods up to one month often favoured sterling.

The reduction in U.S. discount rate on 13th December was followed by changes in official discount rates in several other countries. Bank rate in Western Germany was lowered from 4½% to 4% on 23rd December, in Japan from 5% to 4¾% on the 29th, in Belgium from 5½% to 5% on 6th January and on the same day in the Netherlands from 5% to 4½%. On 13th January Bank rate in France was reduced by ½% to 6% and in Belgium it was again reduced by ½% to 4½% on 3rd February.

Balance of payments

The United Kingdom's balance of payments on current account has continued to play an important part in sustaining sterling in foreign exchange markets. The surplus on current account in the fourth quarter of 1971, at about £250 million after seasonal adjustment, was again very large – though less than in the previous quarter. Part of the fall was probably due to the U.S. east coast dock strike which increased the surplus in the third quarter as U.K. exporters accelerated their shipments in anticipation. The visible trade surplus in the fourth quarter was reduced to about £75 million, some £100 million less than in the previous quarter. The underlying position, however, was then still very favourable. Taking the third and fourth quarters together to reduce the distortion of the figures caused by the U.S. strike, there was a surplus of some £250 million in the second half of 1971 compared with one of about £50 million in the first half. Exports were up by nearly 8%, about half of which was due to prices – which rose steadily throughout the year – and half to volume. Apart from a sharp rise in exports of diamonds (matched by a similar rise in imports), most of the increase in volume was spread over a broad range of manufactured goods. Imports rose much more slowly, by 3%. All of this was due to prices (which increased sharply in the first half of the year, mainly because of oil, but were steady through the second half) and there was little change in volume. On balance, nearly one third of the improvement in the trade surplus between the two half years depended on the terms of trade. A further quarter was contributed by a favourable

U.K. balance of payments



The balance of payments remained strong in the final quarter of 1971 . . .

movement in such erratic items as ships and aircraft and the rest represented a marked improvement in the volume of trade in other goods.

This half yearly comparison, however, obscures a trend which seemed to be emerging near the end of the year towards a rising volume of imports of finished manufactures. In the three months November 1971–January 1972, the value of total imports rose by 2% compared with the previous three months. Prices were little changed so the growth was entirely in volume. Within this increase in the total, the value of imports of finished manufactures rose by 7%, about half of which was in ships and aircraft and the remainder consumer goods, particularly cars. On the same comparison, exports fell by 4%, part of which may have been a once-for-all loss caused by the U.S. dock strike.

The surplus on invisible account was not much changed in the fourth quarter after allowing for seasonal movements such as the payment of interest on the North American loans.

Substantial investment and other capital inflows had been characteristic of the first three quarters of 1971, and the December quarter was no different. The net inflows – both identified and unidentified (in the balancing item) – were again large, to an important extent because of uncertainties about exchange rates. First, the increase in sterling balances of private holders in non-sterling countries was about £210 million, with a further £200 million for private holders in overseas sterling countries. The rise in balances of non-sterling countries did not take place until the second half of November when the exchange control restrictions on payment of interest proved a less powerful influence than the prospect of a capital gain from a realignment. Second, banks increased their net foreign currency borrowing from abroad by over £200 million: most of this movement took place after the realignment when the exchange control restrictions on the switching of funds into sterling by the banks had been removed. Third, an exceptionally large positive balancing item suggests that, in preparation for the realignment, many U.K. traders may have been delaying payments overseas, foreign traders may have been accelerating payments to this country and funds may have been moved in over intra-company accounts. Finally, exchange reserves held in sterling by overseas countries rose by about £60 million despite a withdrawal of funds by Libya. During December, Libya removed almost all her reserve holdings of sterling and, on the 15th, was excluded from the list of scheduled territories for purposes of U.K. Exchange Control.

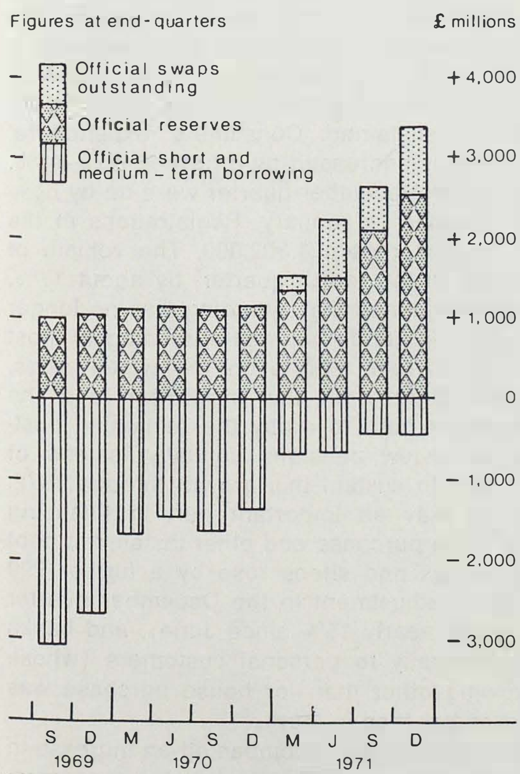
Inward private investment exceeded outward investment during the quarter but net official long-term capital payments were large because of the usual end-year repayments of North American long-term debt.

The total currency inflow of £953 million was not far short of the record figure in January-March, the current account contributing about a quarter of it. This inflow brought the total for the year to a massive £3,228 million. There was also an allocation of S.D.R.s equivalent to £125 million. The annual surplus on visible trade of nearly £300 million was a record – the previous largest was £53 million in 1956 – and with net invisible receipts also reaching a record of about

£650 million, the current account surplus was not far short of £1,000 million for the year. The performance on visible trade, though impressively strong, was not quite so reassuring as the figures suggest. The surplus reflects a faster rise in export than import prices – the increase in U.K. export prices also outstripped those of competing countries – and a comparatively slow growth in the volume of imports because of the slack domestic economy.

In the year as a whole, identified capital and investment movements accounted for over half of the total currency inflow, and there was also a very large positive balancing item (concentrated in the first and fourth quarters). Most of the identified capital inflow showed up in an increase of about £1,400 million in sterling holdings, of which nearly half was in other countries' reserve holdings. Private holdings increased by £735 million, largely because of heavy speculative inflows in the latter part of the year.

Reserves and special facilities



. . . and by the end of December official reserves were well over twice as large as a year earlier.

Reserves and special facilities

Part of the fourth quarter's currency inflow of £953 million, valued at the rates at which the transactions were effected, was placed with overseas monetary authorities through further official swaps. The total of swaps outstanding at the end of September was £541 million at the old par value of \$2·40; at the end of December the amount outstanding was £864 million valued at the new middle rate of \$2·6057 giving an increase of £323 million. This left £630 million of the currency inflow to be placed in the reserves.

At the end of 1971 the reserves stood at £2,526 million valued at the new middle rate, well over twice as large as a year earlier and the highest ever recorded. In terms of sterling, the value of gold and S.D.R. holdings was not affected by realignment, but holdings of certain currencies appreciated. Holdings of dollars, however, depreciated in terms of sterling, and the total value of the reserves at the end of December was £146 million lower calculated at the new middle rate than if calculated at the old par value. For the same reason the value of the official swaps at the end of December was lower by £74 million.

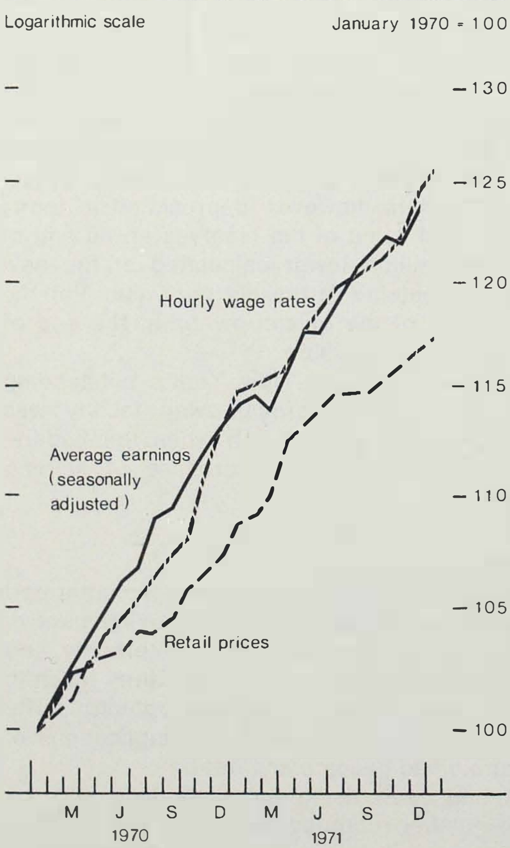
The Federal Reserve Bank of New York's outstanding forward liability under the reciprocal swap facility was reduced by £14 million to £295 million when the Federal Reserve Bank made an advance repurchase of sterling during the quarter.

Domestic economy

At home, business confidence remained low in the latter part of 1971. The Washington agreement on the realignment of exchange rates helped to reduce one major uncertainty, and the Confederation of British Industry's latest survey taken in January 1972 gave some signs of reviving optimism. The survey was completed, however, before the implications of the coal miners' strike had become apparent.

Unemployment had been rising for some time and, by January 1972, the number recorded as out of work in Great Britain and Northern Ireland exceeded one million for the first time since 1947. Even after allowing for the seasonal increase in the winter months, the number of wholly un-

Wages, earnings and prices



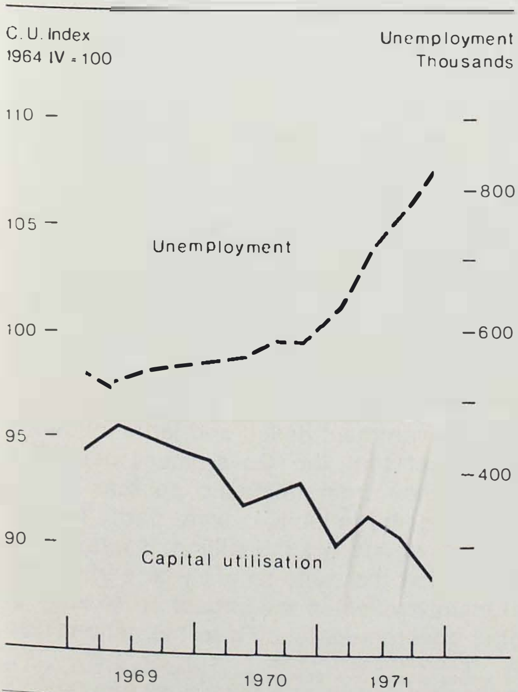
The growth in earnings and prices continued to moderate.

employed (excluding school-leavers) in Great Britain, at 872,000, had risen by 59,000 in the three months November-January, 12,000 more than in the previous three months. The proportion of wholly unemployed in the total work force rose to 3·8%. Information about unfilled vacancies for adult workers was a little brighter – indeed, they increased by 1,000 during the same period after seasonal adjustment – but this by itself hardly gave confidence that the fall in demand for labour had yet come to an end. Other relevant indicators were consistently disappointing: short-time working was still increasing, and both hours of overtime worked and the numbers in employment were continuing to fall – the decline in employment in manufacturing industries was particularly sharp. The February results for unemployment and vacancies, however, were in some ways more encouraging despite the large number of workers temporarily stopped because of the coal strike. The total of wholly unemployed was only 1,000 higher after seasonal adjustment. Moreover, adult vacancies rose quite markedly – by 7,000.

Developments elsewhere in the economy during the December quarter seemed to strengthen the prospects of an improvement in labour requirements in the course of 1972. The recovery in demand which had begun during the summer of 1971 was sustained. Consumers' expenditure, already growing strongly, increased by a further 1¼%–1½%. Sales of new cars in the December quarter were up by 6½% and were well maintained in January. Registrations in the whole year 1971 were a record 1,302,000. The volume of retail sales also rose in the fourth quarter, by about 1¾%, and there was some evidence that spending was no longer concentrated on durable goods but was spreading to most other kinds. To judge from reports on the winter sales, spending continued to grow in the New Year; and the Government's decisions both to repay the remaining post-war credits and to review pensions annually instead of biennially should help to sustain this growth through 1972. Credit continued to play an important part in financing personal spending. Hire purchase and other instalment debt owed to finance houses and shops rose by a further £99 million after seasonal adjustment in the December quarter (giving an increase of nearly 15% since June), and banks continued to lend liberally to personal customers (whose outstanding borrowing other than for house purchase was 37% higher in November than in May).

The continuing flow of credit accompanied an increase in real personal incomes. Prices rose less quickly than earnings and the rate of increase in both was slowing down. Retail prices in the three months October-December increased by only 1·3%, compared with 1·4% and 3·6% in the two previous quarters. The decline in the rate of growth of wholesale selling prices was even more marked, with a rise of 0·7% after 1·5% in the third quarter and 2·1% in the second. The slower trend in both price series was maintained in January. Meanwhile average weekly earnings in October-December rose by 1·9%, more than prices but less than earnings in the previous three months (2·9%). This result reflects some progress in the reduction of average

Capital utilisation and unemployment



Capital utilisation fell again and unemployment continued to rise sharply.

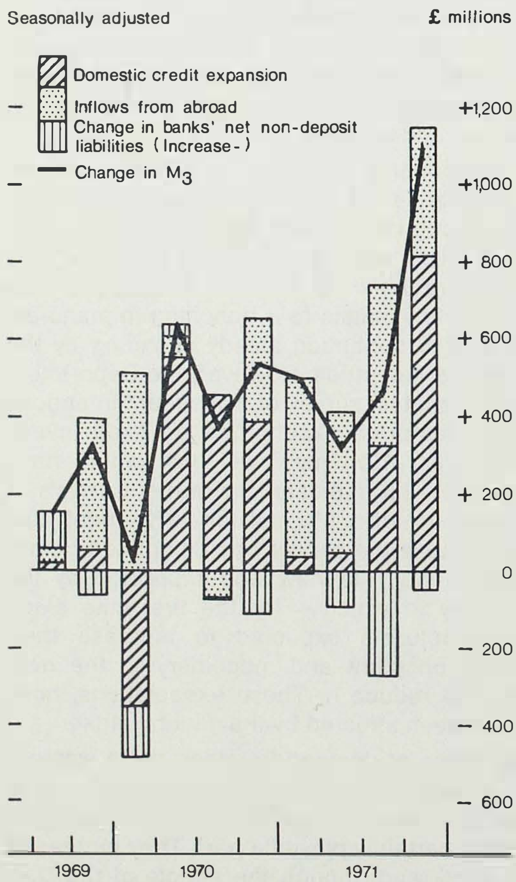
increases in wage rates until the miners' settlement. It must also owe something to the sluggishness of industrial output and the decline in overtime hours worked, and something to a fall in the numbers receiving wage settlements: just over four million manual workers received pay awards in October-December compared with nearly six and three quarter million in the same period of 1970.

Besides personal consumption, the form of demand which clearly continued growing in the December quarter was private housebuilding. The number of new houses started by builders increased by over 16% and owed much to the ready availability of credit from building societies. Housebuilding in the public sector remained low, perhaps because local authorities were uncertain about the possible effect which the Government's new Housing Finance Bill might have on demand for their housing. There were signs of a recovery, however, in December and January.

The remaining components of demand were also subdued. The volume of exports fell in the December quarter and again in January – though these falls were probably largely accounted for by the U.S. dock strike. Fixed investment by private industry also probably fell. It increased unexpectedly in the September quarter, thanks to a bunching in manufacturing investment and to continued steady spending by the distribution and service industries. However, the Department of Trade and Industry's latest survey of investment intentions suggested that manufacturing expenditure on fixed investment for the whole year 1971 may well turn out to have fallen less than the 6%–8% indicated by earlier surveys. It seemed that the forecast of a 3% fall for 1972 might also prove pessimistic because the survey was completed before the currency realignment. This view was supported by the January C.B.I. enquiry in which – for the first time since 1969 – more manufacturers expected to increase their investment spending on plant and machinery in the next twelve months than to reduce it. These expectations, however, may since have been affected by the miners' strike.

Taking all these forms of demand together, there was undoubtedly quite a strong increase in the fourth quarter. It is not clear, on the evidence so far available, how this demand was satisfied. Imports certainly played a part. They increased in volume by some 3% and, though the effects of the U.S. strike make the figures difficult to interpret, most of the growth both then and again in January was in arrivals of finished manufactures. Domestic sources, however, seem to have contributed little. A good deal of additional demand earlier in the year had been satisfied by running down stocks. They fell sharply in the June quarter and again in September when manufacturers reduced holdings of materials, fuels and finished goods. With suppliers working below capacity and offering prompt delivery, it may be that firms did not feel the need to hold as much stock as in the past. They may also have been inhibited by uncertainties about future rates of indirect tax. Preliminary information on the December quarter, however, suggests that some modest restocking had begun, particularly by retailers. Nevertheless industrial production in the three months October-December was 1% less than in the previous three months and probably declined further in the first quarter of 1972 because of the interruption of power supplies by the miners' strike. Though output of the service industries was probably still rising, it can only have met part of the increase in demand. Capital utilisation by manufacturing industry fell again in the fourth quarter, but the concurrent decline in employment and overtime hours worked appears to have led to a faster rate of increase in productivity.

Changes in money stock[a]



Domestic credit increased rapidly in the December quarter, and the rise in the money stock accelerated sharply.

a The broadest coverage (M_3) as in Table 12 of the annex.

Money stock and domestic credit[1]

The growth of the money stock accelerated sharply in the final months of 1971. In the December calendar quarter, the increase amounted to some £1,100 million after seasonal adjustment, or about 5¾%, compared with only £470 million or 2½% in the preceding three months. Inflows from abroad were again an important influence, but the main reason for the faster growth was a strong expansion in domestic credit. In particular bank lending to the private sector, the increase in which had been large in the September quarter, was even larger in the December quarter at over £760 million, as the banks began to take advantage of the relaxation in the control of credit. Part of the additional lending went to other financial institutions, particularly finance houses, but the amount taken by personal borrowers also rose sharply. The growth in borrowing by industrial and commercial companies was much the same as in the previous quarter. The central government were in substantial deficit – though not quite so much as the reflationary measures of last year might have suggested – and, after allowing for seasonal influences, the rest of the public sector borrowed considerably more from the banks than in the previous quarter. These expansionary influences would have led to an even greater increase in the money stock had it not been for further large official sales of gilt-edged stocks to the general public and a sharp increase in national savings.

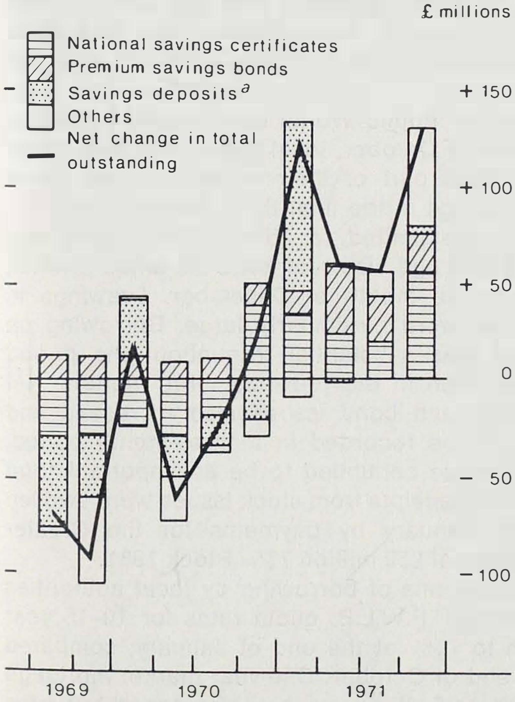
The new monthly series of statistics on the money stock reported at mid-monthly dates showed that, in the six weeks to 19th January, the money stock was provisionally estimated to have increased by some 1¾% after seasonal adjustment, much the same rate as in each of the three previous months. This was closely in line with the movement in the calendar quarter to the end of December. The main expansionary influence was again a sharp rise in bank lending to the private sector.

Central government financing

A substantial central government deficit and large inflows of foreign exchange meant that the Government needed a record amount of finance from domestic sources in the December quarter. Seasonal influences were partly responsible for the deficit but, at nearly £845 million, it was almost £200 million larger than at the same time a year earlier. The size of the deficit mainly reflected the impact on revenue of tax cuts, and higher government lending to the nationalised

1 The references to the money stock are based on the broadest definition, M_3, in Table 12 of the annex; figures of domestic credit expansion are given in Table J of the analysis of financial statistics (see page 36).
A new series of monthly figures on the money stock has been included in Table 12. An article introducing this series and explaining the method of seasonal adjustment is on page 76.

Changes in national savings



Investment in national savings increased . . .

a Deposits with the National Savings Bank, ordinary accounts, and with the trustee savings banks, ordinary departments.

industries and local authorities. Government expenditure also continued to rise, although the rate of increase was less than might have been expected, given the Government's earlier reflationary measures.

A further large amount was needed to finance external transactions and, in total, £1,779 million had to be found from domestic sources – by far the biggest figure ever recorded in one quarter. Investors outside the banking sector provided £756 million; there was a seasonal increase in their holdings of notes and coin and they again purchased substantial amounts – £410 million – of gilt-edged stocks. There was also a further very large increase in national savings, which brought in £129 million. This was the fifth successive quarter in which holdings of national savings increased – by a cumulative total of £388 million – after some years of steady decline. Most of the main national savings assets shared in the improvement, particularly national savings certificates, the current issue of which bears a very attractive rate of interest for those paying tax. British savings bonds also proved popular in the December quarter; and the decline in interest rates offered by alternative savings outlets – such as the announced reduction in building societies' deposit rates – will have increased the appeal of national savings generally.

Purchases of tax reserve certificates were also unusually high in the December quarter: the rates were relatively attractive to both personal and company holders; and companies seem to have been anxious to meet their expected requirements for these assets before the withdrawal of the current issue. The end of the tax reserve certificate scheme was announced in December.[1]

The banks were left to provide £1,029 million. Net government indebtedness to the Banking Department of the Bank of England rose by £118 million. The banks and discount houses sold a small amount of gilt-edged stocks and took up £790 million of Treasury bills – an unusually large amount even for a December quarter.

Over the first nine months of the financial year, the borrowing requirement was £1,285 million, compared with £800 million in the corresponding period of the previous year. Since the March quarter is a period of seasonal surplus for the central government, as payments of corporation tax and surtax fall due, the deficit for the financial year as a whole will be considerably less than the present cumulative total.

Local authorities

There was a marked increase in all forms of longer-term local authority borrowing in the three months to the end of January. This may have been merely a temporary shift in the pattern of the authorities' financing as they moved to take advantage of lower long-term borrowing rates. It could also have been the first sign that the authorities were beginning to provide for the additional capital expenditure which the Government asked them in the second half of 1971 to bring forward for economic policy reasons. So far, however, the growth in their expenditure has been relatively slow, partly perhaps because the authorities have not kept contingency

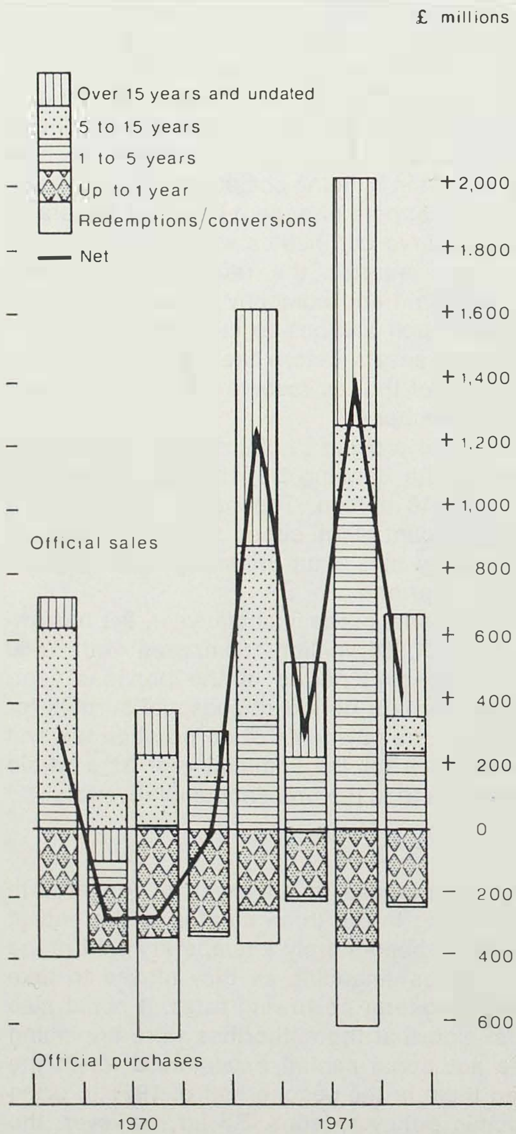
1 The current issue of company certificates was withdrawn after 31st December 1971 and is not to be replaced. A final issue of personal certificates was made, however, as from 3rd January 1972 and will be available until 29th June 1973.

plans for public works for fear that they would quickly become out of date. Some authorities may also have been inhibited by the proposed boundary changes and, as mentioned on page 11, housing developments may have been delayed by uncertainty about the effects of the new fair rents policy.

Borrowing from the Public Works Loan Board increased sharply. By the end of October, local authorities had drawn a comparatively small part of their quotas for the whole financial year. Drawings in the final three months (January-March), however, are limited to 25% of the authorities' quotas, and the Board had also restricted the amount which might be taken in the month of December. Drawings in November therefore were particularly large. Borrowing on market mortgages was substantial throughout the period and a little higher than in the previous three months. Net receipts from stock and bond issues also increased and were the highest to be recorded in a three-month period. Negotiable bond issues continued to be an important form of borrowing and net receipts from stock issues were swollen in November and January by payments for the Greater London Council issue of £50 million $7\frac{3}{4}\%$ Stock 1981.

The cost of most forms of borrowing by local authorities eased over the period. P.W.L.B. quota rates for 10–15 year loans were down to $7\frac{3}{8}\%$ at the end of January, compared with $7\frac{7}{8}\%$ at the end of October. One-year market mortgage rates fell from $5\frac{5}{8}\%$ to $5\frac{1}{4}\%$ during the same period but rates for terms over five years were unchanged at from $7\frac{1}{4}\%$ to 8%. The cost of yearling bonds declined from $5\frac{1}{2}\%$ to just over 5%. Temporary money market rates fell for all maturities with the three-month rate declining from $5\%–5\frac{1}{8}\%$ at the end of October to $4\frac{5}{8}\%–4\frac{3}{4}\%$ at the end of January.

Official transactions in gilt-edged stocks by maturity



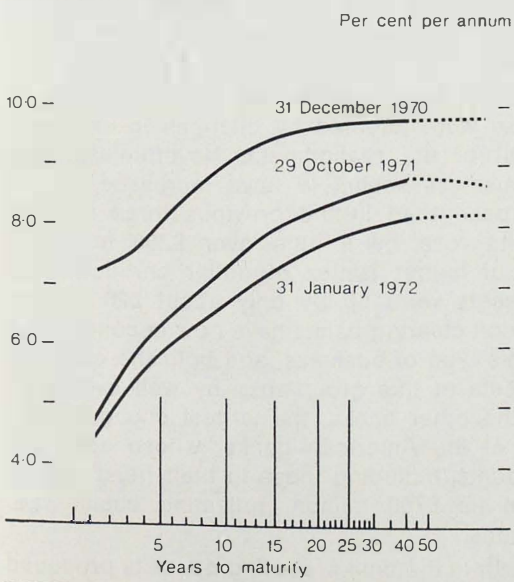
. . . and official sales of gilt-edged stocks were still substantial – though smaller than in the September quarter, which included special transactions of £750 million with the banks.

Gilt-edged market

Demand for gilt-edged stocks was strong in November and January, but for much of December the market was uncertain.

Throughout the period, the flow of funds coming to the market for long-term investment, especially through the financial institutions, was substantial. Early in November, there was also a decline in interest rates in the United States which encouraged the market to hope for a reduction in domestic rates. Prices rose steadily and the market was further strengthened both by the announcement of the large U.K. trade surplus for October and by rising hopes of a settlement with Rhodesia. After the middle of the month, demand for stock – particularly the long tap (8% Treasury Loan 2002/06) – was heavy. When Bank rate was not changed on 25th November, however, and when it was learnt the following day that the sharp fall in the Treasury bill tender rate did not have official support (see page 18), prices fell and the market remained hesitant for some three weeks. It was thought that interest rates were unlikely to fall further; and fears about the outcome of the international currency talks in Rome and the India-Pakistan conflict contributed to the general uncertainty. Another reduction in U.S. interest rates in the middle of December helped to steady prices briefly but they were marked down sharply after the

Time/yield curves of British government securities[a]



Yields continued to fall and by the end of January were generally about ½% lower than three months earlier.

a The continuous lines have been fitted to the gross redemption yields on dated British government stocks with coupons of 5% or higher: the broken lines connect the calculated yield for the longest-dated stock to the flat yield on 3½% War Loan.

international currency realignment in Washington. This was because the market feared that selling might develop in association with an outflow of foreign exchange. When it did not happen, prices quickly rallied and the market was firmer to the end of the year.

The authorities sold about £420 million (net) of stock in the December calendar quarter, mainly in October and November when the market was firm. Official repurchases of stock maturing in 1972 – at £244 million – just outweighed sales of other short-dated issues (£239 million). But sales of longer-dated stocks – principally the tap stock – were very substantial at £321 million; and there were smaller sales (£105 million) of medium-dated stocks. Domestic holders other than the banks took nearly all of the net amount sold.

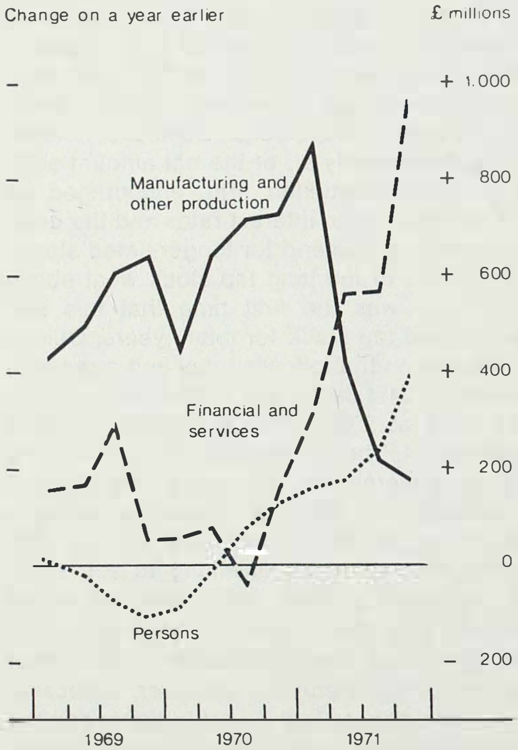
In January, the market continued firm, encouraged by further falls in U.S. and European interest rates and the good trade figures for December. Demand for longer-dated stocks became strong. The price of the long tap stock went above par on 19th January. It was the first time that this had happened to a long-dated tap stock for many years. Official supplies were exhausted on the following day and a replacement was announced on 21st January – £600 million of 7¾% Treasury Loan 2012/15 at £96 per £100 nominal to yield nearly 8⅛% to redemption. The authorities foresaw the need to finance a large government borrowing requirement during the forthcoming year, and also wished to retain a means of influencing long-term interest rates directly. The terms indicated that they were not unwilling to see some further decline in long-term interest rates. Although prices of long-dated stock fell after the announcement, they quickly recovered and the market was generally steady to the end of the month. In the first part of February, however, it became unsettled because of the dispute in the coal industry and the situation in Northern Ireland. Unimpressive January trade figures, the introduction of emergency powers in connection with the coal strike and the Wilberforce recommendations on miners' wages all caused prices to ease, but the market rallied in the last week of February.

Most yields fell quite sharply in November, rose somewhat until shortly before Christmas, and then continued downwards in January. By the end of that month, yields on most short-dated stocks were down by some ⅛%–⅜% to range between 4¼% and 6⅛%, and yields on medium-dated stocks by around ⅝%. The fall in yields on longer-dated stock was a little more pronounced – they decreased by ⅝%–¾% to finish at up to 8⅛% – so that the spread between yields on short-dated and long-dated stocks narrowed over the period.

Banks and discount houses

Total sterling deposit liabilities of all the various groups of banks rose sharply, by well over £1,700 million, in the three months to mid-January. A large part of the increase, some £670 million, was in issues of sterling certificates of deposit (over one third of them by the London clearing banks) of which about £390 million were acquired by the banks themselves. A further £200 million of the increase

Banking sector's advances to U.K. residents



Industrial borrowing remained subdued but lending to other domestic customers rose sharply.

in total deposits was in accounts of overseas residents (chiefly with the other banks) reflecting the inflows from abroad. But the most substantial increase was of some £750 million in the deposits of U.K. residents other than banks, mainly a result of the very large expansion in domestic credit during the period.

On the assets side, the biggest increase was one of nearly £900 million in sterling advances, of which some £850 million went to U.K. residents other than banks, and the remainder to overseas. Nearly £400 million of the domestic lending was done by the accepting houses, overseas and other banks, who expanded this type of business rather faster in proportion to their sterling resources than the clearing banks. Industrial demand for loans remained relatively subdued – though there were signs of a revival of interest towards the end of the period – and the bulk of the advances went to financial concerns and persons. Among the banks' remaining sterling assets, the most important changes were increases of nearly £600 million in money lent to the discount houses – mainly by the accepting houses, overseas and other banks – and of over £250 million in Treasury bills. Loans to local authorities fell by £170 million as the authorities drew more heavily on other sources.

Movements in the sterling equivalent of the banks' total currency business were affected by changes in exchange rates as a result of the realignment. Nevertheless their total currency business seems to have increased, but at a much slower pace than in the previous three months. Currency deposits rose by a little over £200 million – mostly because of higher issues of dollar certificates of deposit – but assets were up by only about £20 million. Some of the London clearing banks have now become much more active in this type of business, and both the currency deposits and assets of this group rose by well over £200 million. Among the other banks, the largest changes were in the business of the American banks, whose advances to overseas residents, including those to their head offices, fell by as much as £700 million, reflecting easier U.S. monetary conditions.

The sharp growth in the banks' sterling deposits produced a rise of almost £900 million in their eligible liabilities since mid-October. As already noted, a substantial part of the funds was lent to the discount market, and nearly £400 million of this qualified as reserve assets. So, too, did the increase in the banks' Treasury bills. Their holdings of 6¾% Exchequer Stock 1973 also became reserve assets when the stock moved within a year of maturity on 15th January. Total reserve assets increased by well over £700 million during the period, and the banks' combined reserve ratio rose from 15·9% at mid-October to 19·1% at mid-January.

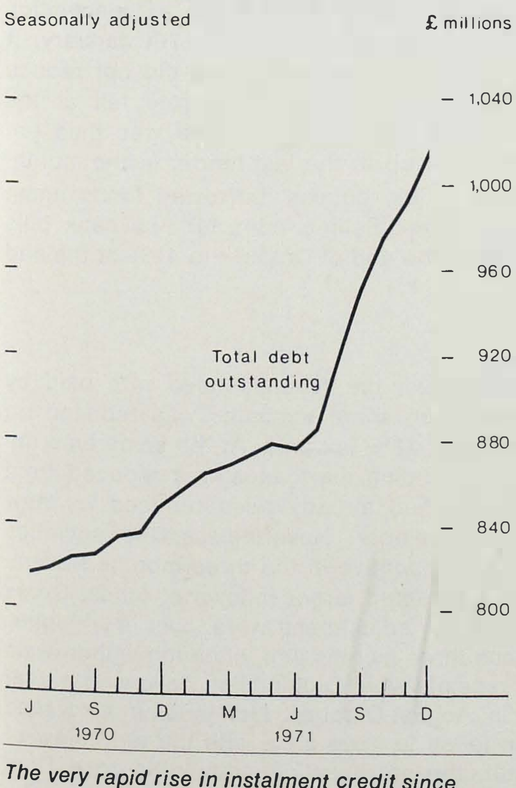
The ready availability of funds enabled the discount houses to increase their borrowed funds by some £800 million in the three months. The houses used the greater part – almost £500 million – of these additional resources to increase their holdings of Treasury bills. Most of the remainder went into other sterling bills and sterling certificates of deposit: other sterling bills rose by almost £150 million and certificates of deposit by £53 million. During the period the houses increased their holdings of eligible public sector debt by a little over £600 million, and at the middle of January their average public sector lending ratio was comfortably above the 50% minimum at 64·1%, compared with 58·8% at mid-October.

Finance houses
Under the new arrangements for the control of credit, the larger members of the Finance Houses Association and certain houses outside the Association have agreed to build up their holdings of reserve assets by stages to 10% of their eligible liabilities by 20th September 1972, a year after the beginning of the scheme. After four months, in mid-January, their aggregate reserve ratio had reached 4·7%. The scheme began with fourteen participating finance houses. In January four of the houses – United Dominions Trust Ltd., Mercantile Credit Co. Ltd., First National Finance Corporation Ltd. and Julian S. Hodge & Co. Ltd. – were informed that they had been recognised as banks by the Department of Trade and Industry under the Protection of Depositors Act 1963. Together with Lombard North Central (whose recognition was confirmed at the same time) they will henceforward also be treated as banks for the purpose of credit control, although their figures will not be included in the banking statistics until later.

New credit extended by the finance houses remained high during the fourth quarter but there were signs that the effects of the removal of terms control were beginning to wear off. Repayments were also substantial in the quarter when the seasonally adjusted total of instalment debt outstanding rose by a further £65 million compared with £73 million in the September quarter. Since the end of July, the finance houses' outstanding debt has risen by £130 million, or nearly 15%, as usual mainly to finance the purchase of new and used cars.

Most of the major finance houses did not quote rates for three-month deposits during the second half of October and November, when their direct borrowing from the banks increased. Quotations from the smaller houses indicated that rates on three-month deposits at first continued downwards. They fell by over $\frac{1}{4}$% to around $4\frac{3}{4}$% during November, and eased further to $4\frac{3}{8}$%–$4\frac{1}{2}$% at the end of December. By the end of January they had risen again to 5%–$5\frac{1}{8}$% as short-term funds became tighter with the onset of the government revenue season. On 1st December the Finance Houses Association base rate, which is used to calculate charges for some longer-term lending, was cut for the third successive month by $\frac{1}{2}$%, to 5%. It then remained unchanged up to 1st February.

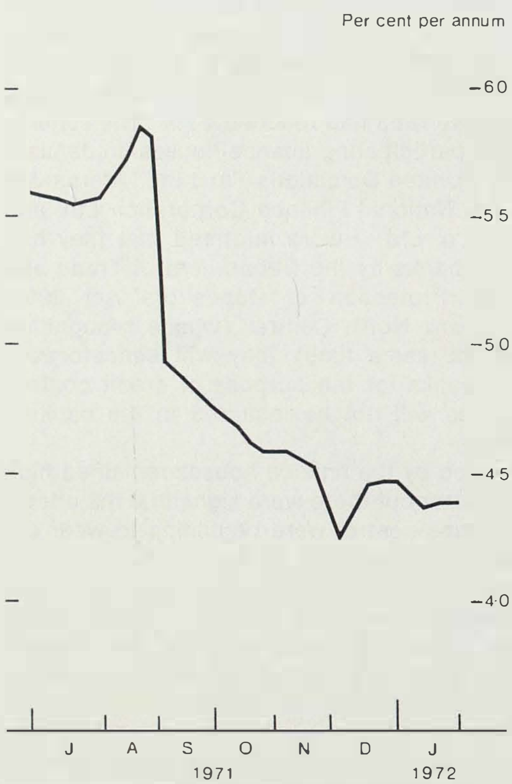
Finance house lending



The very rapid rise in instalment credit since July slowed a little towards the end of the year.

Bill markets
With substantial inflows of funds from abroad, conditions in the money market were generally easy before the Washington agreement. In November, official sales of gilt-edged stocks helped to absorb some of the funds and, occasionally, the Bank had to give help, mainly through buying bills. After

Treasury bill tender rate[a]



The fall in the tender rate was checked in the period November-January.

a Before 17th September 1971, the discount market's joint tender rate; from 17th September the highest rate at which tenders were accepted.

demand for gilt-edged stocks had fallen away at the end of November, conditions were very easy. The Bank mopped up surplus funds with frequent sales of bills. The market was more balanced after the realignment but funds were tight on the last two days of the year when assistance took the form of purchases of bills and some lending over the week-end. During January conditions grew steadily tighter as the seasonal inflow of central government revenue gathered pace.

At the Treasury bill tender, offerings of bills were small in November. The highest rate at which applications were accepted continued to fall, reaching just under $4\frac{3}{8}$% on 26th November. After that tender, the Bank changed their practice for fixing the rates at which they were prepared to deal with the market. Since September, these had been based on the highest rate accepted at the tender, although the market had been made aware that the Bank reserved the right to deal at prices of their own choosing. This time, the Bank did not bring their rates down by as much as the fall in the tender rate, and the market interpreted this as a signal that the fall in bill rates was felt to have gone far enough. The tender rate nevertheless fell a little more on 3rd December but, on 10th December, it rose for the first time since the withdrawal of the agreed market bid in September. After another rise in the following week, the rate at $4\frac{7}{16}$% was again in line with the Bank's dealing rates. Larger offerings of bills to match large government disbursements at the end of December helped this rise in rates.

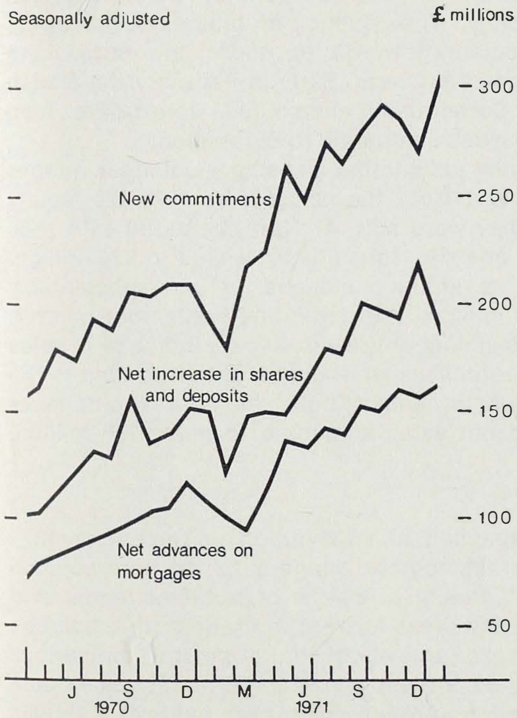
At the last tender in December and in the first half of January, the tender rate began to fall again as speculation grew about a reduction in Bank rate. By 7th January, it had gone below $4\frac{7}{16}$% and the Bank again did not reduce their dealing rates correspondingly. The rate fell at the next tender but rose a little thereafter and was then unchanged at nearly $4\frac{7}{16}$% up to the last tender in the month.

The average cost of the houses' borrowed funds again appears to have declined. Selling rates for fine bank bills fell from about $4\frac{7}{8}$% at the end of October to $4\frac{1}{2}$% at the end of January.

Building societies

As previously announced, the recommended rate paid by the building societies on share accounts was reduced on 1st January from 5% to $4\frac{3}{4}$% tax paid. At the same time the rate charged on outstanding mortgages was reduced from $8\frac{1}{2}$% to 8%; the rate had already been reduced for new borrowers on 1st November. Nevertheless, the societies remained generally competitive in the three months November to January and attracted larger inflows of funds. Gross receipts after seasonal adjustment were over 9% higher than in the previous three months and, although withdrawals rose rapidly, net receipts were £600 million, following a total of £573 million in August-October. Net lending also rose sharply but again failed to keep pace with the net inflow of funds. As a result, the societies' liquidity ratio rose from 18·3% at the end of October to 18·8% at the end of January.

Building society funds



The societies' new lending commitments rose more slowly than before but the inflow of funds was still substantial.

The societies' new commitments to lend rose rather more slowly than before. This slowdown may in part have reflected caution by the societies after the interest rate reductions, in case the inflow of funds should fall away, and in part also reflected a marked shortage of both new and existing houses for sale in some areas. Over the whole year 1971, the societies' net receipts rose by £544 million or 37%, and net advances increased by £488 million or 45%. This exceptionally rapid growth was helped by a favourable combination of circumstances including a sharp increase in total personal incomes, a fall in most competing domestic interest rates and a recovery in demand for new private house-building. Because of the sharp rise in house prices in recent months, however, a given amount of lending covered distinctly fewer properties than it would have done before. Nevertheless, though the societies' resources may not expand so rapidly in the immediate future, their rates continue to be competitive, their liquidity ratio is very high (the highest since the late 1940s) and they should have no difficulty in meeting demand for mortgage finance for some considerable time.

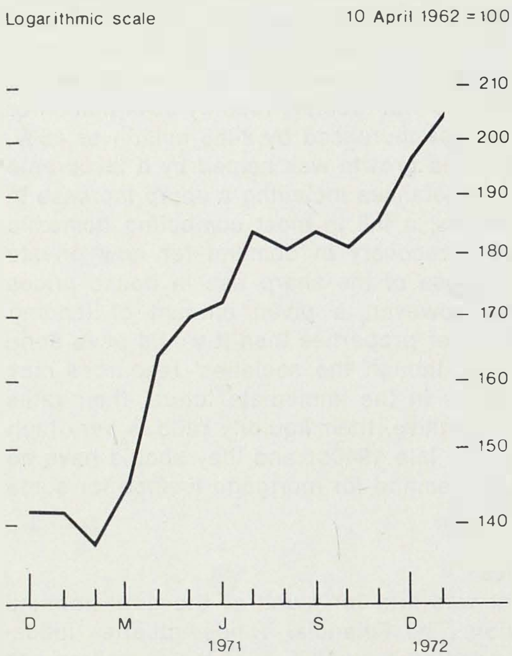
Company securities

The equity market was firm for much of the three months under consideration. The Financial Times-Actuaries industrial share price index rose by 13% over the period and at the end of January stood at 205 compared with 181 at the end of October; it was also some 6% above the peak of January 1969. The less broadly-based Financial Times industrial ordinary share index exceeded 500 on 20th January for the first time since early 1969. The market was influenced by the improved profits reported by many companies and the prospects for further increases as economic activity gathered pace; and by developments on the New York stock exchange where prices, after reaching a low point early in November, staged a strong and sustained recovery until the middle of January. Several large take-over bids also encouraged buyers, and both the currency realignment and the end of the war between India and Pakistan helped to give confidence. The market was only temporarily disturbed by doubts about the prospects for a settlement in Rhodesia and by the coal miners' strike which began early in the New Year. In February the market was at first cautious as the coal strike continued and in view of the situation in Northern Ireland. After the miners' settlement, however, it recovered strongly.

Yields on company fixed interest securities moved fairly closely with those on gilt-edged stocks, falling in November, rising a little in December and falling again in January. At the end of January, first-class high coupon stocks of about twenty-five years' maturity were yielding around $8\frac{1}{2}$% which was about $\frac{3}{8}$% less than three months earlier. The fall in yields on comparable gilt-edged stocks was rather greater so that the differential between them widened to about $\frac{3}{8}$%.

The rise in equity prices and fall in fixed interest yields was accompanied by signs of a revival in the new issues market. In November-January, U.K. companies raised £190 million (of which £133 million by equity issues) compared

Industrial share prices[a]



Share prices rose strongly in the three months to the end of January.

a F.T.-Actuaries (500) share price index: monthly, last working day.

with £115 million (equities £38 million) in the previous three months; but this increase was largely accounted for by the first call (£61 million) on a large rights issue by the British Petroleum Company. The 'queue' of intending borrowers lengthened appreciably towards the end of the period, and included some industrial firms. Early in February the British Leyland Motor Corporation announced convertible loan stock and rights issues amounting to £51 million.

Sales of unit trust units in the December calendar quarter appeared to benefit from the improvement in the equity market, though they were still very low compared with 1968 and the first half of 1969. Net sales increased to £24 million, about the same as in the June quarter and substantially more than the £7 million recorded in the September quarter. The recovery was almost entirely due to an increase in sales by the trusts. Repurchases were only a little less than in the September quarter. In January both sales and repurchases rose sharply and net sales amounted to nearly £8 million.

Conclusion

The agreement reached in Washington in December 1971 averted the most immediate dangers to the international monetary system – though a number of problems remain and it will be important to press forward the search for a solution to them. Nevertheless, the withdrawal of most of the various direct restrictions on trade and payments which some countries had imposed to protect their own national interests removed a potentially serious constraint on the growth of world trade. In spite of some market misgivings about the U.S. dollar since the realignment, the agreement should prove durable and help to provide a more certain background for businessmen both in this country and overseas. In the first few months after the settlement, it was to be expected that the U.S. balance of payments deficit would show no improvement. After a devaluation it usually takes some time before exports make up in volume more than is being lost on price. In the case of the dollar, this delay might be prolonged if the low state of economic activity in many major U.S. export markets – particularly in Western Europe and Japan – were to persist. But steps have already been taken in some of these countries to increase economic activity, and the U.S. economy has sufficient spare capacity to be able to derive rapid benefit.

At home, unemployment was very high at the beginning of the year, but the prospects for relatively strong domestic growth throughout 1972 are favourable. Personal consumption has been rising strongly and the Government's decisions to repay outstanding post-war credits and to review pensions annually will help to sustain the increase during the later part of 1972. Stocks fell sharply in the summer and autumn of 1971 but the decline had come to an end during the last quarter. The Government's various plans announced during 1971 to advance their own and other public sector spending will also begin to take effect quite soon. As well as this build-up in domestic demand, the faster growth in world trade expected as a result of the Washington agreement should lead to increased foreign demand for U.K. goods. Finally, monetary conditions remain easy: interest rates are lower than for some years, the banks have been lending liberally and still have ample spare resources, and since the autumn the growth in the money stock has been very rapid.

This relatively buoyant prospect is bound to have been at least temporarily postponed by the effects of the miners' strike. The shortage of power will have hit both industrial output and earnings in the first quarter of 1972; but demand may not have been affected proportionately because, for the time being, people may have saved less. So stocks may well have been run down again, exports reduced and imports increased to make good the shortages in the home market. Nevertheless, the fall in activity should only have been short-lived and, once the full supply of power is restored the underlying influences should begin to reassert themselves. At least two aspects of the strike, however, could have longer lasting and more damaging effects. First, such a setback – however temporary – may have impaired the still shaky confidence of consumers (at a time when they were borrowing more and increasing their spending) and of companies (which seemed to be on the point of spending more on stocks, if not yet on plant and machinery). Secondly, it is crucial that the size of the miners' pay settlement should be generally recognised as exceptional and that still further progress should be made in reducing the rate of growth in prices and wages. Otherwise it will be difficult to bring about the reduction in unemployment that is so seriously needed.