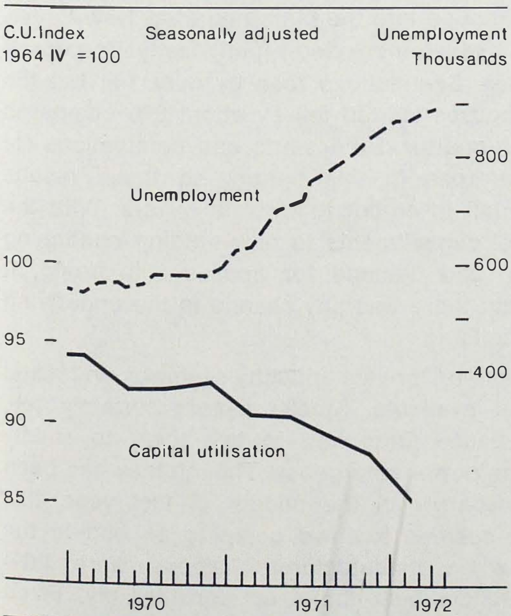
Commentary

The coal miners' strike (which lasted from 9th January to 27th February and seriously curtailed power supplies in the second half of February) reduced domestic economic activity in the first quarter of 1972. It also obscured underlying developments in the three months from February to April with which this Commentary is mainly concerned. In line with the Government's policy of economic expansion, the money stock again rose rapidly, helped by a continued fast increase in bank lending to the private sector. But, so far as can be judged, demand was weakening before the Budget: consumers' expenditure was sluggish and exports fell. Domestic output too was still subdued and unemployment continued to rise, though probably more slowly than hitherto. In his Budget therefore the Chancellor took as his objective an increase from 3% to 5% in the expected annual rate of growth between the second half of 1971 and the first half of 1973.

In the balance of payments, imports continued to rise strongly and, partly because of the coal strike, the current account surplus declined sharply. Foreign exchange markets were unsettled at first by continuing doubts about the U.S. dollar but they were much calmer towards the end of the period. At the end of April, all the remaining U.K. liabilities to the International Monetary Fund were repaid and the United Kingdom became free of official short and medium-term debt for the first time since May 1964.

Capital utilisation and unemployment



The growth in unemployment showed signs of slackening but capital utilisation fell sharply as a result of the miners' strike.

Capital utilisation index

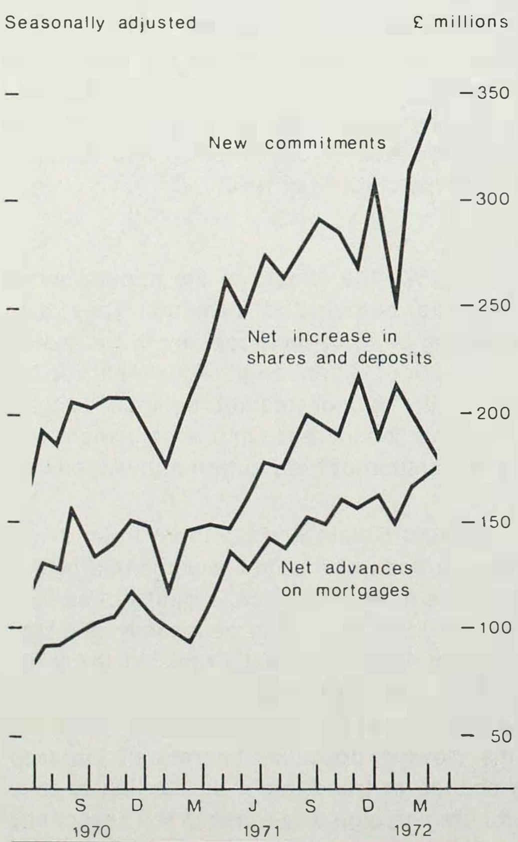
	I	*II*	*III*	*IV*
1969	94·8	95·7	94·9	94·4
1970	94·4	92·3	92·3	92·6
1971	90·8	90·7	89·4	88·1
1972	85·8			

Domestic economy

In the first quarter of 1972 the effects of the miners' strike reduced both domestic output and demand. They also obscured the underlying state of the economy in the weeks before and after the Budget. After rough adjustment for the strike, the trends in the labour market seemed to give grounds for believing that the increase in unemployment was slowing down, but the course of both output and wages was less encouraging.

Unemployment in Great Britain and Northern Ireland was still over one million in each of the first four months of this year and, at 3·9% of the total work force, a cause of serious concern. However, the increase in the seasonally adjusted number of wholly unemployed in Great Britain in the three months ending in April was only 18,000, compared with an increase of 59,000 (over three times as big) in the previous three months. This slowing down in the rate of increase suggested that a change of trend might be starting to take place. Another encouraging sign was a rise in the seasonally adjusted number of adult vacancies from a monthly average of 118,000 in the fourth quarter of 1971 to 124,000 in the first quarter of this year, a rise which continued in April. These

Building society funds



The rate of inflow into the building societies slowed down in the first quarter, but new commitments remained high.

portents were confirmed by the unemployment figures for May. The total for Great Britain and Northern Ireland fell below one million, to 902,000; and the seasonally adjusted number out of work in Great Britain came down very sharply by 62,000 to 3·6% of the total work force. It may be that firms would have taken on more labour earlier in the year but for the uncertainties created by the miners' strike. Meanwhile, adult vacancies rose again, by 5,000, to stand at 133,000.

This evidence of an improvement in the labour market may have reflected the effects of the quickening in economic activity in the late summer of last year, partly in response to the measures taken by the Government in March and July 1971. In the first quarter of 1972, however, the growth in demand seemed to be fading, even before it was affected by the miners' strike. In January, personal consumption was probably no higher than the average monthly rate in the last quarter of 1971; and the volume of retail trade in the March quarter declined a little compared with the previous quarter. Some spending may have been delayed in expectation of tax reductions in the Budget, but high unemployment and a prevailing uncertainty may also have made buyers nervous and caused them to hold off.

All the other kinds of demand probably fell, except perhaps for the public sector's consumption of goods and services. This rose steadily through 1971 – it was 3¾% higher in the December quarter than a year earlier – and the rise probably continued into the March quarter. New housebuilding, however, which increased rapidly last year, paused in the first quarter. Completions rose by over 1% but the number of new houses started fell by about 8% compared with the previous quarter. Both starts and completions for public authorities rose in this period, so these results suggest a sharp fall in output for private buyers. With the building societies' commitments to new lending continuing to rise, however, and demand for houses still strong, it seems unlikely that there was any change in the underlying upward trend in building.

Little information on private industry's stocks and fixed investment is yet available. Stocks almost certainly fell, but probably because firms had to use them to satisfy demand during the power emergency. Though they had been run down quite sharply in the middle of last year, this previous decline seemed to have come to an end in the fourth quarter when manufacturers' stocks were little changed and retailers built theirs up considerably. Fixed investment by private industry is not likely to have changed much in the March quarter. Manufacturers' investment fell by about 8% in 1971 and, with capital utilisation lower than for ten years, there were no particular pressures for renewed investment early in 1972. Some increase may take place later this year, however, as the economy gathers pace; and in the latest survey by the Confederation of British

Industry taken in April, a net 9% of firms said that they planned to increase their spending on new plant in the next twelve months. There was also a fall in the volume of exports in the first quarter, only part of which was probably due to the strike.

On the supply side, industrial production in the March quarter fell by $2\frac{3}{4}$%; some output was permanently lost, and it will have taken time for some industries, such as those relying on continuous processing and the coal industry itself, to make up for the stoppage. It is unlikely that the underlying level of output was much different from the previous quarter. In contrast with the depressed state of domestic output, the volume of imports rose substantially – partly to meet shortages caused by the strike – and supplied an increased proportion of domestic demand.

The strike must have had a short-term effect on earnings, particularly in February when a large number of workers were temporarily laid off through lack of power supplies, and it was impossible to collect any relevant statistics. However, comparing an average of weekly earnings in January and March this year with the first quarter of 1971, the increase was over $9\frac{1}{2}$%, much the same as the annual rate of increase in the last quarter of 1971. The suggestion from this comparison that last year's slowing down of the rate of growth in earnings may have come to an end seemed to be supported by developments in hourly wage rates. Their rate of growth declined from no less than $13\frac{1}{2}$% in July 1971 to just over $12\frac{1}{2}$% in December and about 12% in January. But the extent of the deceleration was less than for earnings, because of the conclusion of such settlements as those with the miners, and the increase in wage rates levelled out from January onwards at an annual rate of around 12%. Meanwhile the rate of growth in retail prices still seemed to be slowing down; but the increase in April alone, at nearly 1%, was the largest monthly change for some time and took place despite the Budget lowering of purchase tax, a reduction in the price of milk and stabilisation of sugar and potato prices announced by the Government, and little change in other seasonal food prices.

The Budget

Against this sluggish background, the Chancellor's Budget was designed to increase the expected growth in output between the second half of 1971 and the first half of 1973 to 5% a year. He announced cuts in tax revenue in the 1972/73 financial year of about £1,200 million; taken together with other Budget measures, they were expected to bring the total financing required for the public sector in 1972/73 to some £3,360 million, an unprecedentedly large figure and nearly three times as much as the estimated actual amount of £1,159 million required in 1971/72.

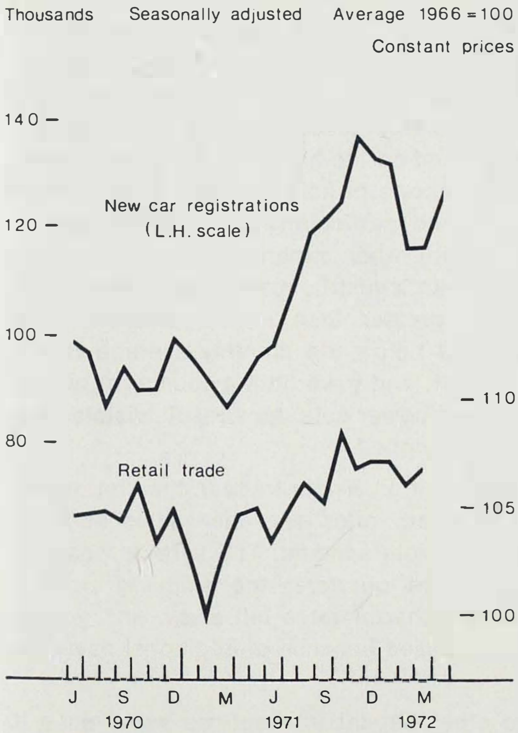
The main tax proposal affecting personal incomes was an increase in the single persons' and married couples' income tax allowances, estimated to cost the Exchequer £960 million in 1972/73 or £1,200 million in a full year. Interest of over £35 a year was to be allowed to be set off against tax (thus reintroducing in a modified form a provision which had been abolished in 1969); and the two top rates of purchase tax were reduced to a uniform 25% immediately, partly in preparation for the introduction of value added tax in 1973. It was also announced that pensions were to be increased by 12½% in the autumn, with corresponding rises in other national insurance and supplementary benefits, and increased contributions by both employers and employees.

On company taxation, the Chancellor proposed to introduce immediately 'free' depreciation for investment in plant and machinery, enabling companies to write off the full cost of an investment in the first year of installation. This concession had previously been available only in development areas. Taken together with the extension to all companies of the 40% initial depreciation allowance for new industrial buildings – also previously restricted to development areas – the Government's assistance to investment in the form of tax allowances was expected to be raised by £5 million in 1972/73 and £115 million in 1973/74. Differentials in favour of investment in the development and intermediate areas were restored by the introduction of a new system of regional development grants.

Further details were announced of proposed longer-term tax reforms. First, value added tax was to replace both purchase tax and selective employment tax in April 1973 at a single rate expected to be 10%. The kinds of business to be exempt or zero-rated were specified and a separate additional 10% tax was to be imposed on cars. Second, an imputation system of corporation tax was to be introduced in April 1973, with the aim of avoiding the present distinction between retained and distributed profits. Third, on personal taxation, unified tax rates (combining income tax and surtax) were announced to take effect in April 1973; and a Green Paper was promised for later in the year on a new system of tax credits to replace both personal tax allowances and the main social security benefits. Fourth, certain relaxations in estate duty were made, and a Green Paper issued at the same time outlined a possible scheme for replacing estate duty by an inheritance tax.

As regards external transactions, the rules restricting the financing from U.K. sterling sources of inward investment were modified, so that U.K. companies controlled by residents of the European Economic Community, Denmark and Norway could borrow domestic funds without limit for direct investment in any part of the United Kingdom. Other foreign-owned companies were also given unlimited access to U.K. funds for new direct investments in the development or intermediate areas. U.K. companies were to be allowed official exchange for the first £1 million in any year of a new direct investment in the enlarged Community; and the volun-

Retail trade and new car registrations



The growth of spending in shops and on cars paused partly because of the miners' strike and partly in anticipation of the Budget.

tary programme of restraint on investment in the developed sterling countries was abolished.

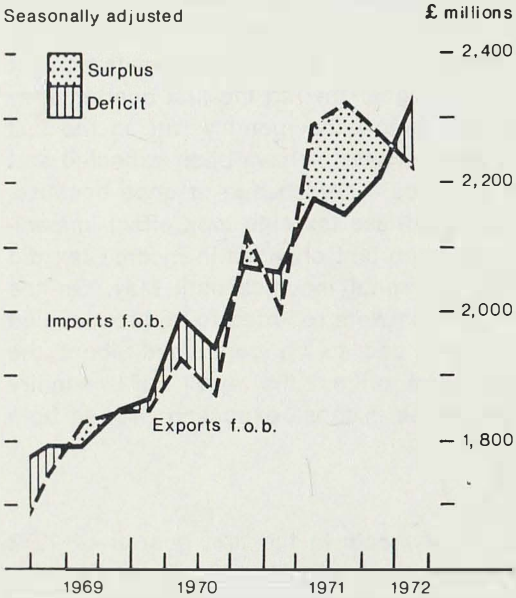
Little information on the domestic economy after the Budget is yet available. Retailers were reported to have been satisfied with the amount of business but not to have detected signs of strong growth; and, though registrations of new cars in April were higher than in the first quarter, they were still considerably below the monthly rate in the last quarter of 1971. It was perhaps to have been expected that personal consumption would not change at once because, although the Budget purchase tax cuts took effect immediately, the much more important changes in income tax did not begin to benefit personal incomes until May. On the industrial front, many firms were reported to be preoccupied with industrial relations and to be concerned about the prospects for costs and prices: the April C.B.I. enquiry indicated a sharp increase in those expecting rises in both in the next few months.

Balance of payments

The U.K. balance of payments in the first quarter of 1972 did not show the same exceptional strength as in 1971. Visible trade was in deficit and capital inflows were greatly reduced after the realignment of exchange rates in December 1971.

The balance on current account swung from a surplus of about £250 million in the fourth quarter of 1971 to a deficit of some £50 million in the first quarter of 1972. After seasonal adjustment, there was a small surplus in the first quarter, much less than the surplus of around £250 million in the previous quarter. Part of the decline was due to the miners' strike and associated power cuts, which caused some temporary loss of exports and some exceptional imports of coal in March. Taking the third and fourth quarters of 1971 together to smooth out the effects of the U.S. dock strike, the visible balance swung from an exceptional surplus of about £40 million per month to an appreciable monthly deficit in the first quarter of 1972. This deterioration would have been even more marked but for a continuing, though diminishing, benefit from the terms of trade: export prices rose by about $2\frac{1}{2}$% between the two periods and import prices by less than 1%.

The average monthly value of exports fell by nearly 4% between the second half of 1971 and the first quarter of 1972. As prices were up by about $2\frac{1}{2}$% and shipments of certain erratic categories such as ships and aircraft were also higher, the underlying volume of other exports fell sharply. This was probably associated with a general slackening in world trade since early last year, which was attributable to the depressed rate of domestic growth in many industrial countries and to the currency uncertainties. Exports may also have been adversely affected by a deterioration in price competitiveness after three years of rapid domestic inflation, Balance of U.K. visible trade



The visible trade balance went into deficit in the first quarter of 1972.

though some U.K. firms are still reported to consider that their export prospects are favourable. Exports of cars were some 14% lower in value and exports of most other manufactured goods also weakened.

In contrast the value of imports rose very rapidly – by nearly 7% – most of which was due to an increase in volume. Part was attributable to higher imports of tobacco from the United States – presumably associated with the ending of the U.S. dock strike – and part to higher coal imports, but the main growth was in imports of finished manufactures, such as consumer goods and particularly cars. These adverse trends continued in April, when imports were as high as the record March figure, with industrial materials starting to pick up. Exports, though greater than in the previous three months, were still well below the monthly average rate in the second half of 1971, and gave little evidence of making good the fall during the power cuts. As a result, visible trade continued in substantial deficit.

Nevertheless the deficit on visible trade in the first quarter was more than matched, after seasonal adjustment, by another surplus on invisible account. The surplus was less, however, than in recent quarters; the shipping account deteriorated as tanker charter rates fell away, and government expenditure increased because of additional payments of aid.

Investment and other capital transactions were close to balance, in marked contrast with the very large inflows recorded in 1971. Exchange reserves in sterling held by overseas countries rose by some £200 million. About £150 million of this was in the official holdings of overseas sterling countries which were in seasonal balance of payments surplus. The sterling balances of private holders were virtually unchanged. The banks increased their net foreign currency borrowing from abroad significantly, and lent a large amount to U.K. customers, to finance portfolio investment overseas. Other private investment abroad was roughly balanced by overseas investment in this country, but there was a net outflow of official long-term capital, including the advance repayment of some earlier U.S. Exim Bank borrowing which had financed the purchase of U.S. military aircraft. U.K. banks' sterling claims (other than for export credit) also rose. The positive balancing item, which represents errors and omissions elsewhere in the balance of payments accounts, was much smaller than in the first quarters of the three previous years.

The voluntary arrangements which were introduced in December 1969 to limit stocks of silver financed in sterling were suspended in April 1972.[1]

With the current account as recorded *i.e.* before allowing for seasonal influences, in small deficit and with a much reduced inflow of capital, the total currency inflow of £57

1 See March 1970 *Bulletin*, page 6.

million was very much less than in any quarter of 1971. This more balanced position may have been partly due to the development of equilibrating capital flows within the wider exchange rate margins agreed at the Washington meeting in December, but it also reflected the deficit in the United Kingdom's visible trade.

Reserves and official financing

The total currency flow of £57 million available for official financing in the first three months of this year was augmented in January by a third allocation of £124 million of Special Drawing Rights on the I.M.F. The amount of foreign currency placed with overseas monetary authorities by official swaps was run down by £20 million, so that at the end of the quarter the swaps outstanding stood at £844 million. Most of the total of £201 million accruing from these three sources went to increase the reserves, which rose by a further £191 million (valued at the rates at which the transactions took place) to £2,715 million (valued at the middle rate of $2·6057) at the end of March. There was also a reduction of £10 million in U.K. liabilities to the I.M.F., arising from the Fund's use of sterling in transactions with other countries. As a result, liabilities to the I.M.F. at the end of March stood at £405 million in respect of outstanding drawings (repayment of which would have begun to fall due in June 1972); plus the obligation to repurchase £83 million of sterling, previously paid to meet charges.

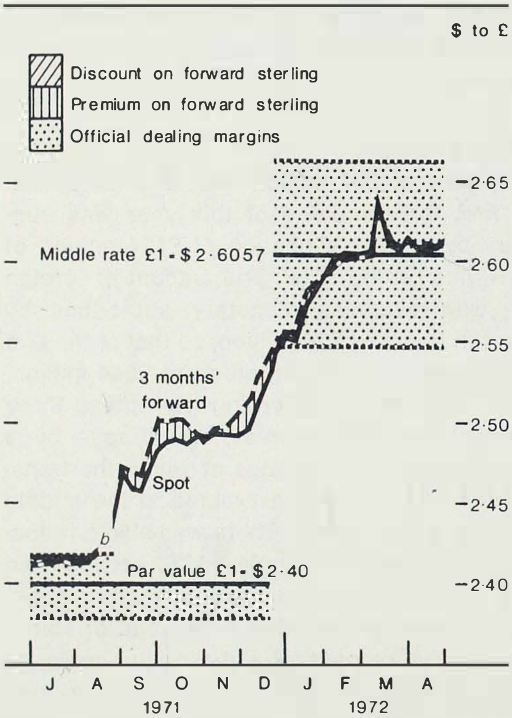
All the liabilities to the I.M.F. were discharged on 28th April and the U.K. reserve position of £292 million in the I.M.F. – the gold tranche which may be drawn on demand – was thereby reconstituted. Arrangements were agreed with the United States, Canada, and seven other countries for assets to be made available to the United Kingdom which would be acceptable to the Fund. The U.K. repurchase obligation was discharged by means of a U.S. drawing of sterling equivalent to SDR 200 million: and U.K. repurchases of sterling from the Fund, first, with currencies bought by the United Kingdom from the countries concerned in exchange for U.S. dollars equivalent to SDR 500 million; second, with gold and S.D.R.s equivalent to SDR 50 million sold to the United Kingdom by Canada; and third with SDR 400 million from the United Kingdom's own holding. Full discharge of these liabilities meant that the United Kingdom was free of all official short and medium-term debts for the first time since May 1964.

At the end of March, the Federal Reserve Bank of New York's outstanding forward liability under the reciprocal swap facility was unchanged from December at £295 million.

Foreign exchange and gold markets

Foreign exchange markets remained unsettled in February and the first part of March, but were subsequently much calmer.

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



After a sharp but temporary rise early in March when the U.S. dollar was under pressure, sterling settled a little above its middle rate.

a Middle closing rates: weekly, Fridays.

b No quotations are available for the period 16th to 20th August when the London foreign exchange market was closed.

In February markets were still uncertain about the durability of the previous December's realignment. In mid-month the publication of a large U.S. balance of payments deficit for 1971, and an American statement that the dollar would remain inconvertible until at least the end of the year, led to renewed weakness of the dollar against all other currencies. Some countries such as Japan, which had continued in large balance of payments surplus, reintroduced measures to discourage dollar inflows. Nevertheless, as the deutschemark, guilder and French and Belgian francs reached their ceilings, fears grew that central banks either might not maintain their intervention rates or might impose even more stringent controls. Some central banks (at different times those of West Germany, the Netherlands, Belgium and Japan) took in large amounts of dollars but by the end of the second week in March the selling had abated, as euro-dollar rates rose sharply. During April movements in exchange rates were mainly connected with changes in interest rates. At least for the time being, the markets seemed to have accepted that the December realignment would endure, so that the U.S. dollar was generally stronger, and not in need of support.

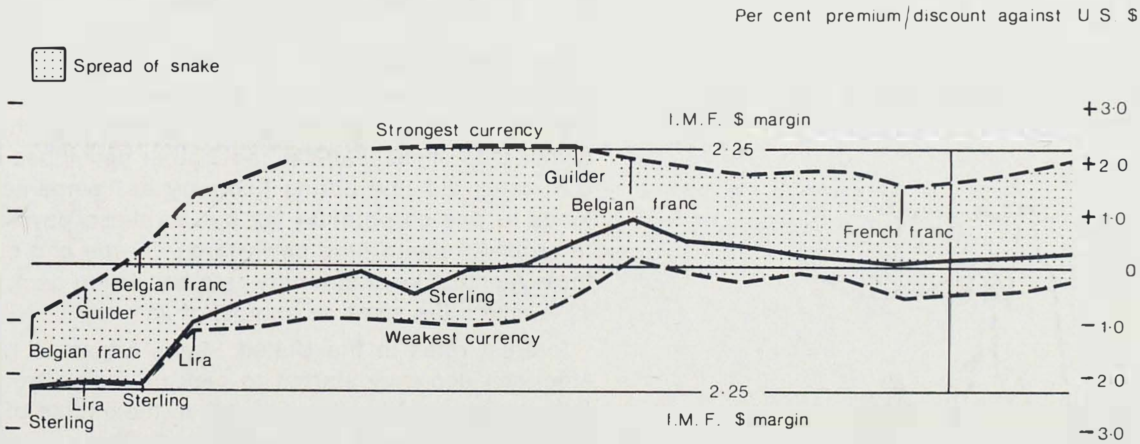
During this period, sterling tended to move closer to its parity than most other major currencies and continued to show virtually no effective change against a weighted average of them. It moved around its new middle rate of $2·6057 in the first part of February and fell only temporarily because of the miners' strike. When renewed uncertainties about the U.S. dollar developed later it rose to within ½% of its ceiling, touching $2·6515 at one time, but was marked down to near its middle rate before the Budget. The Budget itself was not unfavourably received and sterling fluctuated around $2·6150 in quiet markets before Easter. It only fell a little after publication of the poor March trade figures, much of the ground was soon recovered, and it remained at around $2·61 during the rest of April and most of May.

The market price of gold in London rose from $47·15 per fine ounce at the end of January to $49·25 on 2nd February after speculation that the United States might raise the official price by more than $3; but it fell back and steadied around $48 once the U.S. authorities had made it clear that the rumours were unfounded. The market was then fairly steady for two months, with neither the speculation against the dollar early in March, nor later reports that the U.S. authorities were contemplating selling gold, having much effect. In April and the first part of May the price rose very sharply to touch $58·50. The main influences were a growing realisation that production was falling short of demand, and an improvement in the South African balance of payments, which meant that part of the supply of new gold would go into South African reserves rather than on the free market. The speed of the rise in prices induced renewed speculation but there was little evidence of any substantial increase in turnover.

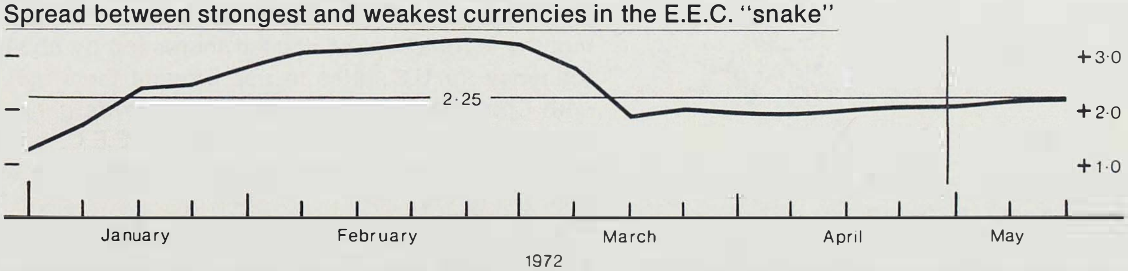
E.E.C. currency arrangements

Under the Washington Agreement of last December which permitted the rates for currencies to fluctuate between margins of 2¼% on either side of their parities or central rates against the U.S. dollar, it was possible for the rate between any two other currencies to vary by 4½% from their cross parity. On 24th April the central banks of the countries of the European Economic Communities took steps to halve this possible divergence between any two of their own currencies from 4½% to 2¼%, *i.e.* to ensure that the rates between any two of their own currencies could not diverge from their cross parities by more than 2¼%. This move was part of a general agreement by these countries to co-ordinate

Sterling and the E.E.C. "snake" in the "tunnel"



Spread between strongest and weakest currencies in the E.E.C. "snake"



After the E.E.C. currency arrangements took effect on 24th April, most E.E.C. exchange rates and sterling were at a premium against the U.S. dollar.

a Tuesdays; middle closing rates.

their policies in the foreign exchange markets, and represented an early step towards monetary and economic harmonisation in the enlarged Community. The measures flowed from an E.E.C. Council Resolution of 21st March accepted by the United Kingdom. The central banks were linked by direct telephone lines to allow rapid discussion and concerted action. At the invitation of the founder members, the Bank of England, together with the central bank of Denmark, joined the scheme on 1st May and the central bank of Norway followed on the 23rd.

The scheme has been put into operation by each participating country quoting buying and selling rates for its currency not only against the U.S. dollar as before but also against the currencies of the other participants at 2¼% on either side of their cross parities. The effect is that, within a total range of fluctuation of 4½% ("the tunnel"), the rates for the participating currencies at any one time are restricted within a community band of 2¼% ("the snake"). When the community band is within the tunnel, intervention at the limits of the community band must take place in community currencies. Intervention may also take place in U.S. dollars when a currency reaches its official U.S. dollar buying or selling rates at the limits of the tunnel. A mechanism for the short-term financing of interventions in community currencies and for subsequent settlement in various reserve assets has been established. Since the scheme came into operation the margin between the strongest and weakest member currencies has ranged between 2% and 2¼%, with sterling in the lower half of the band.

Short-term interest rates in London[a]

Per cent per annum

Euro-dollar rates rose sharply in the first half of March, but at the end of April were about the same as three months earlier.

a Rates on 3-month deposits; weekly, Fridays.

b No adjusted rate is available for the period 16th-20th August when the London foreign exchange market was closed.

Short-term interest rates

U.K. short-term interest rates remained lower in the first few months of 1972 than for several years, though generally higher than similar rates in most other developed countries. U.K. rates did rise during February as companies drew in funds to pay corporation tax but, as these payments came to an end, rates drifted downwards. By the end of April the three months' local authority rate had fallen back to around 4½%, much the same as in most of January.

Interest rates in the United States began to rise as the American economy started to pick up fairly strongly. After falling momentarily almost to 3% in the middle of February, the tender rate for three months' U.S. Treasury bills moved up to over 3¾% in mid-March, but eased in April to some 3½%. From mid-February to early May the rate on three months' certificates of deposit increased by about 1%. The tendency for U.S. rates to rise brought them more into line with Continental Europe, where rates were generally easier than they had been. Each of the five E.E.C. central banks reduced its discount rate during the period, by amounts of from ¼% to 1%.

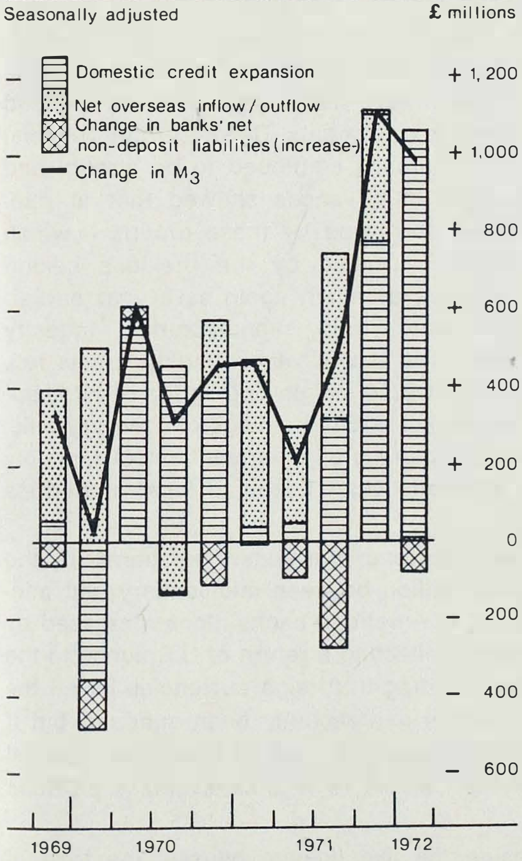
Euro-dollar rates were little changed on balance, with three months' deposits at about 5% at the end of January and at the end of April. They reached over 5¾% for a time during March, however, after dollars had been sold heavily and U.S. interest rates had turned upwards. U.K. interest rates were mostly lower than euro-dollar rates and forward margins moved narrowly around par, so that covered interest comparisons generally remained unfavourable to sterling. Later, as sterling rates eased and euro-dollar rates rose, covered margins of about ½% against sterling reappeared.

Money stock and domestic credit[1]

In the first quarter of 1972 the money stock continued to expand rapidly. After seasonal adjustment, the increase in

1 The references to the money stock are based unless otherwise stated 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 194).

Changes in money stock



Domestic credit expanded very sharply in the first quarter, and the money stock again rose rapidly.

the March quarter amounted to some £975 million or 4¾%, somewhat less than the rise of £1,100 million (5¾%) in the December quarter, but still much higher than the average quarterly growth of £430 million earlier in 1971.

Domestic credit expanded by much more than in the December quarter, the most important influence again being a very large increase of some £1,420 million in bank lending to the private sector, about double the big rise in the final three months of 1971. Personal borrowers took even more than in the previous quarter but, unlike last year, the largest part of the increase was accounted for by industrial and commercial companies – though still mostly financial, property and construction companies rather than manufacturers. After allowing for seasonal influences, the central government was again in deficit but less than in the previous quarter and not so much as might have been expected given the reflationary measures introduced in 1971.

The rise in domestic credit and the money stock would have been even greater but for fresh purchases of gilt-edged stocks by the general public – though these were much smaller than in the previous quarter – and another large increase in national savings. Inflows from abroad, which had been considerable in 1971, were no longer significant.

In his Budget speech the Chancellor said that the fast growth of output for which he was aiming would entail a growth in the money stock that was high by the standards of past years. He did not propose to lay down numerical targets for monetary policy; this would be geared to the needs of the situation.

In the month to mid-April the money stock was provisionally estimated to have increased by some £450 million after seasonal adjustment, or 2¼%, mainly because of a further increase in bank lending to the private sector. Comparing the three months to mid-April with the previous three, the average monthly rise remained at around 1¾%.

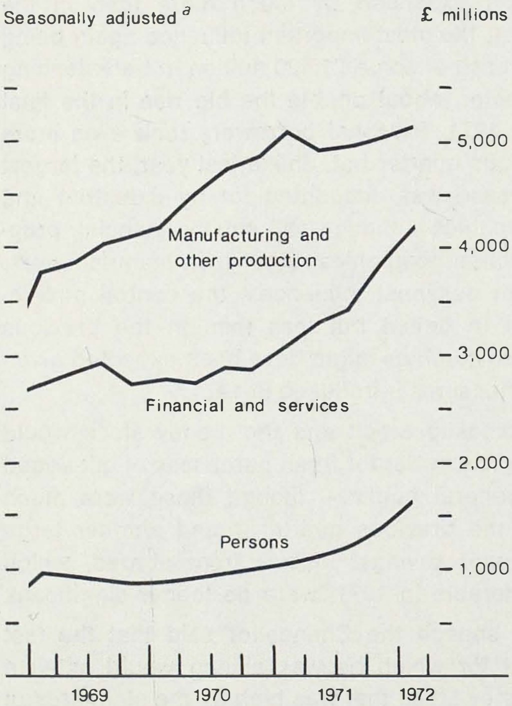
Banks and discount houses

Bank lending continued to rise rapidly and reserve ratios fell in the three months to mid-April.

The interpretation of recent banking statistics has been complicated by the inclusion, as from mid-March, of the five finance houses which are now recognised as banks under the Protection of Depositors Act 1963.[1] In the two months to mid-March, before the inclusion of the finance houses' figures, total sterling deposit liabilities of all the various groups of banks rose by over £570 million. This was a slower rate of increase than in the previous two months, largely because of the tax-gathering season. Over half of the rise was in deposits from U.K. banks, and there were also increases of £215 million in the amount of sterling certifi-

[1] See Table 8 in the annex and additional notes.

Banks' advances to U.K. residents



Borrowing by persons and the financial and service industries continued to rise much faster than borrowing by manufacturing industry.

a New seasonally adjusted figures as described in the article on page 220.

cates of deposit outstanding and of £72 million in overseas residents' deposits. The deposits of U.K. residents other than banks, however, fell by £59 million.

On the assets side, sterling advances to U.K. residents other than banks rose by £879 million, faster even than in the previous three months. There was a high seasonal demand for advances to meet tax payments. Demand from financial companies and from persons continued to be strong; and the quarterly analysis of advances showed that at mid-February outstanding borrowing by these groups – which had been particularly curtailed by the previous ceiling controls – was over half as much again as a year earlier. The underlying demand from manufacturing industry remained quite small. The banks' other sterling assets fell, with reductions of about £350 million both in loans outstanding to the discount market and in holdings of Treasury bills, and of £228 million in holdings of government stocks, mainly stocks maturing after one year. Loans to local authorities fell by £79 million.

The banks' foreign currency business rose sharply by the equivalent of £1,450 million between mid-January and mid-March. The deposits of American banks alone increased by well over £500 million reflecting a return of U.S. funds to the euro-dollar market. Lending in foreign currencies by all the banks to U.K. residents had recently been subdued but it rose by £94 million in this period, most of it going to financial institutions other than banks to finance overseas portfolio investment.

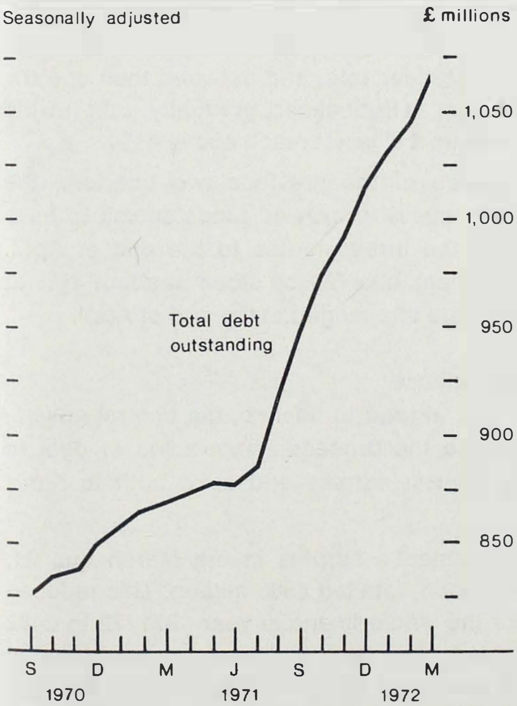
Still leaving aside the five finance houses, the total of eligible liabilities fell by £34 million in the two months to mid-March. With the need to meet the heavy demand for advances, total reserve assets fell by £614 million. As a result, the banks' combined reserve ratio fell from 19·1% in mid-January to 15·7% in mid-March.

In April, the banks' total sterling deposits (including the five finance houses) rose by a further £927 million, of which as much as £664 million was attributable to U.K. residents other than banks and £208 million to an increase in outstanding issues of certificates of deposit. A large part, nearly £160 million, of these additional certificates was taken up by the banks themselves, and they also lent a further £370 million to U.K. residents other than banks. Among their other sterling assets, loans to local authorities increased by £168 million and commercial bills by £140 million, but holdings of gilt-edged stocks fell by another £79 million. The banks' foreign currency business continued to grow but at a somewhat slower rate than recently. Perhaps the chief feature was a further substantial increase of £137 million in lending to U.K. residents other than banks, again mainly for portfolio investment overseas. The banks' combined reserve ratio at mid-April was 15·7%, the same as at mid-March (before the inclusion of the finance houses).

The seasonal fall, owing to tax transfers, in bank funds available to the discount houses reduced their total borrowed funds in the three months to mid-April by some £294 million. Their holdings of Treasury bills fell by £390 million but gilt-edged stocks increased by £53 million. At the same time they took up a further £81 million of local authority bonds and £67 million of sterling certificates of deposit. Altogether, the houses reduced their holdings of eligible public sector debt by £302 million and, at mid-April, their average public sector lending ratio was down to 60·2%, from 64·1% in mid-January.

Finance house lending

Seasonally adjusted



The rise in finance house lending continued to slow down a little.

Finance houses

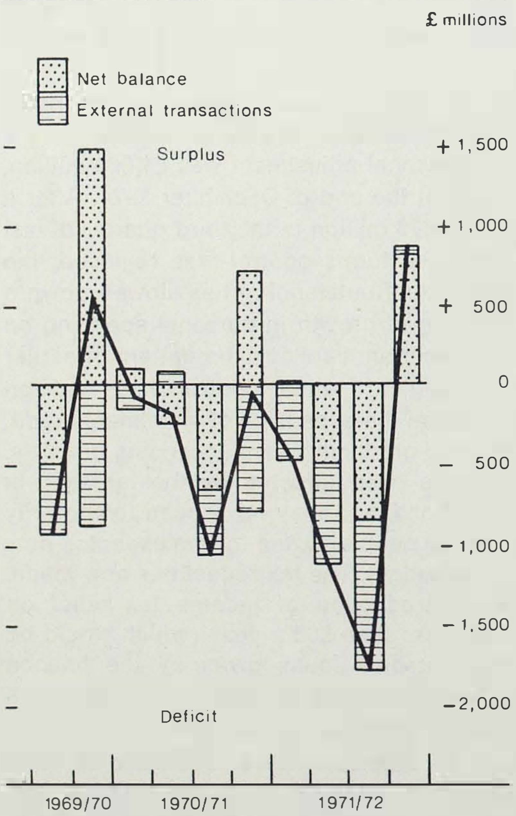
The finance houses continued to build up their reserve ratios. The growth in their instalment credit outstanding was tending to slow down.

By the middle of April eligible liabilities of the finance houses – excluding those now regarded as banks – were £238 million. With reserve assets amounting to nearly £16 million, the houses' combined reserve ratio was 6·6%. This compared with a ratio of 4·7% in mid-January before the houses which were recognised as banks were transferred to the banking statistics. These houses will be expected after a short period of adjustment to observe the minimum reserve ratio of 12½% common to all banks. The remaining finance houses have until 20th September to build up to their reserve ratio of 10%.

The amount of outstanding hire purchase and other instalment debt owed to the finance houses at the end of the March quarter after seasonal adjustment was £1,069 million, £54 million more than at the end of December 1971. After a very sharp increase of £73 million in the third quarter of last year when hire purchase terms control was removed, the increase in instalment debt outstanding has slowed down a little and with it the rate of growth in personal spending on durable goods. This experience follows the pattern of earlier occasions when easing of terms control has had an immediate sharp effect on the expansion of instalment credit, which has then declined gradually over succeeding quarters. Lending may also have been affected by the increase in bank advances to persons, and may have been temporarily reduced early in 1972 as people waited for the expected cuts in purchase tax in the Budget. The tax reductions now made, together with the reintroduction of income tax relief on interest payments of more than £35 a year (which would be applicable to some personal loans given by the finance houses but not to their hire purchase credit) may well revive the growth in the houses' lending later this year.

The rates offered by finance houses to attract deposits eased a little in the period, falling from 5% for three months' money at the end of January to 4¾% at the end of April. On 1st April, the Finance Houses Association's recommended base rate was raised by ½% to 5½%. The rise was reversed on 1st May when the rate reverted to 5%.

Central government's domestic borrowing requirement (—)



The central government had a substantial seasonal surplus, and external transactions had a much smaller impact than recently.

Bill markets

Conditions in the bill markets were seasonally tight until the middle of March when the main tax-paying period came to an end. The Bank gave frequent help, usually through purchases of Treasury bills and corporation bills. Occasionally, it was also necessary to buy bank bills and to make overnight loans to the discount houses. In the second half of March and until the last week in April conditions were much easier and at times the Bank mopped up surplus funds with sales of Treasury bills. At the Treasury bill tender, there was little change at first in the highest rate at which applications were accepted; during this period the Bank encouraged stability in rates by holding their dealing rate for longer-dated bills at $4\frac{3}{8}$%, slightly higher than normal relationships with the tender rate would have suggested. After the second week in March, however, the Bank again dealt at rates in line with the highest accepted tender rate, and between then and the end of April the tender rate declined gradually until, at the last tender in the month, it was not much above $4\frac{1}{4}$%.

After falling in each of the previous two quarters, the average cost of the houses' borrowed funds seems to have increased a little in the three months to the end of April. Selling rates for fine bank bills, which stood at about $4\frac{1}{2}$% at the end of January, were unchanged at the end of April.

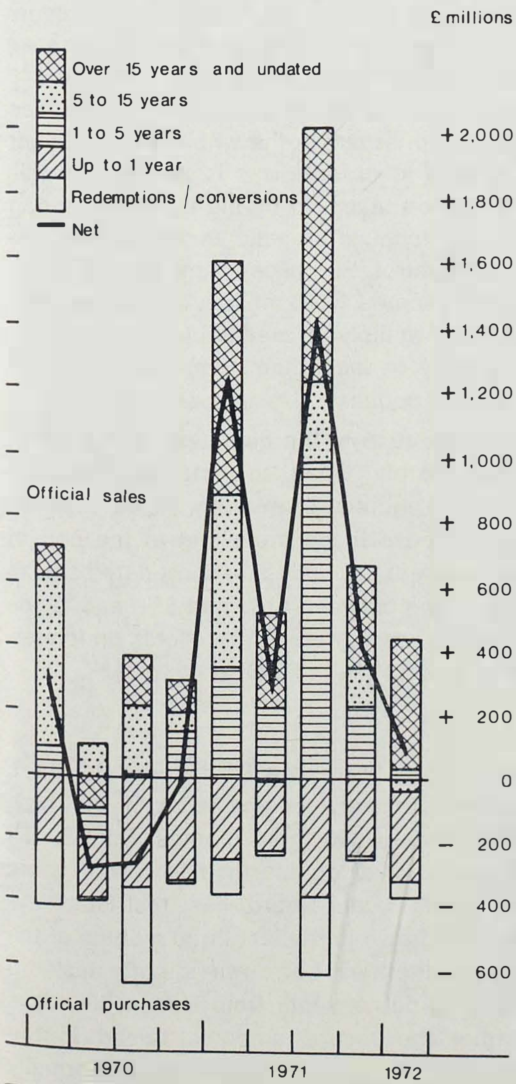
Central government finance

With little inflow from abroad to finance, the central government was able to add the proceeds from sales of debt to its usual revenue quarter surplus and used both to repay the banks.

The central government's surplus in the March quarter, the main revenue season, totalled £808 million. This reduced the total deficit for the whole financial year 1971/72 to £482 million, considerably higher than the previous year's deficit of £78 million. If allowance is made for the effects of the 1971 postal strike, which delayed the receipt of some taxes due in 1970/71 until the next financial year, the contrast was even greater, from a surplus of about £70 million in 1970/71 to a deficit of some £630 million. Even so, the deficit was smaller than might have been expected after the Government's reflationary measures. Revenue receipts remained very buoyant despite the reductions in taxation, while the increases in expenditure and in lending to local authorities and nationalised industries were lower than had earlier seemed likely.

A large inflow of foreign exchange during the year brought the cost of external transactions to no less than £2,050 million, and so the total amount needing to be financed from domestic sources was £2,532 million, nearly double the previous year's record total. Most of this amount was raised through exceptionally large sales of gilt-edged stocks, about one third of which was acquired by the

Official transactions in gilt-edged stocks by maturity



Net sales of gilt-edged stocks by the authorities were much smaller than recently.

banking sector. Net sales of national savings were a record at £437 million; they greatly exceeded the total in 1970/71 which had followed several years of net disinvestment.

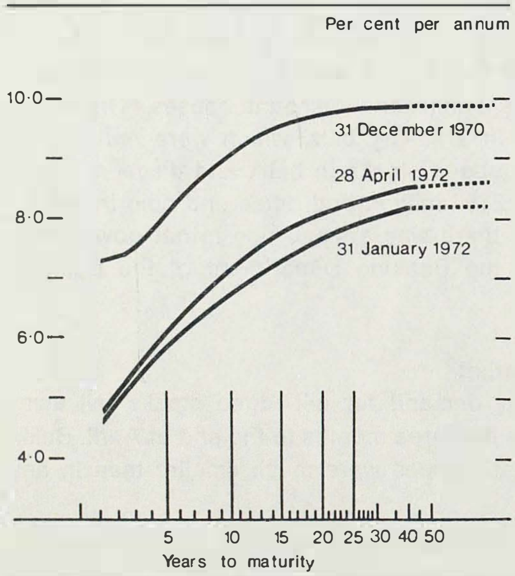
In the March quarter itself, external transactions brought in £27 million. The inflow from abroad was much smaller than at any time last year, and it was more than matched by sales of gilt-edged stock to overseas investors, nearly half going to central monetary institutions. Together with the central government's surplus, the authorities were left with £835 million which could be put towards the repayment of domestic debt. Moreover the general public bought £190 million of national savings, all forms of which shared in the increase, though national savings certificates proved particularly attractive. The general public also bought a further modest amount of gilt-edged stocks but this was broadly offset by large net surrenders of tax reserve certificates. Altogether as much as £1,183 million was available to repay debt held by the banks and discount houses. The major part of this was in Treasury bills, which were reduced by £815 million. Gilt-edged stocks in bank and discount house portfolios fell by £155 million and notes and coin in tills by £208 million; but there was a small rise in net government indebtedness to the Banking Department of the Bank of England.

The gilt-edged market

Last year's heavy demand for gilt-edged stocks fell away and yields rose in the three months to the end of April. Sales of stock by the authorities were much smaller than in any quarter last year.

The gilt-edged market was uneasy in the first part of February because of the miners' strike, the power emergency, and the terms of the settlement after the Wilberforce enquiry, as well as the disturbances in Northern Ireland. On 15th February, 6% Conversion Stock 1972 was redeemed, but only about £40 million of the stock was by then in market hands. Prices rallied towards the end of the month when full power supplies returned more rapidly than expected, and after reductions in the West German bank rate and in the First National City Bank's prime lending rate. Early in March, however, the market again became uncertain. Although a considerable weight of funds was thought to be awaiting investment, buyers on the whole held off. They were mainly influenced by poor trade figures, another labour dispute, this time on the railways, and the anticipation and assessment of a reflationary Budget. The market remained quiet after Easter but towards the end of April generally became firmer. In view of the large amount of government financing expected in the current financial year, and the need to retain a means of influencing interest rates directly, the authorities took the opportunity on 28th April to announce the issue of two new tap stocks – a further tranche

Time/yield curves of British government securities[a]



In the three months to the end of April yields rose, particularly on medium and longer-dated stocks.

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.

of £500 million of 6¼% Treasury Stock 1977 at £101·25 per £100 nominal to yield 5·95% to redemption and £500 million of 7¾% Treasury Loan 1985/88 at £97·50 per £100 nominal to yield 8·03% to redemption. These stocks were complementary to the long-dated tap stock (7¾% Treasury Loan 2012/15) issued in January. The market was also informed that the Government Broker would no longer quote an official selling price for tap stocks but would be prepared to respond to bids at prices of his own choosing. The practice of quoting official selling prices had been reintroduced in May 1971 as part of the new arrangements for credit control but had proved less flexible than the earlier practice to which the authorities were now reverting. Afterwards prices eased, partly because of the continuing pay dispute on the railways.

During the March calendar quarter, the authorities sold only £87 million net of stock, a very much smaller figure than in recent quarters. Sales of long-dated stocks amounted to nearly £400 million largely to overseas and domestic holders other than the banks. Purchases of the next maturing stocks amounted to some £280 million and, together with the £40 million redemption referred to above, more than outweighed sales of other short-dated issues. In the whole financial year 1971/72, the net total of stock sold was £2,200 million; this included over £750 million taken up by the London clearing banks under the transitional arrangements introducing the new system of credit control. Purchases from the market of maturing stock totalled some £1,100 million, but a very large amount of over £2,000 million of medium and long-dated stocks was sold, mainly to insurance companies, pension funds and to the general public.

Yields on most stocks rose at the beginning of February, but declined quite sharply when the market improved towards the end of the month. Thereafter, yields rose on balance and finished above those prevailing at the end of January. Over the three months, yields on short-dated stocks rose by up to ¼% to range between 4¼% and 6%, and yields on medium-dated stocks rose by up to ⅝%. Yields on longer-dated stocks rose by around ½% to finish at up to 8¾%.

Local authorities

Longer-term local authority borrowing fell back in the three months from February to April compared with the high figures recorded in the previous three months. Such a fall seems to have become usual at this time in recent years when the Public Works Loan Board has restricted the amounts which may be drawn in the last three months of the financial year. The authorities borrowed slightly less on market mortgages, and net receipts from issues of stocks and bonds fell from the record amounts raised in the previous three months. Temporary borrowing is normally high during this quarter before the main rate-paying season begins and, as the cost of these funds was low, the authorities may have taken in more than was needed for day-to-day financing.

The cost of temporary borrowing by local authorities rose during February from $4\frac{3}{4}$% to $5\frac{1}{4}$% but, as money became easier, fell back to $4\frac{1}{2}$% at the end of April. P.W.L.B. quota rates for 10–15 year loans, however, rose to $7\frac{7}{8}$% at the end of April compared with $7\frac{3}{8}$% at the end of January. One-year mortgage rates were unchanged at $5\frac{1}{4}$%.

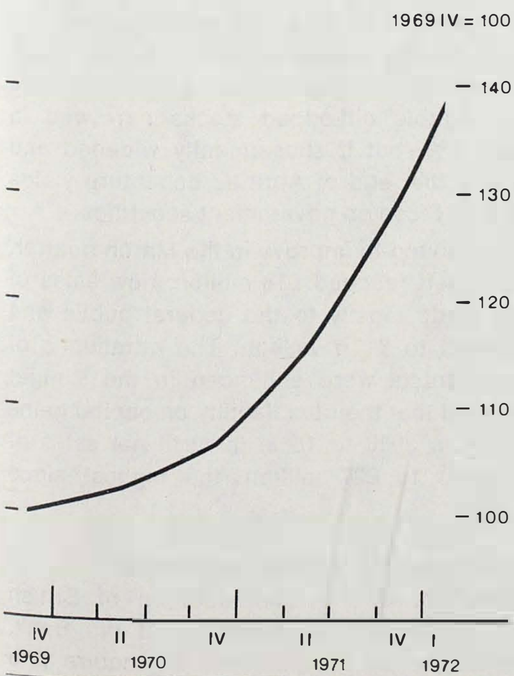
Building societies

For the first time for over a year, the rate of increase in resources becoming available to the building societies started to slow down.

In the period February to April, gross receipts were marginally higher, after seasonal adjustment, than in the preceding three months. But withdrawals were also up; the rising turnover partly reflected the increasing use of building societies' facilities as short-term deposit accounts. Net receipts in the period were just under £600 million, much the same as the record net inflow in the previous three months. This outcome no doubt reflected the reduction in the recommended rate paid on share accounts on 1st January of this year, but may equally have been attributable to firm share prices, which may have encouraged people to switch money from the building societies to the equity market, either directly or through the medium of unit trusts. Meanwhile, apart from a temporary dip in February (perhaps associated with the effects of the miners' strike) the societies' new lending and their commitments to future new advances both continued to rise strongly. Their combined liquidity ratio at the end of April was 18·5%, still very high.

House prices continued to rise rapidly. The Nationwide Building Society's index, which rose by about 20% during the year 1971, suggested that they accelerated to an annual rate of nearly 30% in the first quarter of 1972, reflecting a complex blend of changes in supply and demand. As regards supply, suitable building land was scarce and, at the end of April, the Government took steps to encourage local authorities to increase their approvals for building use. There was also an interval last year before private builders started more new houses to meet growing demand. Building costs too were rising faster. On the demand side, the trend to owner-occupation may have been encouraged by expectations of continuing inflation, against which the ownership of property can be seen as a hedge. This trend was facilitated by the enormous inflow of funds into the building societies in the past year. Mortgage finance was thus easily available and with personal incomes rising fast, people could afford to increase their borrowing. Demand for houses greatly exceeded supply and, once prices were seen to be rising fast, potential buyers were encouraged to enter the market promptly and property-owners to hold back from selling.

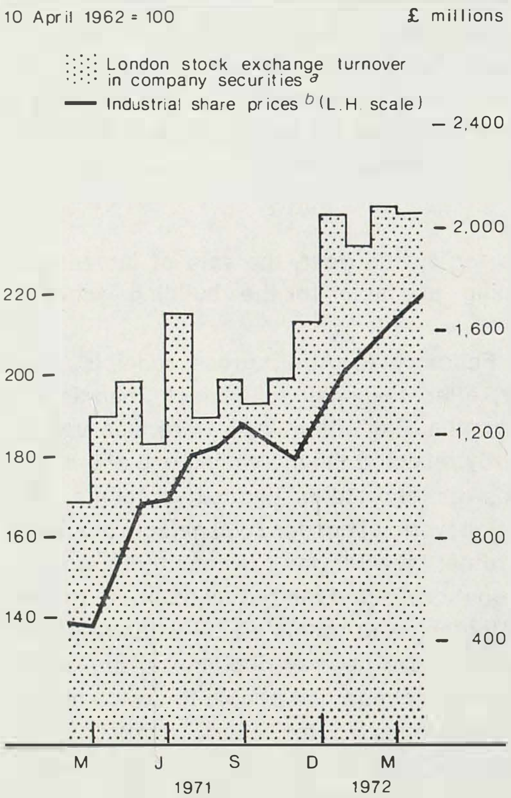
New house prices[a]



House prices continued to rise rapidly in the March quarter.

a Figures calculated by the Nationwide Building Society.

Industrial share prices and turnover



The equity market remained firm with substantial rises in prices and a further high turnover.

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

Company securities
The equity market continued firm for much of the three months February to April and turnover was very high.

The Financial Times-Actuaries industrial (500) share price index rose by a further 9% in the period to stand at over 223 at the end of April compared with 205 at the end of January. The end-April figure was a new record, some 15% higher than the former peak in 1969. The reflationary Budget measures and improved profits reported by a number of companies encouraged investment in equities and outweighed the effects on expected profits of more labour disputes. In May, after firmness at first, the market fell back sharply under the influence of continuing labour disputes and the situation in Vietnam. It recovered, however, during the middle of the month.

Many companies, anxious to take advantage of favourable market sentiment and interest rates, made new issues of shares. Issues during the period totalled £278 million, of which £103 million was for financial companies (including £86 million for investment trusts). The total compared with £216 million raised in the previous three months. A number of issues were heavily oversubscribed. The queue of company borrowers wanting to make issues continued to lengthen. Though the queue at the end of April contained some manufacturing companies, it consisted mostly of financial concerns including several new investment trusts.

After declining through most of 1971 and into January this year, the yield on company fixed interest securities turned upwards in mid-March following the rise in gilt-edged yields. At the end of April first-class high coupon stocks of about 25 years' maturity were yielding over 8¾%, about ¼% more than at the end of January. The differential between such yields and those on comparable gilt-edged stocks narrowed in mid-March to under ¼%, but it subsequently widened and was again over ¼% at the end of April as debenture yields rose more sharply than those on government securities.

Unit trust sales continued to improve in the March quarter. Net sales in March itself reached £18 million; new sales of £35·6 million were made mostly to the general public and repurchases amounted to £17·7 million. The attractions of unit and investment trusts were enhanced in the Budget when it was announced that their tax liability on capital gains would be reduced from 30% to 15%. In April net sales of units rose still further to £27 million, the highest since February 1969.

Industrial management and the institutional investor
In March, the President of the Confederation of British Industry, with the support of the Governor of the Bank, announced the formation of a committee to enquire into aspects of the structure and practice of public companies. Before this the Bank had for their part consulted informally all the main associations of investment institutions and the

banks to find out how much support there would be for improving the means by which investors might collaborate to secure increased efficiency in industry. While the difficulties of this approach were recognised, the support for such an exploration, especially among institutional investors, was enough to justify round table discussions sponsored by the Bank with the main banking and investment associations and the C.B.I.

As a result of these discussions a working party was appointed whose terms of reference are to examine and report upon a possible structure and method of operation of a central organisation through which institutional investors, in collaboration with those concerned, would stimulate action to improve efficiency in industrial and commercial companies where this is judged necessary. The Committee included representatives of the main associations of institutional investors and the Bank of England, with the Deputy Governor in the chair.

Conclusion

In the first few months of this year, the trends in the economy were obscured by the effects of the power shortages resulting from the miners' strike. It was clear, however, that output remained well below capacity before the Budget and that unemployment was still growing, though less quickly than in 1971. In this situation, the appropriate stance of monetary policy was expansionary – interest rates were tending to decline and, helped by a sharp increase in bank lending, the money stock was rising very rapidly. The Chancellor introduced substantial fiscal measures in his Budget designed to raise the growth rate and reduce unemployment. The most important measure – the increase in income tax allowances – did not begin to benefit personal incomes fully until May, and it could be some time before its impact is reflected in higher spending. How long the delay lasts will be influenced by the attitudes of both consumers and industry alike. Confidence had undoubtedly been weakened both by the slow growth of output and real incomes since 1968 and by the rapid rise in costs and prices during the last two or three years. As a result, the effects of previous reflationary actions on final expenditure, output and employment have so far been smaller than was expected; but, when confidence does recover, the delayed cumulative stimulus added to that of the latest measures could eventually be very large.

While the prospects for output and employment are now more encouraging, those for wages and prices are less so. For both of these, there was a significant deceleration up to the beginning of this year: but there must now be a question as to how much further this improvement will go. If recent rates of cost inflation were to continue for long, the implications – not least but not solely for the balance of payments – would be serious.