

Financial review

This review gives first a general survey of financial developments in the financial year to date. It then deals in turn with each of the main sectors — though only partial statistics are available after the second calendar quarter. The third main section reviews the course of interest rates and other developments in the various markets during August to October (earlier months being covered in previous issues of the Bulletin). The regular flow of funds tables appear in the appendix which begins on page 435.

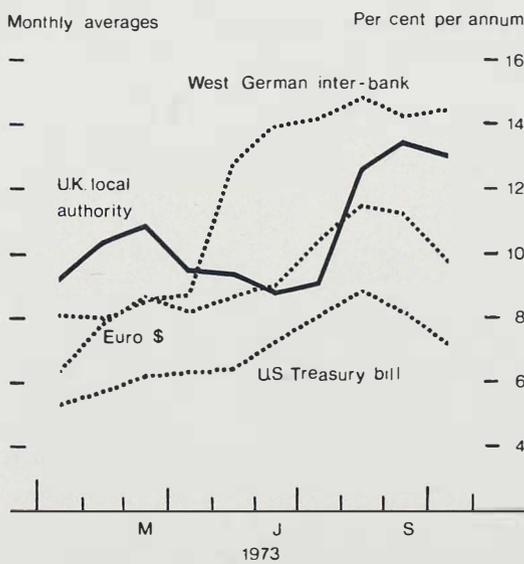
General financial developments

In view of the balance of payments situation it has been necessary to maintain interest rates in the United Kingdom which are attractive in relation to rates abroad, in order to avoid an outflow of capital funds on top of the current account deficit. The tendency for some months until the end of June had, however, been for interest rates in this country to fall, while rates abroad rose. Domestic interest rates were then raised sharply in the latter part of July and early August, primarily because of external considerations.¹ These steps restored the previous positive uncovered interest differentials, and the effective depreciation of the pound was halted without much cost to the official reserves. There appears to have been something of a peak in foreign interest rates towards the end of August. Thereafter U.S. and euro-dollar rates in particular fell, though moving irregularly. In consequence, by the end of September somewhat larger uncovered interest differentials began to open up in favour of London.

The call for Special Deposits in November was occasioned primarily by domestic considerations rather than by the external situation (see page 414). The previous increase in interest rates in the summer had not served to reduce credit expansion, and some further steps to check the pace of bank lending and monetary growth were needed. But in view of the deterioration in the balance of trade, as evidenced by the October trade figures, the further increase in interest rates had a useful effect in preventing a possible depreciation of sterling at that time.

Bank lending to the private sector has been the main source of credit expansion. The central government borrowing requirement in the first half of the financial year ran well below expectations. Sales of government stock to the general public have been large despite an often difficult gilt-edged market, and this has helped to moderate bank lending to the public sector. Meanwhile, lending to the private sector has remained very heavy; it was particularly

Three-month interest rates at home and abroad



For several months, U.K. rates fell while foreign rates rose, and eventually the pound came under some pressure.

Bank lending (increase +)

£ millions: *seasonally adjusted*

	1972				1973		
	1st qtr.	2nd qtr.	3rd qtr.	4th qtr.	1st qtr.	2nd qtr.	3rd qtr.
Public sector	- 470	- 700	- 50	+ 180	+ 360	+ 480	+ 560
Private sector	+1,590	+1,810	+1,190	+1,850	+1,510	+1,000	+2,170

so in the September quarter, when it was mostly to industrial and commercial companies. The monthly figures for October indicated that its growth had continued.

¹ September *Bulletin*, page 276.

Companies and persons have each found bank advances an attractive source of funds, though the company sector, in particular, was already very liquid. For the counterpart of the very large increase in bank lending has been an accumulation of interest-bearing time deposits and certificates of deposit, again largely by industrial and commercial companies. In the two years to the end of September, their bank deposits more than doubled,

Private sector sterling deposit accounts (including certificates of deposit) (increase +)

£ millions: *not seasonally adjusted*

1972				1973		
1st qtr.	2nd qtr.	3rd qtr.	4th qtr.	1st qtr.	2nd qtr.	3rd qtr.
+270	+1,140	+750	+1,170	+1,010	+680	+2,440

while personal deposits increased by about 40%. Company liquidity has, in general, increased greatly since the squeeze in 1969 and 1970 (this is illustrated in the chart on page 416).

Sector financing

The following sections review the flow of funds sector by sector from the second quarter onwards.

Central government

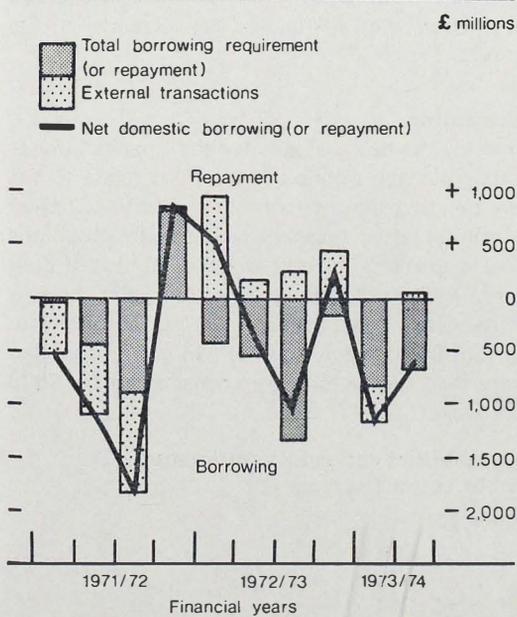
Because of the change-over to value added tax and the consequent interruption to the flow of revenue,⁷ it is better to look at the central government's borrowing requirement than at its financial deficit. The latter does not record the interruption, whereas the borrowing requirement registers its full impact. In the June quarter, the requirement, seasonally adjusted, was around £700 million, considerably bigger than in the previous quarter, largely because of the reduction in revenue. In the September quarter, it was a more modest £420 million, despite an even bigger reduction arising from the tax change-over. In both quarters, especially the September one, the requirement was considerably less than had been foreseen, partly because the rest of the public sector, which was borrowing heavily in euro-dollars, required less from the Government.

Central government borrowing requirement (—)

£ millions: *seasonally adjusted*

1972				1973		
1st qtr.	2nd qtr.	3rd qtr.	4th qtr.	1st qtr.	2nd qtr.	3rd qtr.
70	330	280	760	470	700	420

Central government's borrowing requirement



The borrowing requirement was smaller in the September quarter than in the June quarter, despite the reduction in receipts on the change-over to value added tax, and it was well short of what had been foreseen.

In the June quarter, the central government had not only to meet its net requirement, which was some £810 million before seasonal adjustment, but also to raise £350 million for external transactions, largely to finance the surrender to the official reserves of dollars borrowed by public bodies. Nearly half the total finance needed came from heavy sales of gilt-edged stock to investors other than banks, amounting to some £500 million. Sales of other forms of central government debt to the public (apart from notes and coin) were only some £30 million: the public's response to national savings incentives in the Budget and more especially to the new tax deposit accounts was disappointing. After taking account of an increase of notes and coin in the hands of the public of £180 million, some £450 million (£370 million seasonally adjusted) was left to be provided by the banking sector.

In the September quarter, public bodies borrowed some £370 million in euro-dollars. The reserves fell by £260 million, but the sterling proceeds were largely offset by a fall in overseas holdings of government debt. In all, external transactions provided only £40 million in sterling towards the borrowing requirement, which was £675 million before seasonal adjustment, thus leaving £635 million to be found from domestic sources. Investors other than banks bought £320 million of stock, much of it towards the end of the quarter when the market, which had been quiet since June, began to strengthen on hopes of lower interest rates. Some £50 million was invested in national savings, a very slight improvement allowing for seasonal movements (see Table D in the

⁷ See page 435 for a note on the change-over and its treatment in the sector accounts.

appendix). About £85 million was obtained from a run down of the Issue Department's holdings of commercial bills and local authority debt. On the other hand, the public's holdings of notes and coin fell by about £50 million; this represented little change allowing for seasonal movements, an unusual outcome (see Table B), but in line with a slower underlying growth in consumption. The central government was thus left to borrow £240 million from the banking sector (which was equal to a repayment of £110 million after seasonal adjustment).

Bank finance for central government (increase +)

£ millions: *seasonally adjusted*

1972				1973		
1st qtr.	2nd qtr.	3rd qtr.	4th qtr.	1st qtr.	2nd qtr.	3rd qtr.
-310	-870	-200	+170	+610	+370	-110

In all, in the first half of the financial year, about half the Government's total borrowing requirement was met by sales of debt to the general public; recourse to the banking sector was fairly modest. In October, the central government enjoyed, as expected, a net inflow of funds as manufacturers paid five months' value added tax and car tax, but during the rest of the December quarter a sizable borrowing requirement will have re-emerged. On the financing side, sales of gilt-edged continued to be considerable in October, most of which will have been taken up outside the banking system. Over the financial year as a whole, it seems clear that the Government's total requirement will fall well short of the Budget estimate of £3,650 million. Domestic borrowing, however, will not be as substantially reduced, because much of the shortfall will stem from public bodies' borrowing in the foreign currency market instead of from the Government, and sterling still has to be borrowed to finance the surrender of the currency to the reserves.

The rest of the public sector

The latest comprehensive figures available for the financial transactions of local authorities and public corporations relate to the June quarter, when the two groups' combined financial deficit was around £550 million after seasonal adjustment, much the same as in other recent quarters. So too was the amount of their borrowing. However, whereas both groups normally borrow extensively from the central government, public corporations made net repayments in this quarter, and the two groups together borrowed much more than ever before from other sectors — £570 million.

Borrowing by local authorities and public corporations from outside the public sector (increase +)

£ millions: *seasonally adjusted*

1972				1973	
1st qtr.	2nd qtr.	3rd qtr.	4th qtr.	1st qtr.	2nd qtr.
-30	+270	+210	+170	+50	+570

Some part of local authorities' needs in the June quarter, probably around £75 million, stemmed from a shortfall of local

rate receipts as a result of appeals against rating revaluation; most of this should be paid later in the year. In general, the financing needs of local authorities and public corporations were somewhat greater than expected, and largely offset the shortfall for the central government. The public sector's combined borrowing requirement (at £1,270 million seasonally adjusted) was thus not far short of expectations.

Public sector borrowing requirement

£ millions: *seasonally adjusted*

1972				1973	
1st qtr.	2nd qtr.	3rd qtr.	4th qtr.	1st qtr.	2nd qtr.
40	600	490	930	520	1,270

In the September quarter, however, the shortfall in the central government's requirements was much larger. Over 1973/74 as a whole, the public sector's combined requirement may therefore fall somewhat short of the Budget estimate of around £4,400 million.

Local authorities obtained as much as £320 million from the general public in the June quarter, including £200 million in temporary money from building societies. They also borrowed a fairly normal amount from the Public Works Loan Board, as they did again in the September quarter — full details of other borrowing then are not yet available. In the December and March quarters, more of the authorities' finance is likely to come from the P.W.L.B. as quotas are taken up. The sources of local authorities' borrowing have been affected by the open-market operations of the Bank. The Issue Department increased its holding of local authority debt by £90 million in the June quarter and reduced it by £45 million in the September quarter. The Bank then bought heavily again in October during the shortage of funds in the parallel markets when large payments of value added tax were being made.

In the September quarter, public corporations again reduced their debt to the Government, and continued to borrow heavily in euro-dollars under the exchange guarantee scheme.

Altogether in the first half of the financial year, public bodies borrowed £660 million in euro-dollars. They borrowed about a further £150 million in October. Most of these funds are obtained through the banks, rather than direct from abroad. To enable public sector borrowers to take advantage of favourable interest rates, it was announced on 18th October that currencies other than U.S. dollars would also be acceptable for exchange guarantee in appropriate cases.

Industrial and commercial companies

In the second quarter, the latest for which estimates are available, gross trading profits of companies (including financial companies) were about £1,990 million after seasonal adjustment. This maintained the high rate of the previous quarter, although after provision for stock appreciation there may well have been a fall. The savings of industrial and commercial companies were once again depressed by payment of dividends which had been delayed to take advantage of reliefs under the new system of corporation tax, and their expenditure on fixed investment and stockbuilding

(although less in real terms) was greater in value than in the first quarter. They consequently moved into substantial financial deficit for the first time in two years.

**Financial position of industrial and commercial companies
(surplus +/deficit -)**

£ millions: *seasonally adjusted*

1972				1973	
1st qtr.	2nd qtr.	3rd qtr.	4th qtr.	1st qtr.	2nd qtr.
+220	+40	+90	+250	-70	-380

Since June, payments of dividends are likely to have reverted to a more normal amount; the volume of fixed investment and stockbuilding has probably moved ahead again; and the prices of raw materials entering company stocks have continued to rise strongly. Companies are therefore unlikely to have moved back into financial surplus in the September quarter.

Because of the change-over to value added tax, companies had a better cash flow in the second and third quarters than the income and expenditure accounts might suggest. (See the note on the change-over on page 435, and Table E.)

The main source of their outside funds continues to be bank borrowing, where the increase has been very large, particularly in the third quarter. Some of the borrowing has been in foreign currencies, partly for investing abroad, but the bulk has been in sterling.

**Bank borrowing by industrial and commercial companies
(increase +)**

£ millions: *seasonally adjusted*

1972				1973		
1st qtr.	2nd qtr.	3rd qtr.	4th qtr.	1st qtr.	2nd qtr.	3rd qtr.
+820	+800	+660	+850	+690	+560	+1,530

The flow of funds from the banking sector, together with the benefit from the change-over to value added tax and with restraint on dividends, has been large enough to allow companies to build up very large holdings of liquid assets (see the chart on page 416), mostly in deposit accounts and certificates of deposit.

Bank deposits (including certificates of deposit) of industrial and commercial companies (increase +)

£ millions: *seasonally adjusted*

1972				1973		
1st qtr.	2nd qtr.	3rd qtr.	4th qtr.	1st qtr.	2nd qtr.	3rd qtr.
+250	+510	+580	+710	+570	+60	+1,300

It is not yet entirely clear why companies have built up so much liquidity. Some part of the increase both in advances and in deposits reflects their taking advantage of opportunities for arbitrage between the two. But it is probable that the desire to accumulate liquid reserves has been a more important motive.

Higher prices of materials will absorb some of this; and companies may also need internal resources as they expand their capital expenditure.

The personal sector

Personal disposable income was larger in the second quarter, after seasonal adjustment, than in the first, but consumption (at current prices) was about the same. Savings thus rose sharply, and the personal sector once more moved into sizable surplus, which, to judge from the trends of income and spending, has probably been continued in the third quarter.

Financial position of personal sector

£ millions: *seasonally adjusted*

	1972				1973	
	1st qtr.	2nd qtr.	3rd qtr.	4th qtr.	1st qtr.	2nd qtr.
Financial surplus (+)/deficit (-)	- 10	+ 380	+ 170	+ 240	- 130	+ 440
Identified financial transactions:						
Borrowing (-)	-1,000	-1,240	-1,060	-1,570	-1,280	-1,100
Acquisition of assets (+)	+1,520	+1,670	+1,480	+1,750	+1,880	+2,460
Unidentified	- 530	- 50	- 250	+ 60	- 730	- 920

In the second quarter, identified transactions in financial assets by the personal sector indicated a surplus very much greater than that calculated from the national income figures. The rate of identified net new borrowing fell back slightly: borrowing for house purchase, bank borrowing, and hire purchase debt were all somewhat less. By contrast, the sector's take-up of financial assets was very large, and deposits with both building societies and banks rose markedly. The unidentified difference partly reflects items for which there are no adequate statistics; but it also stems from errors in the income and expenditure figures, and its size in this quarter suggests that the true surplus was exceptionally big.

The limited statistics available for the third quarter indicate that persons deposited much less net with building societies and much more with banks. This shift reflected movements in relative interest rates. When other interest rates rose in July and August, building societies' rates became less competitive. Withdrawals of deposits with the societies increased rapidly through August and September, and the flow of deposits was reduced. The increase in building society rates in October helped to restore the net flow. Sums borrowed for house purchase were, however, little reduced until October, though the societies became more restrictive in entering into commitments to lend. Persons borrowed more heavily from the banks in the third quarter than in the second, though not as heavily as in most of 1972.

The banking sector

For reasons already indicated, bank lending to the public sector, though sizable, has been less than might have been expected from the scale of public sector borrowing as a whole. And, although banks have still lent substantial amounts to the personal sector, there has been some decline in the rate of lending since 1972. The main feature of recent quarters has been heavy bank lending to industrial and commercial companies. The main counterpart among the banks' liabilities has been the growth in the companies' deposits, though personal sector deposits have also risen very strongly.

Bank lending and bank deposits by sector (increase +)

£ millions: *seasonally adjusted*

	1972				1973		
	1st qtr.	2nd qtr.	3rd qtr.	4th qtr.	1st qtr.	2nd qtr.	3rd qtr.
Lending							
Public sector	-470	-700	- 50	+180	+360	+480	+ 560
Industrial and commercial companies	+820	+800	+660	+850	+690	+560	+1,530
Other financial institutions	+270	+340	+170	+250	+280	+ 60	+ 150
Personal sector	+500	+670	+360	+750	+540	+380	+ 490
Deposits							
Public sector	- 10	- 10	-	+100	- 10	+ 60	- 30
Industrial and commercial companies	+250	+510	+580	+710	+570	+ 60	+1,300
Other financial institutions	+130	+500	- 40	+330	+230	+240	+ 220
Personal sector	+460	+410	+400	+500	+580	+800	+ 960

The gap between the deposits of domestic sectors and lending to them is closed by the banks' net transactions with overseas, and by changes in non-deposit liabilities, such as increases in capital and reserves. In the last few quarters the banks have been sizable net borrowers from overseas, mainly to finance foreign currency borrowing by U.K. companies and public bodies. The net totals were about £420 million in the second quarter and £160 million in the third, and net borrowing is probably still continuing quite strongly.

Almost all the recent increase in bank deposits has been in deposit accounts (time deposits) and certificates of deposit. Current accounts have increased much less. In some large part this

Private sector sterling deposits (increase +)

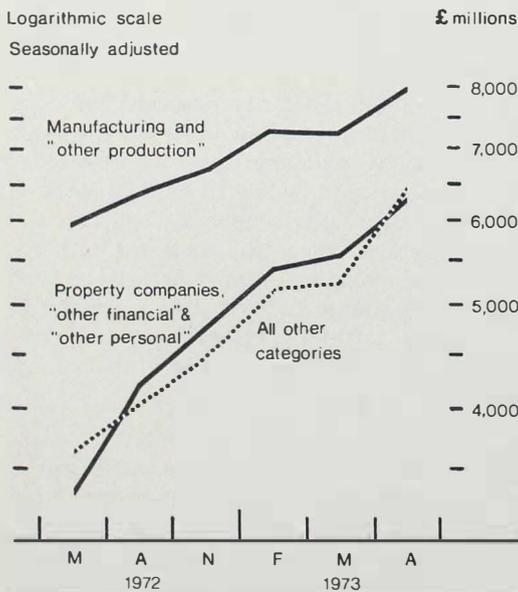
£ millions: *not seasonally adjusted*

	1972				1973		
	1st qtr.	2nd qtr.	3rd qtr.	4th qtr.	1st qtr.	2nd qtr.	3rd qtr.
Current accounts	- 90	+400	+160	+550	- 420	+660	- 240
Deposit accounts	+350	+710	+510	+920	+1,100	+860	+2,000
Certificates of deposit	- 80	+430	+240	+250	- 90	-180	+ 440

divergence in rates of growth — reflected also in the divergent rates of growth of the monetary aggregates M_1 and M_3 — will have been the consequence of the rise in interest rates, which has increased the advantage of shifting balances from current accounts (bearing no interest) into deposit accounts and certificates of deposit. The advantage of holding bank balances rather than other assets, where interest rates have adjusted more slowly, has similarly increased.

The industrial classification of bank lending at mid-August showed that much of the increase had been for ordinary personal spending or to finance property dealing and other financial transactions (see Table 10 of the statistical annex). Against this background, the Governor wrote to the banks on 11th September, drawing attention to the necessity of finance being available for industrial investment and exports, and asking for significant restraint in lending to persons (other than for house purchase), and for further restraint in lending for property development and for financial transactions. The letter is reproduced on page 445. The banks were also asked to pay no more than 9½% on deposits of under £10,000 so as to lessen their competition with building societies.

Domestic bank advances^a



The Governor wrote to the banks on 11th September (see page 445) asking for restraints in less essential lending, which had grown very strongly.

^a Categories as in Table 10 of the statistical annex.

The monthly figures for mid-September and mid-October, as in earlier months, were affected by special factors. In September, funds were still accruing to companies from the change-over in taxation; this was sharply reversed in October. This change must have strongly affected their deposits and overdrafts in these two months, though by how much is uncertain. The figure for bank lending to the private sector at mid-October suggests that much of the heavy payments of value added tax had been financed by bank borrowing. There was probably some run-off of arbitrage transactions affecting the September figures. After all allowance for special factors, there was clearly a continued rapid growth in bank lending to the private sector, mainly to companies.

The banks' eligible liabilities rose by over £1,300 million between August and October, and their reserve assets by £300 million. Their combined reserve ratio consequently rose from 13.3% in mid-August — immediately after the lodgment of the Special Deposits called earlier in July — to 13.8% in mid-October.

Following the modified arrangements announced on 19th July,¹ the discount houses soon made use of their greater freedom to adjust their books to current conditions and expectations about interest rates. In the two months to mid-September, when interest rates still seemed set on an upward course, the houses reduced their books, and their holdings of central government debt. But in October, when interest rates had begun to come down and appeared set to continue, they bid more aggressively for funds, and expanded their books. Altogether in the three months to mid-October, the discount houses reduced their holdings of Treasury bills by £120 million and their holdings of gilt-edged stocks by £180 million, but increased their holdings of sterling certificates of deposit by £290 million. The market's newly established undefined assets multiple, which has an upper limit of twenty times each institution's capital and reserves and which would have been about 14.0 on 18th July, consequently fell to 13.8 in August and 13.3 in September, and then rose sharply to 16.2 in October. The average cost of the houses' borrowed funds rose steeply — from about 7¼% in mid-July to 9% early in August, 10¼% by the end of September, and 11% by the end of October.

On 14th September the Bank announced the constitution of a working party to review the organisation and procedures of the markets for sterling inter-bank money and certificates of deposit.² Membership includes representatives of the Bank, the clearing banks, the accepting houses, and the discount houses, with further members being co-opted if required. The working party's discussions began in late September and regular meetings are continuing.

Finance houses

The finance houses' hire purchase and other instalment credit business continues to grow strongly. During the third quarter, the rise in instalment debt outstanding was about £85 million after seasonal adjustment, a fairly average figure for this year and last. Nearly £370 million of new credit was extended in the third quarter, about the same as on average in the first two quarters (which are taken together to smooth out the impact of heavy spending before the start of value added tax). These figures suggest that some elements of personal spending have continued unabated.

¹ September *Bulletin*, page 306.

² The situation as revealed by a survey in April was reviewed in an article in the September *Bulletin*, page 308.

The combined reserve ratio of the ten houses observing a minimum ratio of 10% has remained steady between about 10½% and 11%. Rates of interest offered by finance houses on deposits rose steeply during August, a typical three-month rate from under 11½% at the end of July to a peak of over 14½% towards the end of August. Thereafter rates eased. The three-month rate was around 13½% for most of September, then fell a little further, and was around 13% during the second half of October.

Building societies

The inflow of funds to the building societies fell sharply after the end of July when other interest rates rose. The mortgage rate recommended by the Building Societies Association was raised to 10% in mid-August, and the recommended share rate, which by an earlier decision would have come down to 6.4% on 1st September, was left at 6.75%. But this proved insufficiently competitive: the net inflow, allowing for seasonal movements, fell from about £290 million in July – the largest ever – to about £160 million in August, and to less than £50 million in September – the smallest in recent years. Relief was offered by the request to the banks, announced on 11th September, to limit the rates they paid on their smaller deposits (see page 445). The association raised its recommended rates on 14th September to 11% for new mortgages and, with effect from 1st October, to 7.5% for share accounts (equivalent to 10.7% grossed up at the basic rate of income tax). The inflow then began to revive, and in October, as interest rates generally eased a little, it was £150 million. As the societies' lending had been maintained in August and September, their combined liquidity ratio, allowing for seasonal movements, was reduced from 16.4% at the end of July to 15.9% at the end of September, before recovering slightly in October to 16.0%.

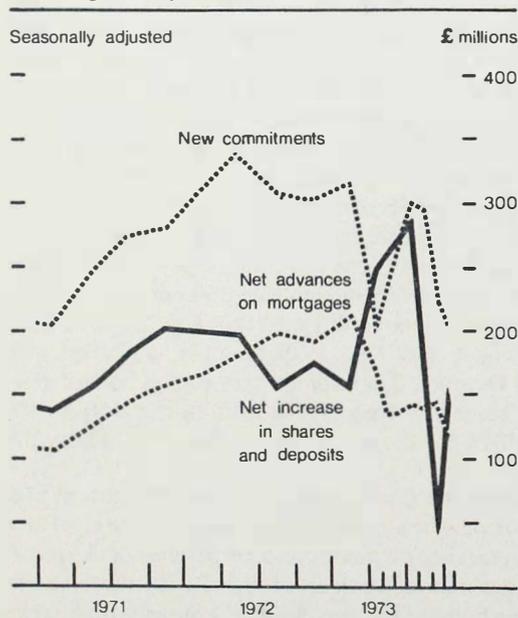
Net advances on mortgage averaged about £140 million a month during the third quarter, much the same as in the previous three months, and fell to £115 million in October. These figures compare with an average of about £200 million a month in the second half of last year and the first quarter of this. Because new commitments have inevitably been reduced, the earlier rate of lending seems unlikely to be restored for a while. As mortgages have become more difficult to obtain, house prices have begun to steady.

The combination of high prices and expensive mortgages has been difficult for many first-time buyers. On 8th October, the Government announced two new measures. The first was a selective scheme for first-time borrowers, allowing those who qualify to pay a low rate of interest to start with, rising to market rates over five years; later payments, including the backlog of interest, would be correspondingly heavier. Secondly, they announced the establishment of a permanent joint advisory committee of the Government and the Building Societies Association; this will regularly provide the council of the association with an analysis of the current situation and with forecasts of possible future requirements, with a view to a more stable provision of mortgage finance and the avoidance of excessive increases in house prices. The Bank are represented on this committee.

The overseas sector

The development of the current account deficit, capital flows, and reserve movements are discussed in the economic commentary (pages 409 and 412).

Building society funds



The inflow of funds fell very sharply in August and September but recovered considerably in October. Lending on mortgage did not slow very much.

Developments in financial markets

The following sections discuss developments in financial markets in the more recent period, for which full information on developments in different sectors (discussed in preceding sections) is not available. Most of the discussion refers to events in the three months August to October: later developments are noted only where particularly important.

Short-term interest rates

International interest rates, after rising further during August and September, later fell back a little from the peaks then reached. Until the new sharp rise on 13th November, rates in London roughly moved in line with those elsewhere.

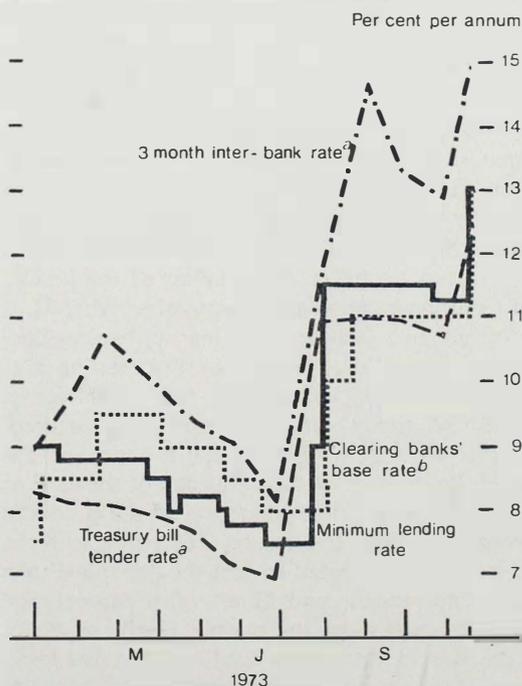
On the Continent, monetary policy in several countries was tightened further during the period, and interest rates generally continued to harden for a while. French bank rate was raised by 1%, to 9½%, at the beginning of August, and by a further 1½% to 11%, on 20th September, as part of a group of measures to counter speculation against the franc. Bank rate in both Belgium and the Netherlands was increased in stages from 6% to 7%, and Belgian domestic credit restraint was intensified. In Western Germany, however, conditions were relaxed in August so as to reduce the upward pressure on the deutschemark, though they were tightened again in October; and in Switzerland the negative rate of interest of 2% per quarter on increases in non-resident deposits was suspended from 1st October.

U.S. interest rates also continued to rise for much of the period as action to dampen inflation continued. Federal Reserve rediscount rates were soon raised a further ½%, to 7½%, and the main U.S. banks raised their prime rates on a further five occasions, in all from 8¾% to 10%. In the second half of October, however, prime rates fell back a little, mostly to 9¾%. Yields on U.S. Treasury bills at the tender reached a record 9% on 10th September, but thereafter eased; they were 7¼% at the last tender in October. Euro-dollar rates reached a peak in early August, when the three-month rate was around 11¾%, and remained high until mid-September, but by the end of October had declined, the three-month rate to around 9¾%.

U.K. interest rates rose sharply following the measures taken in July, and continued to rise through most of August. The main banks raised their base rates from 8% to 10% early in August and by a further 1% later in the month. Inter-bank rates rose quickly, and the three-month rate reached 15% towards the end of August, but they then eased, and the three-month rate was around 12¾% by the end of October. Yields on three-month Treasury bills remained a little under 11% through most of the period, easing to 10% at the end of October. The decline in rates was abruptly reversed on 13th November, when the Bank raised minimum lending rate from 11¼% to 13%.

Following the rises in U.K. interest rates in July, the cost of forward cover increased. Forward margins widened very sharply in the middle of August, as domestic money conditions tightened in advance of the payment of another instalment of Special Deposits: the discounts on one-month and three-month sterling at one time reached 8% and 5¾% per annum respectively. Although these soon narrowed, they widened again in early September as sterling came under pressure and some continental operators took up short positions in sterling. At the end of October, after a more favourable period, the discount on three-month sterling was 4¼%.

Short-term interest rates in London



Short-term rates reached a temporary peak in August, thereafter tending to ease until mid-November.

^a Last Friday of month.

^b Changes are recorded when a majority of the big four London clearing banks have moved to a new rate.

The rise in U.K. interest rates was generally larger than elsewhere; this more than offset the increase in the cost of forward cover, so that covered differentials against sterling narrowed considerably. On the three-month inter-bank/euro-dollar covered comparison, the differential against sterling fell from 3% at the end of July to ¼% at the end of October.

Foreign exchange and gold markets

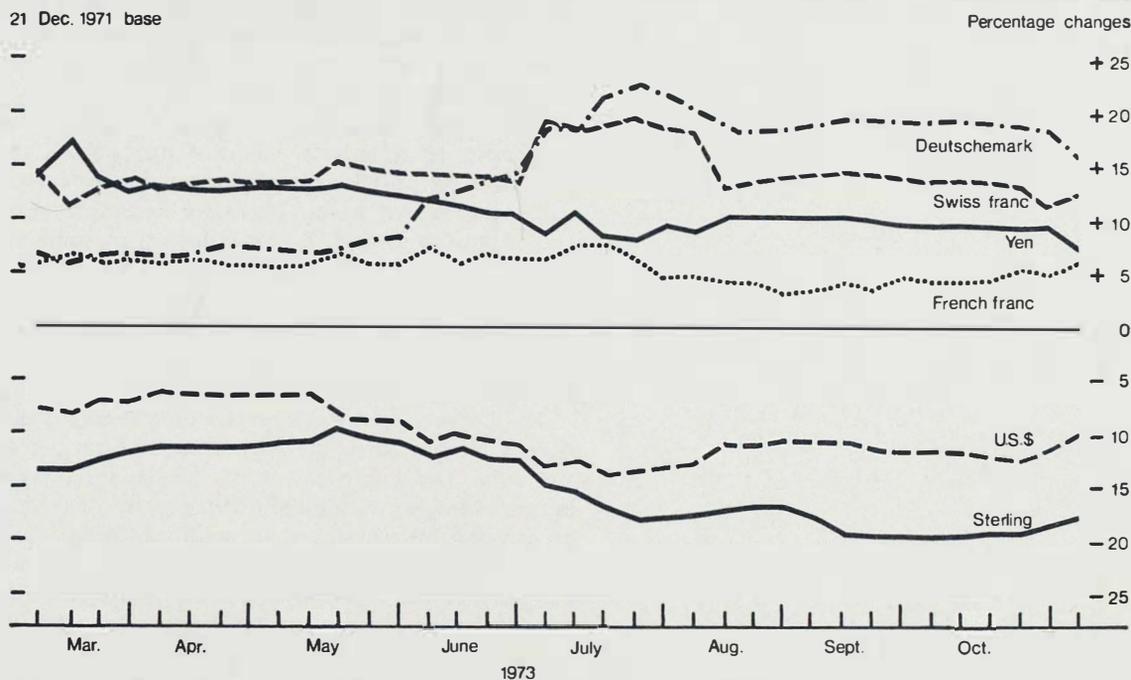
During August to October, despite the renewed war in the Middle East, foreign exchange markets were quieter, and rates for the most part less volatile, than earlier in the year. Confidence in the dollar improved, and there was some reversal of the previous substantial outflows. There were occasional short periods of sharp activity in sterling and, following the revaluation of the guilder in the middle of September, in some of the main Continental currencies.

Sterling weakened a little during the three months but was recovering again towards the end of the period; its effective depreciation against other main currencies, based on Smithsonian parities, increased from 17¼% to 19¼%, before recovering to 18½% at the end of October — and to 17% by mid-November. Concern about the balance of payments was the main continuing influence on the market: the effective depreciation of the pound was seen to be producing (along with rising world commodity prices) immediate adverse effects on import costs, whereas the benefits of improved export competitiveness were appearing more slowly. Other developments affecting the market from time to time were uncertainty about the sterling guarantee arrangements, the progress of the government's anti-inflation programme, and the course of relative interest rates. The dollar rate for sterling, which had been U.S. \$2.51 at the end of July, was \$2.44 at the end of October.

At times in the first part of August, sterling was fairly heavily sold, and some modest support was provided; but as domestic monetary conditions tightened in advance of the transfer of the second instalment of Special Deposits on 15th August, the pound strengthened, and on the 16th the effective depreciation against other currencies decreased to 16½%, the smallest of the period. Further pressure on sterling came in early September, when U.K. interest rates eased from their peak and the market became conscious of the approaching date of expiry of the sterling area guarantee arrangements. Sterling fell sharply, the dollar rate at one point touching \$2.38, and the effective depreciation exceeding 19%. The rate steadied after further official support and the announcement on 6th September of the extension of the sterling guarantees (see page 432). After the revaluation of the guilder in mid-September, when there was also strong upward pressure on the deutschemark, sterling appreciated against the dollar less than other main European currencies, and its effective depreciation increased to 19¼%, the largest of the period. Until the dollar weakened during the war in the Middle East, sterling was fairly steady, and, around the time of the outbreak of the war, began to strengthen. Rumours that the Arab states were switching out of dollars led some Continental operators to abandon their short sterling positions. New York and euro-dollar interest rates fell as sterling deposit rates remained firm. The effective depreciation of sterling narrowed to around 18½% by the end of October.

With some occasional support, the *U.S. dollar* staged a modest recovery over the three months as a whole, and it continued to

Effective changes in exchange rates^a



In a more settled market, the effective rate for sterling changed comparatively little on balance during August to October.

^a Defined in the additional notes to Table 29 of the statistical annex.

strengthen into November. There was a sharp improvement in August stemming from further increases in American interest rates, and from expectations, subsequently confirmed, of encouraging American balance of payments figures for the second quarter. This improvement was not sustained into September, and the dollar fell back early in the month on news of further sharp increases in domestic prices. This generally weaker tendency was reinforced by the firmness of some European currencies at the time of the guilder revaluation and later by the war in the Middle East. However, in the second half of October, the dollar recovered once more following the cease-fire and good trade figures for September. Over the period as a whole the effective appreciation of the dollar against other currencies generally amounted to 1%. In November, the oil crisis looked increasingly more damaging for other countries, and the dollar appreciated further.

Most of the *other main currencies* correspondingly fell back a little against the dollar (more sharply so in November). For the greater part of the period to the end of October the deutschemark remained near the top of the E.E.C. 'snake', the guilder and, later, the Danish krone also had spells at the top, and the French franc was mostly at the bottom. There was little tension within the 'snake' until the revaluation of the guilder by 5% on 17th September. This generally took the markets by surprise and provoked speculation on other possible rate changes. Strong upward pressure on the deutschemark developed at the expense of the French franc, and substantial support was needed to maintain the 2% Community band. The pressure on the 'snake' eased after a sharp increase in French bank rate and after French and Belgian action to discourage movements of funds. The band was thereafter stretched only rarely up to the end of October, by

which time the Danish krone had moved to the top, with the Norwegian krone at the bottom. In mid-November, however, with the mark and the guilder falling sharply against the dollar, other currencies came into demand, and the Norwegian krone was revalued by 5% on 15th November.

Among currencies outside the E.E.C. scheme, the Swiss franc declined to an effective premium at the end of October of some 11% over its post-Smithsonian rate; the commercial lira effectively appreciated from 17% below its Smithsonian rate at the end of July to some 12% below, helped by some sales of dollars by the Bank of Italy; and, in Tokyo, the Japanese authorities continued to provide dollars to meet the market's needs as the yen fell somewhat below an effective premium of 10%. (Changes in the effective exchange rates of the main currencies are given in Table 29 of the statistical annex.)

The *London gold market* had a quieter period during most of August to October as the price dropped from the peaks of June and July. The improvement of the dollar in Europe, reduced industrial buying during the holiday season, and the growing cost of carrying long positions in gold, all helped the price to fall sharply in August. It was around U.S. \$117 at the beginning of August, but had dropped to \$92.50 by the 15th, the lowest for three months. A reaction followed, helped by rumours of a possible temporary cessation of Russian sales, and on the 20th the price was nearly \$110. Thereafter the price moved in a narrower range, \$107 to \$100, than for several months past. In early October, after war had broken out in the Middle East, gold briefly came into demand and the market became quite active again, but not for long. The price remained below \$104, and at the end of the month it was \$98.

The termination of the agreement of March 1968 which had established a two-tier market in gold⁷ was announced on 13th November. Under the agreement the central banks of Belgium, Italy, the Netherlands, Switzerland, the United Kingdom, the United States, and Western Germany had ceased to buy or sell gold in the market. On the announcement, the price was marked down fairly sharply, soon settling for a while around \$90.

Sterling guarantee arrangements

The sterling guarantee agreements, made originally in 1968 with individual overseas sterling countries and subsequently renewed with most of them for two years in 1971, expired on 24th September. These agreements had provided a useful element of stability in a period of uncertainty in international monetary affairs, and the Government announced on 6th September that they had decided to continue to guarantee certain official sterling reserves for a period of six months from 24th September.

The guarantee is given at \$2.4213, the average of the noon rates on 4th, 5th and 6th September. The guarantee will be implemented in sterling in respect of the balances that are covered by it if the average of the daily rates for sterling in terms of the U.S. dollar throughout the six-month period is below the guarantee rate. The balances eligible for a guarantee payment, if one is made, are official sterling reserves held on 24th September 1973 or the last working day of March 1974, whichever are the less, after deduction (as formerly) of an amount equivalent to any official holdings of U.K. equities or 10% of total official external

⁷ June 1968 *Bulletin*, page 108.

reserves, whichever is the greater. To be covered by the guarantee a country has to hold a minimum proportion of total official external reserves in sterling as prescribed in the 1968 arrangements, or if it is less, an absolute amount of sterling derived by applying this minimum proportion to total reserves on 24th September 1973. Thus, to qualify, countries do not have to add to their sterling holdings as a result of a rise in their reserves, while countries with falling reserves may use their sterling to the extent that their minimum sterling proportions allow.

The bill market

After the adjustment to the large rise in interest rates at the end of July, the bill markets during August to October had a period of little change in rates. Conditions were usually tight, though to a varied extent, and on most days help was needed from the Bank. During August, but not in September or in most of October, the Bank, as well as buying Treasury, local authority, and bank bills, occasionally lent at minimum lending rate. From the middle of September onwards, official sales of gilt-edged stock were large; with exceptionally heavy payments of value added tax early in October, conditions became very difficult, and few Treasury bills were left in the market. These conditions tended to push up rates in the parallel markets. To restrain the rise, the Bank placed substantial funds on deposit in the local authority market during the first three weeks of October, and also bought local authority bonds from the discount market.

At the weekly Treasury bill tender the offerings in the middle of the period were generally larger than for some time (see Table 6 of the statistical annex); but as the Bank frequently bought heavily, the number of bills in the market did not increase so much. The average rate of discount on allotment reached a peak on 7th September — only just falling short of producing a further rise in the Bank's minimum lending rate. It then declined, to a point when on 19th October the Bank's minimum lending rate fell from 11½% to 11¼%. The Bank were content at that time to see a small fall (interest rates were also easing in other countries), and their own dealing rate was adjusted downward accordingly.

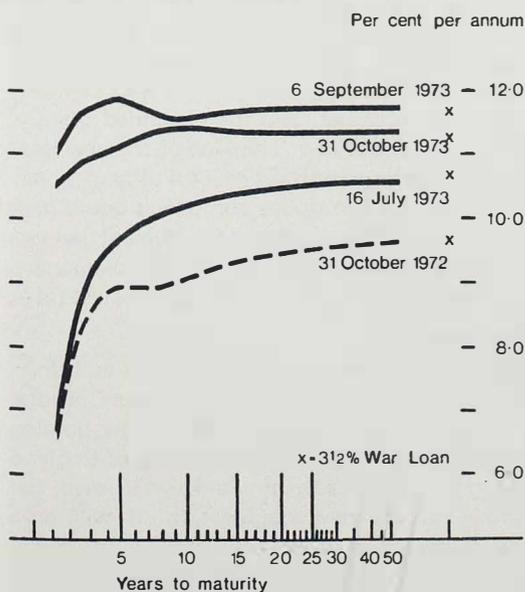
The gilt-edged market

During August and up to the middle of September the gilt-edged market was generally quiet, adjusting to the steep rise in interest rates at the end of July, and official sales of stock were small. Yields were generally at a new peak in the first half of September (to be surpassed, however, in November); the yield on undated 3½% War Loan reached nearly 11¼%.

From the middle of September sentiment improved, interest rates eased slightly and official sales became heavier. Supplies of the short tap stock (8% Treasury Stock 1975) were low, and a replacement issue of £600 million 10½% Treasury Stock 1976 at £98.75 per £100 nominal was announced on 21st September. The coupon was 1% higher than any previously offered on a government stock, and the gross redemption yield was all but 11%, roughly in line with existing rates. The terms of the issue, and a drop in the U.S. bill rate between the announcement and the day of issue, led to an unusually large subscription. The market continued to strengthen as short-term rates eased further both in London and abroad.

On balance in the September quarter, the authorities sold about £75 million. Stocks with between five and fifteen years to

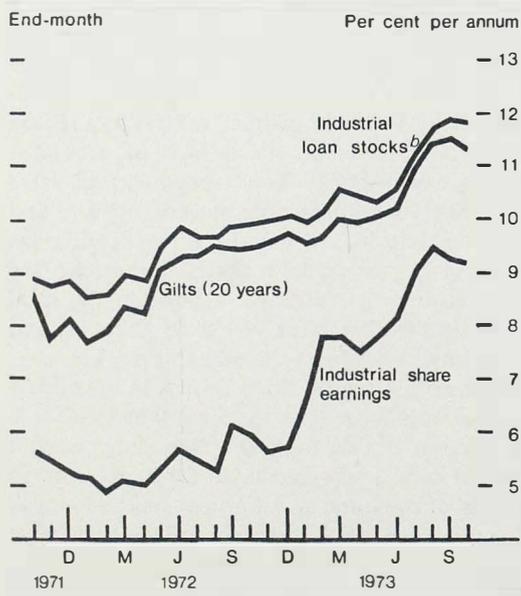
Time/yield curves of British government stocks^a



Yields rose strongly between mid-July and mid-September, but thereafter eased for a while.

^a The lines measure the nominal rate of interest which a stock at each maturity should bear if issued at par. The curve runs from the shortest-dated stock with a life of more than one year to the longest-dated stock. The construction of the curves is discussed in the September *Bulletin*, page 315.

Security yields^a



Yields in the capital markets generally reached a temporary peak in September.

^a From Table 31 of the statistical annex.

^b Newly published Bank index.

maturity accounted for £60 million, and those with more than fifteen years to run for £140 million. Official purchases of next maturing stocks amounted to £50 million, and of stocks with between one and five years to maturity to £75 million. The banks and discount houses sold heavily, and net purchases by the general public amounted to as much as £320 million.

In October the market remained strong until growing concern about the war in the Middle East caused prices temporarily to fall a little, but it soon largely recovered. Net sales by the authorities were very substantial.

Equity and debenture markets

The *equity market* remained very quiet. Turnover was smaller in August and September than in any month since March 1971, but recovered considerably in October. The fall in prices continued into September. The F.T.-Actuaries industrial (500) share price index fell from 183 at the end of July to a low point of 174 on 5th September. Thereafter, with interest rates easing and some good company results, it began to recover; and, despite a mixed reaction to the proposals for the prices and incomes policy announced on 8th October, it had reached 185 at the end of October. (Later, after the big rise in interest rates in mid-November, it fell very sharply, to 170.) New equity issues were exceptionally few: only £4 million of new money was raised in the three months, compared with nearly £80 million in the previous three months, and as much as £350 million in the second quarter of 1972.

Not surprisingly, net sales of unit trust units in the three months were also unusually small — only £30 million, compared with around £60 million in the previous period.

Turnover in the *debenture market* also remained low until September, but quickened in October. As in other markets, prices generally continued to fall into September but later in the month began to rise a little, fluctuating in October. Yields, as measured by the Bank's index of 20–25 year debenture and loan stocks (see Table 31 of the statistical annex), rose from 11.2% at the end of July to 11.9% in mid-September, and then declined slightly; they were 11.8% at the end of October. This side of the new issue market was also inactive, and again only £4 million of new money was raised in the three months. No doubt companies could have raised more — the gilt-edged market was strong for much of September and October — but companies had ample liquid assets, and probably wanted to avoid long-term finance at high interest rates.

Finance for Industry Limited

It was announced on 18th October that the Industrial and Commercial Finance Corporation Limited and the Finance Corporation for Industry Limited were to merge under a new holding company — Finance for Industry Limited. The Bank of England and the London and Scottish clearing banks will own the majority of the shares in the new corporation. It will have combined borrowing resources of some £500 million, of which about £300 million will be absorbed by existing commitments. The promotion of an increased scale of industrial investment is crucial to the future strength of the economy; and, although industry is generally well served for finance, there will certainly be circumstances in which the new corporation should be able to make a significant and distinctive contribution to future industrial investment.

Appendix

Flow of funds accounts

After a note on the impact on the figures of the change-over to value added tax come the regular quarterly tables. They are seasonally adjusted, but the unadjusted flows in the second quarter are given in Table H. The tables are followed by brief notes on sources, definitions and seasonal adjustments.

Value added tax

In the national income and expenditure accounts, purchase tax, selective employment tax, and value added tax are entered as tax receipts by the central government when the liabilities to tax accrue, with balancing entries representing notional lending by the public sector to the private sector; this notional lending is extinguished later when the tax is paid.

In the quarter to the end of June, purchase tax was paid over in the normal way for the last time, in respect of liabilities accruing in the preceding quarter, but there was a partial offset in the form of net repayments of S.E.T. to manufacturers. At the same time, liabilities of V.A.T. due for payment by the private sector began to accrue from 1st April. None was due for payment until the next quarter or later; on the other hand, some traders — where entitled to net refunds of V.A.T. — began to receive refunds from May onwards. The net effect of all these developments was to reduce the cash inflow to the central government, and increase public sector lending to the private sector, by some £300 million.

The initial payments of the new tax were staggered, with retailers due to pay three months' tax at the beginning of August, wholesalers four months' tax in September, and manufacturers five months' tax in October. As a result, in the quarter to end-September, retailers will have paid over a normal quarter's tax, roughly equivalent to their accruing liabilities, wholesalers will have paid over more than a quarter's tax, but manufacturers, accounting for most of the tax, will have continued to acquire liabilities. Moreover, sizable repayments of purchase tax were made in August to avoid double taxation on stocks held at 31st March; and there were a few more S.E.T. refunds. The result was a further large figure for government lending, on account of net accruals of tax not yet paid, the cumulative total reaching about £900 million.

In the December quarter, however, the manufacturers will have paid five months' V.A.T. (and car tax), possibly up to £300 million more than a normal quarter's liabilities for tax accruing, while retailers and wholesalers will have paid a normal quarter's liabilities. The effect will be some repayment of the previous notional government lending. In subsequent quarters payments of tax due will roughly balance the accruals; and the private sector will be left with an estimated once and for all increase in financial resources of about £650 million. It is difficult to identify the exact counterparts of this notional government lending in the figures for the personal and company sectors as presented; but up to a quarter of this bonus will perhaps have gone to the personal sector and three quarters to the company sector.

The change-over is producing a new seasonal pattern of indirect taxation, especially in the monthly figures, but it is not yet well enough established to be incorporated in the seasonal adjustments used in this *Bulletin*.

Table A
Income and expenditure
 £ millions
Seasonally adjusted

	Income from employment and trading(a)(b)	Transfer incomes etc.(b)	less Consumption(c)	less Current transfer payments	equals Saving	less Gross domestic capital formation(a)(d)	less Capital transfers (net payments -)	equals Financial surplus/deficit(e)
Personal sector								
1972 1st qtr.	8,817	3,810	- 9,320	-2,577	730	- 634	-102	- 6
2nd "	9,137	4,016	- 9,616	-2,408	1,129	- 654	- 99	376
3rd "	9,392	3,897	- 9,954	-2,488	847	- 587	- 86	174
4th "	9,792	4,211	-10,373	-2,619	1,011	- 685	- 85	241
1973 1st qtr.	10,089	4,420	-10,872	-2,834	803	- 840	- 90	-127
2nd "	10,364	4,687	-10,859	-2,898	1,294	- 791	- 68	435
Company sector(f)								
1972 1st qtr.	1,499	1,331		-1,703	1,127	-1,044	105	188
2nd "	1,614	1,356		-1,911	1,059	-1,098	86	47
3rd "	1,692	1,469		-1,859	1,302	-1,308	68	62
4th "	1,779	1,597		-1,852	1,524	-1,349	68	243
1973 1st qtr.	1,950	1,809		-2,153	1,606	-1,673	78	11
2nd "	1,988	1,822		-2,311	1,499	-1,899	61	-339
Public sector								
1972 1st qtr.	343	5,562	- 2,832	-2,346	727	-1,134	- 3	-410
2nd "	453	5,636	- 2,843	-2,377	869	-1,180	13	-298
3rd "	476	5,617	- 2,954	-2,336	803	-1,192	18	-371
4th "	518	5,798	- 3,073	-2,540	703	-1,228	17	-508
1973 1st qtr.	469	6,086	- 3,143	-2,574	838	-1,427	- 26	-615
2nd "	482	6,195	- 3,208	-2,597	872	-1,370	- 12	-510
Overseas sector(g)								
1972 1st qtr.					- 73			- 73
2nd "					- 126			-126
3rd "					105			105
4th "					11			11
1973 1st qtr.					183		38	221
2nd "					198		19	217

(a) Before providing for depreciation and stock appreciation.

(b) Rent and income from self-employment are included with transfer incomes and not with income from trading.

(c) Other than depreciation.

(d) Including stocks.

(e) The sum of sector surpluses and deficits corresponds to the residual error in the national income accounts.

(f) Including financial institutions.

(g) See the note on line 5 on page 444.

Table B
Public sector
 £ millions
 Seasonally adjusted

	1971		1972				1973		
	3rd qtr.	4th qtr.	1st qtr.	2nd qtr.	3rd qtr.	4th qtr.	1st qtr.	2nd qtr.	3rd qtr.
Capital expenditure	+1,124	+1,169	+1,134	+1,180	+1,192	+1,228	+1,427	+1,370	
less Saving	-1,144	-1,018	- 727	- 869	- 803	- 703	- 838	- 872	
less Capital transfers (net)	+ 35	+ 3	+ 3	- 13	- 18	- 17	+ 26	+ 12	
<i>equals</i> Financial surplus—/ deficit +	+ 15	+ 154	+ 410	+ 298	+ 371	+ 508	+ 615	+ 510	
Lending and other transactions (increase in assets +)(a)	+ 186	+ 235	- 47	+ 143	+ 147	+ 321	+ 14	+ 612	
Import deposits (repayments +)	+ 1								
Unidentified	+ 96	+ 34	- 323	+ 160	- 32	+ 102	- 111	+ 152	
Borrowing requirement (increase +)	+ 298	+ 423	+ 40	+ 601	+ 486	+ 931	+ 518	+1,274	
<i>Financed by (borrowing -):</i>									
<i>Central government:</i>									
<i>External transactions</i>	+ 779	+ 976	- 35	- 955	- 184	- 221	+ 144	+ 342	- 51
Notes and coin with the public	- 54	- 41	- 138	- 125	- 95	- 137	- 138	- 129	- 4
Bank borrowing	- 248	- 546	+ 306	+ 865	+ 201	- 169	+ 610	- 368	+ 114
Other domestic borrowing(b)	- 632	- 631	- 203	- 111	- 198	- 230	+ 133	- 547	- 482
	- 155	- 242	- 70	- 326	- 276	- 757	- 471	- 702	- 423
<i>Local authorities: †</i>									
External finance	+ 2	- 28	- 41	+ 17	- 60	- 65	- 70	- 24	
Bank borrowing	- 174	- 163	+ 57	- 28	- 73	+ 13	+ 134	+ 32	- 96
Other domestic borrowing(c)	+ 35	+ 65	- 81	- 114	- 30	- 116	- 217	- 404	
	- 137	- 126	- 65	- 125	- 163	- 168	- 153	- 396	
<i>Public corporations: †</i>									
External finance	- 6	- 7	- 22	- 9	+ 10	+ 1	- 27	- 19	
Domestic borrowing	-	- 48	+ 117	- 141	- 57	- 7	+ 133	- 157	
	- 6	- 55	+ 95	- 150	- 47	- 6	+ 106	- 176	
Total net borrowing	- 298	- 423	- 40	- 601	- 486	- 931	- 518	-1,274	

† In 1973 public bodies have borrowed in euro-dollars as follows:

<i>Local authorities:</i>			
From U.K. banks	18	60	13
Direct from overseas	10	46	24
<i>Public corporations:</i>			
From U.K. banks	25	177	330
Direct from overseas	50	10	- 8

(a) Consisting principally of lending to overseas and private sectors (including refinancing of export credits and public corporations' identified trade credit) and changes in bank deposits.

(b) Issue Department's transactions in commercial bills and local authority debt are included here.

(c) Including Issue Department's transactions in local authority debt.

Table C**Overseas sector^(a)**

£ millions

*Seasonally adjusted*Claims on U.K.: increase +/decrease -
Liabilities to U.K.: increase -/decrease +

	1971		1972				1973		
	3rd qtr.	4th qtr.	1st qtr.	2nd qtr.	3rd qtr.	4th qtr.	1st qtr.	2nd qtr.	3rd qtr.
Financial surplus +/deficit -	-380	- 248	- 73	-126	+105	+ 11	+221	+217	
Transactions with the U.K. private sector									
Investment flows:									
Transactions in company and overseas securities	+217	+ 30	-182	-156	-121	-102	+ 12	+ 51	
Miscellaneous private investment	+ 4	+ 20	+ 10	- 50	- 13	-130	- 89	- 31	
Other transactions:									
Net external transactions by U.K. banks ^(b)	+153	+ 541	+178	-219	- 11	+ 64	+287	+415	+152
Other identified	+219	- 105	- 61	-215	-103	+364	+ 52	+121	
Balancing item	- 97	+ 288	- 51	-331	+183	-393	+117	+ 35	
	+496	+ 774	-106	-971	- 65	-197	+379	+591	
Transactions with the U.K. public sector									
Lending etc. ^(c)	-101	- 81	- 65	-102	- 64	- 77	-111	- 75	
External finance: ^(d)									
Central government	-779	- 976	+ 35	+955	+184	+221	-144	-342	+ 51
Local authorities	- 2	+ 28	+ 41	- 17	+ 60	+ 65	+ 70	+ 24	
Public corporations	+ 6	+ 7	+ 22	+ 9	- 10	- 1	+ 27	+ 19	
	-876	-1,022	+ 33	+845	+170	+208	-158	-374	

(a) It has not been possible to include in this table the balance of payments estimates for the 3rd quarter of 1973, and revisions to previous quarters, which were released in December and appear in the statistical annex, Table 20.

(b) Other than purchases of securities.

(c) These overseas transactions of the public sector contribute to its borrowing requirement.

(d) These overseas transactions of the public sector are among the items financing its borrowing requirement.

Table D
Personal sector
 £ millions
Seasonally adjusted

	1971		1972				1973		
	3rd qtr.	4th qtr.	1st qtr.	2nd qtr.	3rd qtr.	4th qtr.	1st qtr.	2nd qtr.	3rd qtr.
Saving	+ 755	+ 814	+ 730	+1,129	+ 847	+1,011	+ 803	+1,294	
Capital transfers (net)	- 87	- 87	- 102	- 99	- 86	- 85	- 90	- 68	
Capital expenditure	- 527	- 597	- 634	- 654	- 587	- 685	- 840	- 791	
Financial surplus (+)	+ 141	+ 130	- 6	+ 376	+ 174	+ 241	- 127	+ 435	
Borrowing (-)									
For house purchase	- 504	- 545	- 587	- 673	- 718	- 701	- 751	- 652	
Bank borrowing(a)	- 236	- 233	- 444	- 580	- 259	- 644	- 469	- 279	- 407
Hire purchase debt	- 88	- 77	- 65	- 46	- 65	- 65	- 43	+ 6	
Other(b)	+ 53	- 106	+ 101	+ 56	- 20	- 158	- 18	- 179	
	- 775	- 961	- 995	-1,243	-1,062	-1,568	-1,281	-1,104	
Acquisition of financial assets (+)									
Life assurance and pension funds	+ 519	+ 512	+ 558	+ 623	+ 581	+ 612	+ 740	+ 640	
Government stocks	+ 174	+ 101	- 130	+ 33	+ 56	+ 46	+ 126	+ 211	
Company and overseas securities	- 319	- 351	- 215	- 296	- 261	- 250	- 270	- 176	
Unit trust units	+ 9	+ 22	+ 23	+ 57	+ 58	+ 65	+ 57	+ 52	+ 32
Bank deposits, notes and coin	+ 319	+ 382	+ 532	+ 471	+ 445	+ 565	+ 652	+ 866	+ 962
Building society shares and deposits	+ 527	+ 583	+ 588	+ 584	+ 453	+ 514	+ 454	+ 743	+ 488
National savings	+ 88	+ 140	+ 130	+ 170	+ 108	+ 67	+ 57	+ 80	+ 86
Local authority debt	- 66	- 89	- 33	- 60	- 25	+ 36	+ 70	+ 16	
Other	+ 59	+ 114	+ 67	+ 92	+ 69	+ 91	- 33	+ 24	
	+1,310	+1,414	+1,520	+1,674	+1,484	+1,746	+1,883	+2,456	
Identified financial transactions	+ 535	+ 453	+ 525	+ 431	+ 422	+ 178	+ 602	+1,352	
<i>Unidentified</i>	- 394	- 323	- 531	- 55	- 248	+ 63	- 729	- 917	

(a) Other than for house purchase.

(b) Including accruals adjustments and trade credit extended by public corporations.

Table E
Industrial and commercial companies

£ millions

Seasonally adjusted

Assets: increase +/decrease -
Liabilities: increase -/decrease +

	1971		1972				1973		
	3rd qtr.	4th qtr.	1st qtr.	2nd qtr.	3rd qtr.	4th qtr.	1st qtr.	2nd qtr.	3rd qtr.
Domestic capital formation	+961	+882	+ 915	+986	+1,120	+1,186	+1,503	+1,711	
<i>less</i> Saving	-826	-872	-1,013	-932	-1,127	-1,354	-1,342	-1,260	
<i>less</i> Capital transfers (net)	-134	-101	- 117	- 98	- 81	- 82	- 93	- 76	
<i>equals</i> Financial surplus -/deficit +	+ 1	- 91	- 215	- 44	- 88	- 250	+ 68	+ 375	
Trade investments, mergers, etc. in the United Kingdom	+128	+ 85	+ 114	+124	+ 119	+ 175	+ 135	+ 103	
Long-term investment abroad	+157	+186	+ 168	+167	+ 176	+ 257	+ 275	+ 277	
Import deposits	- 1								
Total requiring financing (+)	+285	+180	+ 67	+247	+ 207	+ 182	+ 478	+ 755	
Capital issues (including euro-currency issues)	-119	-141	- 136	-203	- 212	- 176	- 109	- 86	- 16
Overseas investment in U.K. companies	-158	-142	- 140	-107	- 151	- 100	- 128	- 231	
Import credit and advance payments on exports	- 47	- 33	- 54	- 4	- 88	- 124	- 82	- 58	
Export credit and advance payments on imports	- 6	- 10	+ 13	+ 43	+ 56	+ 21	+ 53	+ 2	
Bank borrowing	-228	-266	- 770	-727	- 648	- 843	- 671	- 557	-1,494
Other borrowing(a)	-106	- 50	- 5	- 25	- 13	- 12	- 410	- 227	
Bank deposits, notes and coin	+145	+394	+ 317	+568	+ 626	+ 775	+ 638	+ 127	+1,301
Other liquid assets(b)	+ 73	+ 41	+ 35	- 4	+ 6	+ 37	+ 62	+ 80	
Other items(c)	+ 32	+ 63	+ 90	- 61	- 25	+ 5	+ 181	- 45	
Other overseas transactions (including the balance of payments balancing item)(d)	- 55	-114	+ 63	+475	- 19	+ 99	- 172	- 98	
<i>Unidentified domestic transactions(d)</i>	<i>+184</i>	<i>+ 78</i>	<i>+ 520</i>	<i>-202</i>	<i>+ 261</i>	<i>+ 136</i>	<i>+ 160</i>	<i>+ 338</i>	
Total financing	-285	-180	- 67	-247	- 207	- 182	- 478	- 755	

(a) Including transactions in commercial bills by the Issue Department of the Bank of England, and also accruals adjustments for local authority rates, bank advances and deposits, purchase tax, S.E.T., and V.A.T.

(b) Treasury bills, local authority debt, tax reserve certificates, and deposits with other financial institutions.

(c) Trade credit to public corporations, and hire purchase lending.

(d) Most of the balancing item in the balance of payments accounts, especially when large, reflects unidentified transactions between companies and overseas. The whole of it is here regarded in this light in order to distinguish roughly between companies' domestic transactions and their overseas ones. It is deducted from the total amount unidentified in the accounts to leave a rough estimate of unidentified domestic transactions.

Table F
Banking sector

£ millions

Seasonally adjusted

Lending: increase +/decrease -
Deposits: increase -/decrease +

	1971		1972				1973		
	3rd qtr.	4th qtr.	1st qtr.	2nd qtr.	3rd qtr.	4th qtr.	1st qtr.	2nd qtr.	3rd qtr.
Lending to:									
Public sector	+ 432	+ 758	- 466	- 697	- 45	+ 182	+ 357	+ 482	+ 561
Industrial and commercial companies	+ 232	+ 270	+ 820	+ 800	+ 656	+ 854	+ 685	+ 559	+1,532
Other financial institutions	+ 155	+ 217	+ 271	+ 338	+ 174	+ 249	+ 285	+ 63	+ 154
Personal sector	+ 261	+ 273	+ 499	+ 670	+ 359	+ 744	+ 539	+ 374	+ 487
Total domestic lending	+1,080	+1,518	+1,124	+1,111	+1,144	+2,029	+1,866	+1,478	+2,734
Deposits by:									
Public sector	- 7	- 30	+ 13	+ 5	+ 4	- 102	+ 14	- 56	+ 32
Industrial and commercial companies	- 118	- 372	- 248	- 505	- 578	- 706	- 569	- 62	-1,299
Other financial institutions	- 2	- 228	- 128	- 498	+ 36	- 330	- 227	- 242	- 215
Personal sector	- 292	- 362	- 463	- 409	- 398	- 497	- 583	- 802	- 960
Total domestic deposits	- 419	- 992	- 826	-1,407	- 936	-1,635	-1,365	-1,162	-2,442
Net lending to overseas sector(a)	- 357	- 559	- 197	+ 295	+ 34	- 123	- 204	- 420	- 160
Non-deposit liabilities (net)	- 304	+ 33	- 101	+ 1	- 242	- 271	- 297	+ 104	- 132

(a) Claims on overseas sector net of overseas deposits. Including foreign currency borrowing to finance loans to U.K. public sector.

Table G
Financial institutions other than banks

£ millions

Seasonally adjusted

	1971		1972				1973		
	3rd qtr.	4th qtr.	1st qtr.	2nd qtr.	3rd qtr.	4th qtr.	1st qtr.	2nd qtr.	3rd qtr.
Increase in financial liabilities (-)									
Life assurance and pension funds	- 519	- 512	- 558	- 623	- 581	- 612	- 740	- 640	
Building society shares and deposits	- 545	- 606	- 602	- 596	- 465	- 524	- 464	- 778	- 498
Other deposits	- 78	- 105	- 7	- 61	- 74	- 71	- 125	- 14	
Capital issues	- 55	- 50	- 99	- 230	- 78	- 32	- 46	- 5	- 4
Unit trust units	- 9	- 22	- 23	- 57	- 58	- 65	- 57	- 52	- 32
Other (mainly bank) borrowing	- 155	- 201	- 270	- 337	- 173	- 249	- 284	- 62	
	-1,361	-1,496	-1,559	-1,904	-1,429	-1,553	-1,716	-1,551	
Increase in financial assets (+)									
Short-term assets(a)	- 8	+ 237	+ 107	+ 553	- 94	+ 405	+ 255	+ 477	
Government stocks	+ 342	+ 310	+ 240	+ 66	+ 13	+ 99	+ 84	+ 291	
Company and overseas securities:									
Ordinary shares	+ 260	+ 254	+ 379	+ 589	+ 468	+ 356	+ 100	+ 88	
Fixed interest	+ 85	+ 33	+ 87	+ 31	+ 46	+ 71	+ 39	+ 23	
Loans for house purchase	+ 440	+ 461	+ 493	+ 560	+ 598	+ 566	+ 634	+ 489	
Long-term lending to local authorities	+ 6	+ 39	+ 66	+ 15	+ 54	+ 8	- 3	- 7	
Hire purchase claims	+ 65	+ 47	+ 49	+ 42	+ 20	+ 52	+ 29	+ 24	
Other lending	+ 9	+ 61	- 19	- 32	+ 83	+ 48	+ 198	+ 73	
	+1,199	+1,442	+1,402	+1,824	+1,188	+1,605	+1,336	+1,458	
Net identified financial transactions	- 162	- 54	- 157	- 80	- 241	+ 52	- 380	- 93	

(a) Bank deposits, tax reserve certificates, Treasury bills, and local authority temporary debt.

Table H
Flow of funds: second quarter 1973

£ millions

Not seasonally adjusted

	Line	Public sector	Overseas sector (a)	Personal sector	Industrial and commercial companies	Banking sector	Other financial institutions	Residual error
Capital account								
Saving	1	+ 618	+166	+1,256	+1,549	+357		
Taxes on capital and capital transfers	2	- 19	+ 19	- 72	+ 77	- 5		
<i>less:</i>								
Gross fixed capital formation at home	3	-1,180		- 722	- 993	-203		
Increase in value of stocks and work in progress	4	- 114		- 126	- 721	+ 22		
Financial surplus +/-deficit -	5	- 695	+185	+ 336	- 88	+171		+91
Changes in financial assets and liabilities								
Assets: increase +/decrease -								
Liabilities: increase -/decrease +								
Net indebtedness of Government to								
Bank of England, Banking Department	6	- 123				+ 123		
Life assurance and pension funds	7			+ 640			-640	
Loans by the U.K. Government	8	+ 3	- 3		- 1		+ 1	
Total external currency flow	9.1	+ 377	-377					
Other central government external transactions	9.2	- 26	+ 26					
Banks' net external transactions	10		+441			- 441		
Miscellaneous investment overseas (net)	11	+ 43	+ 23		- 63		- 3	
Notes and coin	12	- 195		+ 91	+ 92	+ 12		
Bank deposits of domestic sectors	13	+ 30		+ 844	+ 187	-1,345	+284	
Deposits with other financial institutions	14		- 6	+ 759	+ 39		-792	
National savings	15.1	- 63		+ 63				
Tax reserve certificates/tax deposit accounts	15.2	+ 4		- 7	+ 3			
Bank lending to domestic sector	16	- 147		- 389	- 656	+1,267	- 75	
Hire purchase debt	17	- 2		+ 15	- 51		+ 38	
Loans for house purchase	18	+ 68		- 657		+ 95	+494	
Other loans and accruals	19	+ 143		- 73	- 64	- 96	+ 90	
Marketable government debt held by domestic sectors:								
Treasury bills	20	+ 72			- 7	- 57	- 8	
Stocks	21	- 859		+ 211		+ 357	+291	
Local authority debt	22	- 340	+ 27	+ 13	+ 79	- 17	+238	
U.K. company and overseas securities:								
Capital issues	23		+ 10		- 86	- 25	- 5	
Other transactions	24	- 5	+ 41	- 176	+ 110	+ 25	+111	
Unit trust units	25			+ 54			- 54	
Identified financial transactions	26	-1,020	+182	+1,388	- 418	- 102		- 30
<i>Unidentified</i>	27	+ 325	+ 3	-1,052	+ 330	+303		+91
Total=Financial surplus +/- deficit -	28	- 695	+185	+ 336	- 88	+171		+91

- nil or less than £½ million.

(a) It has not been possible to incorporate in the table the revised balance of payments estimates released in December.

Table J
Flow of funds: second quarter 1973

£ millions
Seasonally adjusted

	Line	Public sector	Overseas sector (a)	Personal sector	Industrial and commercial companies	Banking sector	Other financial institutions	Residual error
Capital account								
Saving	1	+ 872	+198	+1,294	+1,260		+239	
Taxes on capital and capital transfers	2	- 12	+ 19	- 68	+ 76		- 15	
<i>less:</i>								
Gross fixed capital formation at home	3							
Increase in value of stocks and work in progress	4	-1,370		- 791	-1,711		-188	
Financial surplus +/-deficit -	5	- 510	+217	+ 435	- 375		+ 36	+197
Changes in financial assets and liabilities								
Assets: increase +/decrease - Liabilities: increase -/decrease +								
Net indebtedness of Government to								
Bank of England, Banking Department	6	- 46				+ 46		
Life assurance and pension funds	7			+ 640			-640	
Loans by the U.K. Government	8	+ 13	- 13		- 1		+ 1	
Total central government external transactions	9	+ 342	-342					
Banks' net external transactions	10		+415			- 415		
Miscellaneous investment overseas (net)	11	+ 43	+ 42		- 82		- 3	
Notes and coin	12	- 121		+ 64	+ 65	- 8		
Bank deposits of domestic sectors	13	+ 56		+ 802	+ 62	-1,162	+242	
Deposits with other financial institutions	14		+ 5	+ 774	+ 13		-792	
National savings	15.1	- 80		+ 80				
Tax reserve certificates/tax deposit accounts	15.2	+ 4		- 7	+ 3	-	-	
Bank lending to domestic sectors	16	- 146		- 279	- 557	+1,045	- 63	
Hire purchase debt	17	- 2		+ 6	- 28		+ 24	
Loans for house purchase	18	+ 68		- 652		+ 95	+489	
Other loans and accruals	19	+ 337		- 179	- 241	+ 7	+ 76	
Marketable government debt held by domestic sectors:								
Treasury bills	20	+ 49			- 7	- 34	- 8	
Stocks	21	- 859		+ 211		+ 357	+291	
Local authority debt	22	- 315	+ 24	+ 16	+ 71	- 32	+236	
U.K. company and overseas securities:								
Capital issues	23		+ 10		- 86	- 25	- 5	
Other transactions	24	- 5	+ 41	- 176	+ 110	+ 25	+111	
Unit trust units	25			+ 52			- 52	
Identified financial transactions	26	- 662	+182	+1,352	- 678	- 101	- 93	
<i>Unidentified</i>	27	+ 152	+ 35	- 917	+ 303		+230	+197
Total=Financial surplus +/- deficit -	28	- 510	+217	+ 435	- 375		+ 36	+197

- nil or less than £½ million.

(a) It has not been possible to incorporate in the table the revised balance of payments estimates released in December.

Notes on sources, definitions and seasonal adjustments¹

Sources

The main statistical series used in compiling Tables H and J appear in the statistical annex to this *Bulletin* or in the Central Statistical Office's *Financial Statistics* or *Economic Trends*. The seasonally adjusted figures are not published elsewhere.

Definitions (line numbers refer to Tables H and J)

Public sector The central government, local authorities, and nationalised industries and other public corporations.

Overseas sector Non-residents as defined for the balance of payments estimates.

Persons Individuals, unincorporated businesses, and private non-profit-making bodies.

Industrial and commercial companies All corporate bodies other than public corporations, banks, and other financial institutions.

Banks As in Table 11 of the statistical annex.

Other financial institutions Insurance companies, pension funds, building societies, investment trusts, finance houses, savings banks investment accounts, authorised unit trusts, property unit trusts, special finance agencies and Crown Agents for Oversea Governments and Administrations.

Lines 1-4 As defined in the national income and expenditure accounts.

Line 5 The sum of the financial surpluses/deficits for all sectors equals the residual error in the national income accounts. For the overseas sector, the entry is the counterpart of the U.K. balance of payments on current account plus, from the first quarter of 1973, capital transfer payments.

Line 6 See footnote (c) to Table 1 of the annex.

Line 7 The increase in persons' net claims on these funds.

Lines 9.1 and 9.2 See additional notes to Table 1 of the annex.

Line 10 Broadly, changes in overseas deposits with the banking sector less lending to overseas by the banking sector.

Line 11 Those parts of the balance of payments items classified as investment and other capital flows which are not elsewhere included. That part of export credit extended by U.K. banks which is refinanced by the central government is included here.

Line 12 Changes in Bank of England notes (treated as liabilities of the public sector), in banks' liabilities on account of issues of Scottish and Northern Irish notes, and in coin.

Line 13 Changes in gross current and deposit accounts of U.K. residents, after the entries for the banking sector and industrial and commercial companies have been adjusted for 60% of transit items (see additional notes to Table 11 of the annex). Changes in domestic holdings of sterling certificates of deposit are included here.

Line 14 Includes building society shares. Deposits by banks with finance houses are in line 16.

Lines 15.1 and 15.2 As in Table 3 (2) of the annex but including tax deposit accounts.

Line 16 Advances and overdrafts, money at call and short notice, and transactions in commercial bills; excluding loans for house purchase (included in line 18); lending to local authorities (line 22); and lending to the Northern Ireland Government (line 19). Recorded advances to industrial and commercial companies are adjusted for 40% of the change in transit items (see also line 13).

Line 18 New loans less repayments, including estimates for banks, and lending by the public sector to housing associations.

Line 19 Loans between domestic sectors not entered elsewhere, including trade credit given or received by public corporations; and differences between accruals of local authority rates, purchase tax, value added tax, and interest charges (the basis of entries in the national accounts) and the corresponding cash payments.

Lines 20 and 21 As defined in additional notes to Table 3 (1) of the annex. For Treasury bills (stocks), the entries for persons (industrial and commercial companies) are residuals and include unidentified transactions by industrial and commercial companies (persons) and overseas.

Line 22 Total identified borrowing by local authorities from outside the public sector.

Line 23 Net issues on the U.K. market, and euro-currency issues by U.K. companies.

Line 24 All other transactions. The entries for persons are residuals from the estimates in lines 23 and 24 for all other sectors.

Line 25 Net sales of units to persons by authorised unit trusts.

Line 27 The net total for all sectors corresponds to the residual error in the national income accounts.

Seasonal adjustments

After preliminary adjustments have been obtained for each item which displays seasonality, consistent adjustments have been estimated by a system of balancing, under which the sum of the adjustments for each item over the four quarters in each calendar year is zero and the sum of the adjustments of all sectors for a particular line entry in any quarter is zero. Also, for certain series (such as notes and coin) an adjustment is made to allow for the days of the week on which a quarter begins and ends; but these will not usually completely cancel out over the year. The adjustments take account of the data up to the end of 1972.

¹ Fuller notes were given in the June 1972 *Bulletin*, pages 202-4. A detailed description is given in *An introduction to flow of funds accounting: 1952-70* (Bank of England, August 1972).