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Recent Financial Developments in the United Kingdom 11 pages

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Summary

Towards the end of 1956, business activity began to expand in Britain, after having remained on a plateau for about two years; by the spring months, there was evidence of a general business upturn. Consumer durable and other consumption lines began to expand rapidly and exports and investments also increased.

The turn in business activity, which probably commenced in the final months of last year, was paralleled by a shift in credit trends. In the financial sphere, a renewed growth in private credit commenced in November 1956 against a background of declining short-term money rates. This easing of money rates rested mainly on Britain's better balanced domestic demand situation and the improved international payments position. It was materially accelerated by an unexpected boom in the gilt-edged market, commencing in December, which enabled the authorities to retire Treasury bills through bond sales to the public. On February 7, 1957 the Bank of England reduced its discount rate from 5-1/2 to 5 per cent in line with Treasury bill trends; the authorities stressed the technical nature of this adjustment. In a shift in the burden of restraint from monetary to fiscal policy, the 1957-58 budget, introduced on April 9, indicated that the Treasury might need no new cash from the market during the current year, even for capital expenditure.

Bank loans to the private sector rose by 11 per cent between November and May after 12 months of contraction. In addition to further growth of loans to manufacturing, there were sharp rises in loans for hire-purchase and retail-trade finance. The growth in private credit produced an upturn in bank deposits of about 2 per cent, seasonally adjusted, between the second quarters of 1956 and 1957. There was a further substantial rise in loans in June.

During the past six months, the gilt-edged market has fluctuated widely. After reaching a 30-year low last November, prices rose sharply in December and January: the successful international support of the pound and the market conviction that bond prices had finally reached the bottom led to rapid price rises. Funding through bond sales on the rising market threatened bank liquidity and reinforced the downward trend in short-term money rates. It established a market expectation of further declines in short money rates.

On May 3, however, the Bank of England decided against a second cut in Bank rate, probably because of the pace of the business recovery and the expansion in private credit. The authorities made security sales to check the decline in the Treasury bill rate. Gilt-edged values then began to decline rapidly and by the latter part of June had fallen even below the post-Suez lows to the lowest levels since 1921. The sharp rise in bond yields has been a drag on rising stock prices.

The severe shake-out in gilt-edged was completely unexpected; it produced criticism in the financial press of "official mismanagement" in funding operations over the past six months. The shake-out was in part an outgrowth of the speculative bond price rises from last November through February. At that time, investors had optimistically concluded that Britain's improved economic balance would permit an easing in the credit squeeze; they also thought that the authorities favored (or at least would acquiesce in) a continuing downward drift in short-term money rates in order to stimulate funding. The Bank's refusal on May 3 to lower discount rate punctured these expectations and demonstrated that the authorities intended to maintain the credit squeeze to keep in check the expansion in business activity.

From a technical market point of view, this disappointment led to a virtual withdrawal of demand for bonds while investors took another look at the gilt-edged outlook. Without buying interest, limited sales produced a rapid fall in prices. In this situation, the British authorities resisted the temptation to intervene: they explicitly refused to support gilt-edged by what a Treasury official called "artificial means" which in the past have had "rather disastrous results." The decline in bond prices has brought intermediate bond yields to, or above, the yields on industrial shares in the London market. The resolution of the authorities has been maintained in the face of general concern in Parliament and in the press about the "credit of the government." Within the past few weeks, the Chancellor has made two speeches on the dangers of inflation in Britain and reiterated the Government's determination to stand firm in attempts to keep the business expansion from getting out of hand.

British economy: adjustment in 1956 and expansion in 1957

During 1956, fiscal and monetary restraints brought major adjustments within the British economy. The principal developments were: the rise in consumption was halted, most of the increase in goods available went into exports, and imports were brought under control without use of direct restrictions. During this adjustment period, investment continued to expand but at a reduced rate. The failure of industrial output to expand in aggregate was the chief adverse development in 1956, but there were important shifts in composition between various industry sectors; capital goods sectors continued to expand but consumer durable lines had a set back. The magnitude of the adjustments in major economic sectors are seen in the estimated year-to-year changes (in millions of pounds at constant prices):

	1954 and 1955 (actual)	1955 and 1956 (actual)	1956 and 1957 (forecast)
1. Supplies:			
Gross domestic product	+540	+240	+400
Imports	+370	+100	+150
Total supplies	+910	+340	+650
2. Expenditures:			
Consumers	+330	+60	+290
Current government	-40	+50	-50
Gross fixed investment	+160	+80	+50
Inventories	+220	-100	+40
Exports	+240	+250	+220
	+910	+340	+650

With the redirection of resources into exports during 1956, Britain's international current account shifted from a deficit of £79 million in 1955 to a surplus of £233 million in 1956.

Forecasts for prospects in 1957 made by about 100 economists indicate a growth in consumption of about 2.5 per cent compared with a rise of only 0.5 per cent last year. (See column three above.) Industrial production is expected to rise by 2.6 per cent compared with no change in 1956. Exports are forecast to expand by 4.5 per cent compared with the 5.6 per cent increase last year. Retail prices may rise by 3.7 per cent compared to a 5.0 per cent increase in 1955.

Business activity expands as consumer and export demands rise

Business activity expanded during the first half of 1957, sparked by rising consumer and export demands. During the first quarter, consumer's expenditures, other than food and fuel, rose by

4 per cent in constant prices compared with the same period in 1956. Total retail sales were 6 and sales of household goods about 13 per cent above those a year ago. Between the same two quarters, capital investment by manufacturing industry rose by 10 per cent in money terms or about 5 per cent in real terms. Within this total, building spending rose by 25 per cent and plant and machinery outlays by 10 per cent. Investment by nationalized industries is also rising.

This pickup in consumer's spending was reflected in a pickup in production. The index of industrial production, seasonally adjusted, rose in May about 2 or 3 per cent above the level previously prevailing, the first increase in nearly two years. There was a major recovery in automobiles, which accelerated in March. By mid-June total automobile output was rising rapidly and already above the record peaks of 1955; several major producers set output records in May. Machine tool deliveries in March were nearly one-fifth above the 1956 average. The Financial Times reported on June 11 a "marked revival in . . . inquiries about new (construction) projects sufficient to save the industry from the fall in output at the end of the year, which seemed inevitable only a few weeks ago."

The business recovery has tightened the labor market over the past twelve months. In June, seasonally-adjusted unemployment was at 303,000 workers compared with 324,000 in January and 266,000 in June 1956. Seasonally-adjusted reported vacancies were at 280,000 jobs in June 1957 compared with 292,000 in January and 356,000 in June 1956. Labor surveys showed fewer workers on overtime and more workers on short-time in February 1957 than in the same month in 1956 and 1955. However, the number of short-time workers declined in March and may have dropped further with the motorcar expansion.

Market rates: bills fall, bonds rise, topping stock yields

With Treasury bill rates falling and bond yields rising, short-term market rates declined below bond yields in early 1957 for the first time since Bank rate was raised to 5-1/2 per cent in February 1956. Bond prices fluctuated widely during this period and in early July were below the low levels reached during the Suez invasion. The Treasury bill rate fell continuously in the last quarter of 1956 contributing to a reduction in Bank rate in February 1957, but the decline was halted by official market action in early May.

The principal recent changes in the rate structure in the London market may be seen in the following representative yields (in per cent per annum):

	February 1956	July 10, 1957	Change
Treasury bills	5.27	3.85	-1.42
Bonds:			
1959	5.10	4.40	-0.70
1963	5.03	4.70	-0.33
1975	5.13	5.63	+0.50
Consols	4.75	5.07	+0.32

The peak of the yield in February 1956 was in the Treasury bill rate which materially exceeded longer-term bond yields; by June 1957, however, the peak of the curve had shifted to long-term bonds. Between February 1956 and July 1957, short rates declined sharply, medium-term bonds showed little change and long-term bonds rose substantially. On July 10, an 18-year Treasury bond had a 5.63 and Consols a 5.07 per cent yield.

After reaching a 3-year low in November 1956, stock prices rose on an index basis from 166 in December to 200 in April. During May and June, they fluctuated only between 201 and 203. At the end of June, industrial stocks were at a 5.16 per cent yield compared with a 5 per cent yield for Consols and a yield up to 5.50 per cent for intermediate maturities. By contrast, stocks were nearly 1.5 per cent above Consols in yields during 1956. The high bond yields were serving as a drag on the rise in stock prices in June and July.

New capital issues in Britain have risen sharply in 1957. Through June, British enterprises raised £188 million in the capital market compared with £130 million and with £89 million in the same six months in 1956 and 1955 respectively. Metals manufacturing, paper and printing, communication and engineering were the principal industrial borrowers in the first quarter. Funds raised by overseas borrowers totaled £23 million compared with £21 and £11 million in the two preceding years.

Private credit expanding: large second quarter growth

The seasonal decline in credit supplies during the first quarter as a result of heavy Treasury bill repayment by the Exchequer was followed by a large expansion in the second quarter (see table 1 appended). Throughout both quarters, private loans expanded: between November and June, clearing bank loans to the private sector increased by £220 million and their holdings of commercial bills grew by £46 million. Through May, the authorities retired about £266 million net of Treasury bills from the banks or about £100 million more than in the same months in the previous year. During this period, bank holdings of government bonds increased by only £14 million. Since official sales of bonds during December and January are reliably estimated at about £200 million, it would appear that the bulk of bonds were sold to non-bank investors. Furthermore, since the decline in supplies of tender Treasury bills through May was over £700 million, it would appear that the bulk of Treasury bills retired were also in non-bank hands.

Between November and May, the growth in loans by all British banks totaled £70 million between November and February and £78 million between February and May. The principal increases have been in financial and personal loans which were heavily curtailed in the credit squeeze. The textile industries (currently in an expansion phase) and engineering also expanded (see table 2 appended).

In April, the authorities reiterated the need for continued credit restriction; they also asked the Capital Issues Committee to review applications for long-term bank loans and have refused to withdraw this restraint.

The Chancellor also established a special Committee (known as the Radcliffe Committee) to inquire into the workings of the monetary and credit system because, in his words, "the monetary machine has been working under great difficulty" over the past two years.

Hire-purchase: new credit extensions set record

In March and April, new hire-purchase credit extended established records for the 19 months for which statistics are available. This increase was due chiefly to the credit extended for motorcycles, used and new cars and trailers. A further 12 per cent increase is reported for May. Recent trends in credit extended (with December 1955 = 100) are:

		Total goods	New cars	Used cars	Motor-cycles	Furniture	Appliances
1956:	Jan.	114	117	118	107	95	111
	Feb.	117	102	120	131	91	128
	Mar.	90	107	105	98	77	66
	Apr.	96	115	123	126	86	80
1957:	Jan.	128	96	203	237	111	86
	Feb.	131	119	204	254	88	54
	Mar.	162	151	259	330	95	81
	Apr.	179	156	298	388	100	84

Even with the record new credit extended, however, total credit outstanding at the end of April, estimated at about £369 million, was nearly 12 per cent below the volume outstanding in April 1956.

Because of the rapid expansion in automobile sales, instalment credit restrictions were tightened late in May. Down-payments for cars, motorcycles and light trucks were raised from 20 to 33-1/3 per cent. On the other hand, down-payments on commercial vehicles and industrial machinery were cut from 50 to 33-1/3 per cent. This tightening in car terms followed the reduction in down-payments on automobiles from 50 to 20 per cent which was announced on December 21, as a means of aiding the motor industry.

Treasury's budget position improved in second quarter

During the second quarter, the Treasury reported a current-account deficit of £120 million compared with a deficit of £158 million for the same three months in 1956. The reduced deficit reflected mainly larger tax receipts. The over-all deficit, including capital expenditures, totaled £188 million in 1957 compared with £219 million a year earlier. Local authority repayments exceeded new loans in the first quarter but loans to nationalized amounted to £34 million. After reducing the interest rate on these loans from 5-1/4 to 5 per cent in February, the Treasury raised the rate to 5-1/2 per cent on July 11. The principal budget figures for the April-June period are as follows (in millions of pounds):

	1957	1956
Current account:		
Expenditures	1134	1070
Revenue	1014	912
Balance	-120	-158
Capital spending (net)	-68	-61
Over-all deficit	-188	-219

Local authorities borrowing rates rising

Between April 1956 and March 1957, new issues of local authorities totaled £61 million compared with £12 million in the preceding twelve months. This increase resulted from Treasury instructions in October 1955 requiring local authorities to borrow in the capital market. To shorten the backlog of authorities waiting to present new issues, the Treasury decided in May to limit new issues to a minimum of £3 million. This new policy means that all but the largest local authorities must now rely mostly on the mortgage market for funds.

Local authority borrowing rates have moved up rapidly in the past few months. On July 11, the Treasury raised its rates on loans from the Local Loans Fund to these municipalities by 1/2 per cent for short and intermediate and 1/4 per cent for long term advances. Recent changes in these rates (in per cent per annum) are:

	Nov. 10, 1956	Feb. 16, 1957	July 11,1957
Less than 5 years	5-1/4	5-1/4	5-3/4
From 5 to 15 years	5-3/4	5-1/2	6
Over 15 years	5-3/4	5-1/2	5-3/4

This rise in Exchequer charges was preceded by tighter conditions in the mortgage market. Rates in this market have been rising during 1957. This trend was accelerated by the Treasury's exclusion order in May. Recent trends in mortgage rates during 1957 are as follows:

	January	May	July
2 - 5 years	5-3/4	6	6-1/8 - 1/4
More than 5 years	—	5-1/2 - 3/4	6

The shortage of funds in this market has encouraged local authorities to advertise for deposits in competition with the hire-purchase companies; they offer 5-1/4 or even 5-1/2 per cent for deposits which can be withdrawn at a month's notice.

Table 1

London clearing banks: Change in net deposits
and principal assets, March to June
(In millions of pounds)

	1955	1956	1957
1. Net deposits	+ 47	+160	+259
2. Private sector:			
Advances	+162	+ 70	+112
Commercial bills	- 10	- 9	+ 3
Total	+152	+ 61	+115
3. Public sector:			
Short-term	+ 43	+105	+140
Securities	-182	- 30	- 4
Total	-139	+ 75	+136

Table 2

Great Britain: Recent changes in bank loans by business category
(In millions of pounds)

	Nov. 1955 to Nov. 1956	Nov. 1956 to Feb. 1957	Feb. 1957 to May 1957
I. Public sector:			
Nationalized public utilities	+ 19	- 34	- 11
Local authorities	- 3	+ 2	+ 10
Total	+ 16	- 32	- 1
II. Private sector:			
1. Financial and personal loans	- 52	+ 31	+ 20
2. Textile industries	+ 1	+ 19	+ 11
3. Retail trade	- 20	+ 1	+ 10
4. Food, drink and tobacco	- 13	+ 6	+ 18
5. Building	- 9	+ 2	+ 1
6. Selected industries:			
Engineering	+ 46	+ 17	+ 11
Iron and steel	+ 8	+ 21	- 3
Non-ferrous metals	- 2	+ 4	- 1
Shipping	+ 5	+ 2	- 2
Total selected industries	+ 57	+ 44	+ 5
7. Miscellaneous industry and trade	- 6	- 2	+ 3
8. Other categories	- 12	--	+ 10
9. Total private	- 66	+101	+ 79
III. Total, public and private sectors	- 50	+ 70	+ 78