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Recent Economic Developments in the  
United Kingdom: May-October 1962

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Recent Economic Developments in the United Kingdom: May-October 1962Summary and Conclusions

In the period covered by this review, the British economy enjoyed balance of payments equilibrium but suffered from some under-utilization of industrial capacity. The present satisfactory state of the balance of payments followed a half-year (fourth quarter of 1961 and the first quarter of 1962) of substantial balance of payments surplus which was brought about by a large inflow of foreign capital, attracted by relatively high interest rates, and by an improvement on trade account. The recovery from the March-July 1961 balance of payments crisis has been so rapid that the \$1.5 billion drawing from the IMF was entirely repaid by the end of July 1962.

The current problem facing the Government is how to stimulate domestic demand without endangering the balance of payments. The possibility of a payments deficit became apparent in the third quarter of this year when imports of industrial raw materials recovered from their abnormally low levels in the first quarter of this year. Therefore, Government policies have been very cautious. Reflationary measures have been taken in small steps, and sufficient time has been allowed to elapse between each action to see how the economy would react. Because of concern over falling private investment and rising unemployment, the Chancellor announced additional tax measures to expand output on November 5.

Capital inflow produced payments surplus in early 1962

Recently published data show that Britain had a balance of payments surplus of £259 million (See Table 1) in the first half of 1962 as

Table 1. The United Kingdom Balance of Payments, 1961 - June 1962 <sup>1/</sup>  
(In millions of pounds)

	1961		1962 - First Half		
	Jan. - June	July- Dec.	Jan. - June	Jan. - Mar.	Apr. - June
A. Goods, Services and Transfer Payments					
Exports, f.o.b.	1,965	1,898	2,011	979	1,032
Imports, f.o.b.	-2,080	-1,926	-2,027	-1,012	-1,015
Trade balance	- 115	- 28	- 16	- 33	17
Invisibles and transfer payments	55	11	112	53	59
Total	- 60	- 17	96	20	76
B. Long-Term Capital <sup>2/</sup>	- 72	8	- 41	19	- 60
C. Net Errors and Omissions	39	41	93	94	- 1
D. Private Short-Term Capital Sterling liabilities to foreign private:					
Sterling area	51	34	57	14	43
Other	<sup>3/</sup> - 427	<sup>3/</sup> --	- 33	- 35	2
Miscellaneous capital	<sup>3/</sup> - 59	<sup>3/</sup> - 16	87	111	- 24
Total	- 435	18	111	90	21
E. Total (A through D)	- 528	50	259	223	36
F. Extraordinary Aid Received					
Basle Agreement aid	323	- 323	--	--	--
Advance debt payments	45	27	--	--	--
Loan from Switzerland	--	18	--	--	--
Total	368	- 278	--	--	--
G. Sterling liabilities to Foreign Official Sterling area	68	--	1	- 72	73
Other	<sup>3/</sup> - 58	<sup>3/</sup> 34	- 39	- 14	- 25
Total	10	34	- 38	- 86	48
H. Reserve Movements					
Net IMF position	- 15	389	- 180	- 89	- 91
Gold and foreign exchange	165	- 195	- 41	- 48	7
Total	150	194	- 221	- 137	- 84

Source: "U. K. Balance of Payments, 1959 to 1962," October 1962 (Cmd. 1837). The figures have been rearranged to facilitate analysis.

<sup>1/</sup> No sign indicates credit; minus sign indicates debit.

<sup>2/</sup> Excluding advance debt payments, which are included in Group F.

<sup>3/</sup> Excluding Basle agreement aid, which is included in Group F.

contrasted with a deficit of £528 million in the first half of 1961. Since June, the balance of payments has been roughly in equilibrium, as far as can be determined by available data: a net decline in reserves in the third quarter of £32 million was offset by a gain of £11 million in October.\*/

Two factors account for Britain's payments surplus in the first half of 1962: a massive inflow of foreign capital and an improvement on current account. On capital account, purchases of British securities by foreigners, attracted by the high level of interest rates prevailing in London relative to other financial centers and the prospect that bond prices would rise rather than fall, helped to account for net foreign purchases of British securities of £222 million in the second half of 1961 and to £83 million in the first half of 1962. As a result, the long-term capital item became a net credit in the balance of payments instead of a net debit. In addition, the capital inflow took the form of a shift from Euro-dollar deposits into short-term loans to local authorities. This movement is thought to represent a substantial part of the credit of £111 million recorded for miscellaneous capital in the first quarter of 1962 when there was an interest differential (with forward exchange risk covered) in favor of the local authorities loans. The differential in favor of the three-month local authorities loans as against Euro-dollar deposits during this period was as follows (in per cent per annum):

January	5	+0.24	March	2	+0.31
February	2	+0.34	April	6	+0.02

Even though the inflow of capital was attracted to London by high interest rates, the danger that this flow might be reversed when the British

\*/ The balance of payments surplus or deficit is here measured as the change in U.K. gold and foreign exchange assets, changes in liabilities to foreign governments, central banks, and international institutions, and for 1961, extraordinary economic aid. Only reserve data is available for the third quarter of 1962.

interest rates declined does not appear to have materialized. There appears to have been no significant outflow of capital between April and October of this year when interest rates dropped continuously in all maturities. Long-term rates remain above 5-1/2 per cent as compared with 6-3/4 per cent a year ago and around 6-3/8 per cent in April.

On current account, the second source of the payments surplus, there was some improvement in invisibles. Net investment income showed an increase of £58 million in the first half of 1962 over the first half of 1961. But the bulk of the gain was in the balance of trade. Part of the gain was temporary: imports fell with the reduction in economic activity in the second half of 1961, chiefly because of reduced purchases of industrial raw materials. The level of imports remained unchanged at a low level from the last quarter of 1961 through the second quarter of 1962, and then began to rise during the third quarter.

But exports began to rise steadily in early 1962 before imports began to recover. However, they leveled off during the third quarter, probably because of the general decline in the expansion of world trade associated with the tapering-off of the industrial boom in Western Europe and North America. To be sure, the average monthly volume of British exports in the third quarter of 1962 was still 6.2 per cent greater than in the third quarter of 1961; but a quickening pace of industrial activity may stimulate additional imports, and further advances in exports would be required to offset heavier import payments. Monthly averages of foreign trade, seasonally adjusted have been as follows (in millions of pounds):

	<u>1960</u>	<u>1961</u>	<u>1 9 6 2</u>		
			<u>Jan. - Mar.</u>	<u>Apr. - June</u>	<u>July - Sept.</u>
Imports, c.i.f.	-380	-367	-367	-369	-385
Exports, f.o.b.	296	307	306	319	320
Re-exports, f.o.b.	<u>12</u>	<u>13</u>	<u>12</u>	<u>14</u>	<u>13</u>
Trade balance*	- 72	- 47	- 49	- 36	- 52

Sterling has remained above par throughout the past six months. The spot rate rose to just below \$2.81 per pound in June. In the following months sterling slowly fell, but this is a normal seasonal development. The spot rate for selected dates are as follows (in U.S. cents per pound):

May 4	280.28	Aug. 3	280.56	Nov. 7	280.17
June 1	280.97	Sept. 7	280.14		
July 6	280.66	Oct. 5	280.10		

Lagging trend in domestic business activity

The strengthened British balance of payments position in 1962 in part reflected the sluggish state of domestic demand. The decline in British industrial output, associated in part with the emergency stabilization measures of July 25, 1961, came to an end over the winter months, and by spring industrial production began to expand again. The index rose from 115 in early 1962 (1958=100) to 117 in June and has since leveled off. In August, the index was 117.

The principal factors accounting for the sluggish business recovery in 1962 have been the decline in private investment and a slower-than-expected advance in domestic consumption and in exports. Consumer demand has been relatively well maintained but has not been a major source of strength. The inventory cycle appears to have bottomed out in the first quarter and showed

\*/ These figures are not completely comparable with the trade figures shown in the balance of payments owing to adjustments in the balance of payments for valuation and coverage.

a minor recovery in the second. The revival of industrial primary product imports in the third quarter, which suggests a quickening in the tempo of inventory recovery, has had significant implications for the balance of payments. The major components in the business recovery in the second quarter of 1962 are estimated in Table 2.

Table 2. Allocation of Resources, Jan.-June 1962  
(In millions of pounds, in 1958 market prices, seasonally adjusted)

	<u>Jan.-Mar.</u>	<u>Apr.-June</u>	<u>Changes</u>	
			<u>Jan.-Mar.</u>	<u>Apr.-June</u>
<b>Sources:</b>				
Gross domestic product	6,180	6,339	-123	+159
Imports of goods and services	1,384	1,421	+ 20	+ 37
Inventory disinvestment	42	--	+ 42	- 42
Total	<u>7,606</u>	<u>7,760</u>	- 61	+154
<b>Uses:</b>				
Consumers expenditures	4,158	4,211	+ 3	+ 53
Government current expenditures	1,050	1,058	+ 19	+ 8
Fixed domestic investment	1,092	1,108	+ 4	+ 16
Inventory investment	--	25	- 82	+ 25
Exports of goods and services	<u>1,306</u>	<u>1,358</u>	- 5	+ 52
Total	<u>7,606</u>	<u>7,760</u>	- 61	+154

Source: U.K. Central Statistical Office, Economic Trends, October 1962.

Despite the modest business recovery during the second and third quarters, there is evidence of general underutilization of industrial resources in Britain. Two-thirds of the firms responding to a September survey of the Federation of British Industries reported that they were working below capacity. Equally if not more significant from a political point of view, the number of unemployed (seasonally adjusted) has risen steadily during 1962 from around 400,000 in the first three months to 512,000 in October. The October figure was the highest recorded since the recession in early 1959. (See Table 3.)

Investment in manufacturing declined by 3.4 per cent in the first half of 1962 and the outlook is for further reductions in this spending in 1963. Almost half the firms responding in the Federation of British Industries survey reported that they planned to authorize less capital expenditure in the next 12 months than they had in the preceding year. A reduction of 10 per cent below 1962 levels of investment spending for all types of industries is estimated for 1963 in a Board of Trade inquiry of capital spending plans.

Table 3. United Kingdom: Number of Unemployed and Reported Vacancies, Seasonally-adjusted  
(in thousands)

	<u>Unemployed</u>	<u>Vacancies</u>
1959:		
January	564	183
December	421	279
1960:		
December	366	324
1961:		
June	301	354
December	390	277
1962:		
March	401	222
June	432	223
July	454	209
August	496	194
September	497	195
October	512	185

Prices have risen slightly in the United Kingdom. Export prices have risen less than wholesale prices of goods produced for the home market. Wages, however, have continued to drift upwards. Recent wage and price figures are as follows (1958=100):

	1960	1961	1962			
			Jan. - Mar.	Apr. - June	July	Aug.
Wholesale prices	102	104	106	106	107	107
Cost of living	102	105	108	110	110	110
Export prices	101	102	103	103	103	103
Wages	105	110	112	113	114	115



Stimulating demand without affecting exports

The British authorities have been concerned about the sluggish business recovery; but they have relaxed the restrictive measures introduced in the July 1961 stabilization program only cautiously over the course of 1962, because they wanted selling energies to be directed to expanding exports.

Between March 6 and April 26, Bank rate was reduced from 6 to 4-1/2 per cent in three steps of one-half per cent each. These steps were designed primarily to reduce the inflow of temporary foreign capital into Britain. During this period, short-term rates fell rapidly: for example, the Treasury bill rate declined from 5.41 per cent on March 1 to 3.97 per cent on May 3. This fall in short-term rates had no noticeable effect on the domestic business situation.

The authorities took two further steps in early June to expand activity. On June 1, the Bank of England announced that the Special Deposit requirements would be reduced from 3 to 2 per cent for the London clearing banks (and from 1-1/2 to 1 per cent for the Scottish banks). On June 4, restrictions on installment credit were eased: the down-payment minimum was reduced from 20 to 10 per cent on all goods except motor vehicles. Despite this relaxation, installment credit outstanding rose only £5 million between May 31 and August 31. However, prices of government securities rose rapidly, reacting in part to purchases of the London clearing banks utilizing releases from Special Deposits.

On October 3, the authorities took further cautious steps in the direction of credit and fiscal relaxations. The Special Deposits of the London clearing banks were again reduced, from 2 to 1 per cent (and from 1 to 1/2 per cent for the Scottish banks) and the Bank of England informed all

financial institutions that existing qualitative controls on lending were withdrawn. In addition, the Chancellor made two changes in fiscal policy:

- a. Public investment in 1963 was to be raised by £175 million to offset any fall in private investment; and
- b. Some £42 million in post-World War II tax credits for the elderly were released.

Finally, on November 5, the Chancellor announced a series of further expansionary measures to bolster domestic activity:

- a. Purchase tax on automobiles was reduced from 45 to 25 per cent to stimulate home-market sales; and
- b. Tax benefits on increases in investment spending were advanced from 20 to 30 per cent on new equipment and from 10 to 15 per cent on new industrial building.

The number of small expansionary steps taken during the course of 1962 to bolster home demand reflect the desire of the British authorities to accelerate business recovery without jeopardizing the balance of payments. Developments during the third quarter made it more difficult to reconcile these two objectives. The leveling off in industrial output after June, the growth in unemployment in August (See Table 3) and the unfavorable outlook for private capital spending in 1963 pointed to the need for further steps to maintain the momentum of industrial recovery. However, the sizeable rise in imports with no further advances in exports in the third quarter underscored the need for caution on the part of the Government.

How to advance economic growth: planning for 1961-66

Britain's difficulties in reconciling domestic growth with balance of payments stability have been so persistent that the Government early in 1962 created a National Economic Development Council (NEDC) to study the problem of long-term growth in Britain. On October 17, the staff of this

Council released estimates of what would be required in major sectors of the British economy if Britain were to achieve a 4 per cent rise in GNP per annum from 1961 to 1966. These estimates are summarized in the third column of Table 4.\*/

Table 4. Economic Expansion in the U.K.,  
Selected Five-year Periods 1/  
(increases, per cent per annum)

	<u>Actual Growth</u>		<u>NEDC</u>
	<u>1952-57</u>	<u>1956-61</u>	<u>Projections</u> <u>1961-66</u>
<u>Resources Available</u>			
Gross domestic product at market prices	3.25	2.51	4.0
Imports of goods and services	<u>4.75</u>	<u>4.95</u>	<u>2/ 4.5</u>
Total	3.55	3.03	4.1
<u>Use of Resources</u>			
Consumers expenditure	3.21	2.86	3.2
Public consumption	- 0.41	0.99	3.6
Investment	9.16	6.53	6.2
Exports of goods and services	<u>5.08</u>	<u>2.57</u>	<u>2/ 5.7</u>
Total	3.55	3.03	4.1

Source: The NEDC projections--The Financial Times, October 18, 1962, p. 13; all other years--U.K. Central Statistical Office, National Income and Expenditure 1962 (London: HMSO, 1962).

1/ Growth rates are percentage changes per annum in output and expenditure is valued at 1958 market prices for the periods 1952-57 and 1956-61. The 1961-66 projections are valued at 1961 market prices.

2/ Imports for 1961-66 are net of exports of services; exports include commodities only.

\*/ These figures assume that Britain will join the Common Market. Negotiations are moving slowly, but steadily. In August, the British negotiators obtained important concessions from the EEC to protect the Commonwealth. In October, the U.K. agreed to accept the EEC price-support program for British agriculture, but the timetable for adopting these measures has not been settled. The Commonwealth Prime Ministers, at their meeting with Macmillan in September, voiced their concern over U.K. membership in the Common Market, but they did not place any obstacle in Britain's path.

The projections prepared by NEDC underscore the extent to which growth in the United Kingdom is being held back by the unsatisfactory export performance in recent years. The NEDC estimate of a 5.7 per cent annual increase in exports needed for 4 per cent over-all growth must be compared with the 2.57 per cent per annum expansion in the years 1956-61. (See Table 4.) This shortfall in export performance in 1956-61 compared with the 1961-66 projection is in marked contrast with the performance in other major sectors of the British economy, as the following shortfall of the annual average 1956-61 performance below the NEDC estimates indicates:

Consumer expenditures	- 0.34
Public consumption	- 2.61
Investment	+ 0.33
Exports of goods and services	<u>- 3.13</u>
	- 1.07

The NEDC estimates propose a high rate of export expansion because an export surplus is needed to finance the heavier imports, official aid to underdeveloped areas, and net private investment abroad. In addition, they recognize that Britain's external position must be strengthened to lessen the need in the future for the recurring cycles of "stop and go" policies which have been brought on by balance of payments difficulties from 1947 through 1961. With a satisfactory external position, the authorities could, if needed and desired, take steps to remedy any shortfalls in private and public consumption so as to realize the NEDC growth projections. The critical limiting factor, from the point of view of Britain's record in the 1956-61 period, is to be found in export performance. However, the fact that Britain's growth in exports in 1952-57 averaged 5.08 per cent per year would suggest that the NEDC projection of 5.7 per cent is not unrealistic, at least from a historical point of view. Yet the sluggish trend in exports in the third quarter of 1962 does not provide grounds for optimism that the

British economy is at present in a position to move from the 2.57 per cent annual growth trend in exports in 1956-61 to the 5.08 per cent trend realized in 1952-57. To take steps to achieve this shift in export trend and, at the same time, to act to bolster a higher rate of domestic resource utilization remains the major conflict in policy objectives confronting the United Kingdom authorities at this time.

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