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Recent Economic Developments in the United Kingdom
April - July 1963

15 pages

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Summary

The immediate outlook for the revival of business activity in Britain is uncertain. From March through May, industrial output recovered steadily from the low levels of last winter, but in May the industrial production index at 118 barely exceeded the preceding peak of 116 for July 1961. There is no clear indication that growth in industrial output is being sustained during the summer months. On the external side, during the second quarter sterling experienced none of the adverse speculative moves of the first quarter of the year.^{1/} In late July, the foreign exchange market and the securities markets were not affected by the increase in the Federal Reserve discount rates or by the proposed U. S. interest equalization tax.

The recovery of domestic production in the second quarter was stimulated by an expansion of exports and by a sharp rise in the domestic demand for automobiles. Automobile production in the first five months of 1963 was close to the record level reached in 1960. Exports, which had not increased since the second quarter of 1962, began to rise during the second quarter of 1963. In the year ended June 1963, the growth rate of exports was 4.7 per cent. This record is better than the 3.0 per cent increase experienced during 1962, but is still well below the 5-1/2 per cent target annual growth rate set by the National Economic Development Council. In a review of Britain's export problem, the N.E.D.C. said that the success of the incomes policy is vital for achieving the export target growth rate.

^{1/} See "Recent Economic Developments in the United Kingdom, January-March 1963," dated May 2, 1963.

The balance of payments improved during the second quarter of 1963. In addition to repaying £89 million (\$250 million) borrowed from various Continental central banks, the Exchange Equalisation Account added £36 million to its gold and foreign exchange holdings.

The United Kingdom renewed its \$1.0 billion standby with the International Monetary Fund for another year, effective August 8.

Industrial production revives

The British economy has recovered from the sharp drop in domestic output experienced in the first quarter of 1963. (See Table 1.) Between January and March, a £148 million fall in demand (seasonally adjusted) resulted mainly from a decline in personal consumption, associated with the widespread unemployment caused by the severe winter. Personal income, however, did not decline. Fixed capital formation, with the exception of construction activity, was up slightly, after it had contracted during the third and fourth quarters of 1962.

With an end to winter, industrial production recovered rapidly. The seasonally adjusted industrial production index rose by a point a month from March through May; unemployment dropped below the half-million mark in May, and unfilled vacancies expanded steadily. (See Table 2.) By May, steel production rose well above the first quarter low. Passenger car output and exports sparked the resurgent demand. The economy was buoyed further by a significant rise in new orders for engineering products from the home market as well as from abroad.

Table 1. United Kingdom: Final Expenditure, First Quarter 1962-First Quarter 1963
(millions of pounds; seasonally adjusted; 1958 prices)

	Actual	Changes:				Actual
	1962	1962				1963
	I	II	III	IV	I	I
SOURCES						
Gross domestic product	6,242	+159	-49	+ 4	-127	6,229
Imports	<u>1,377</u>	<u>+ 32</u>	<u>+44</u>	<u>-25</u>	<u>- 21</u>	<u>1,407</u>
Total	<u>7,619</u>	<u>+191</u>	<u>- 5</u>	<u>-21</u>	<u>-148</u>	<u>7,636</u>
FINAL EXPENDITURE						
Personal consumption	4,191	+ 69	+ 4	+64	- 60	4,268
Public consumption	1,036	+ 10	- 1	-10	+ 10	1,045
Fixed capital formation:						
Plant and Machinery	411	- 10	-14	+ 1	+ 1	389
Vehicles, ships & aircraft	135	+ 3	-10	- 4	+ 13	137
Construction	553	+ 19	+22	-25	-106	463
Inventory Investment	- 4	+ 52	+ 2	-48	- 21	- 19
Exports	<u>1,297</u>	<u>+ 48</u>	<u>- 8</u>	<u>+ 1</u>	<u>+ 15</u>	<u>1,353</u>
Total	<u>7,619</u>	<u>+191</u>	<u>- 5</u>	<u>-21</u>	<u>-148</u>	<u>7,636</u>

Table 2. United Kingdom: Recent Economic Indicators
(Monthly or Monthly Averages)

	1961	1962	1963				
	Apr. - June	Apr. - June	Jan. - Mar.	Apr.	May	June	July
<u>LABOR MARKET</u>							
Unemployment (ths.)	302	420	799	605	554	461	436
Unfilled vacancies (ths.)	358	245	148	190	195	215	233
<u>PRODUCTION AND DEMAND</u>							
Industrial production */ (1958=100)	114	115	113	117	118		
Steel production */ (th. tons, wkly av.)	461	402	398	409	414	415	
Passenger cars (ths., wkly. av.)	22	26	29	30	34	33	
Retail sales */ (1961=100)	100	102	105	105	107	105	
<u>NEW ORDERS</u>							
Engineering industries (1958=100)							
Export	114	124	121	168	137		
Domestic	125	121	134	119	147		
Industrial Building							
Authorizations (mn. sq. ft.)	14.3	9.5	9.2	9.9	9.9		
<u>FINANCE</u>							
London Clearing Banks:							
Net advances (mthly change; £.mn.)	+ 48	+ 18	+109	+ 28	+ 42	+ 17	+ 65
Liquidity ratio	31.9	32.9	32.2	30.5	30.7	31.6	31.4
New Installment credit (1957=100)							
Household goods shops	104	103	97	101	114	111	
Finance houses	207	160	132	177	201	169	

*/ Seasonally adjusted

A slight increase in industrial building authorizations for the second quarter suggests that the decline in commercial construction has at least been arrested if not reversed. Business sentiment became markedly more optimistic as early as February. The Federation of British Industries survey of industrial trends revealed that 56 per cent of the respondents to the February survey felt more optimistic about the general business situation than they did in October. Only 18 per cent felt so inclined in October. This was the largest shift in business sentiment observed since the surveys began five years ago.

However, it is not certain whether the revival of activity has been primarily a recovery from a bad winter or whether a sustained business expansion is underway. Much importance had been attached to the sharp rise in London clearing bank advances during the first quarter of the year. Now it is recognized that they, too, were a consequence in part of the severe winter. Retail sales, which had risen sharply in May, fell back in June to the level which had persisted since the third quarter of 1962. Likewise, the increase in installment credit in May was not sustained in June.

There is some feeling that the Government should have given a more immediate stimulus to the economy, as output is showing signs of a possible leveling off at a time when the industrial production index (118 in May 1963) is only two points above the 116 peak reached in July 1961. However, the official views continue to be hopeful about the immediate business outlook as the effects of earlier government expansionary measures are expected to become evident.

The recovery of sterling

Sterling has recovered from the waves of speculation which attacked the pound from January through March. To cover the reserve drain, the Bank of England was forced to borrow £89 million (\$250 million) from Continental central banks. The first quarter reserve losses were due to adverse capital movements, mainly short-term; the trade balance and the current account on the whole were in surplus. (See Table 3.) Sterling liabilities to foreigners, both private and official, declined sharply as sterling assets were liquidated. Leads and lags in commercial payments played an important role: There was only a small credit entry in errors and omissions for the first quarter of 1963 compared with a much larger figure for the comparable period a year earlier. On long-term capital account, the apparent increase in net capital outflow is mainly the consequence of a change in presentation. (See footnote b, Table 3.)

With the abatement of speculative pressures in April, the balance of payments recovered. During the second quarter Britain accumulated £36 million of gold and foreign exchange while repaying the entire sum borrowed from Continental central banks. In July, sterling continued strong and official reserves increased by an additional £7 million (\$20 million).

Between the end of March and early August, the spot rate for sterling was maintained close to par. The renewed confidence in the pound can be seen in the steady accumulation of reserves and in the improvement in forward sterling. (See Table 4.) The three-month forward discount narrowed from 1.31 per cent per annum on March 29 to 0.69 per cent on May 17

Table 3. United Kingdom: Balance of Payments, First Quarter 1962 through first quarter 1963 (in millions of pounds)

	1962				1963	
	I	II	III	IV	I	II
Balance of Payments						
A. Goods, Services, and Transfer Payments, Seasonally Adjusted						
Exports, f.o.b.	963	1,013	1,006	1,006	1,027	
Imports, f.o.b.	-982	-1,016	-1,047	-1,014	-1,013	
Trade balance	-19	3	41	8	14	
Services and transfer payments	38	34	22	44	45	
Total, seasonally adjusted	19	31	19	36	59	
Seasonal influences	--	50	19	31	3	
Total	19	81	38	5	56	
B. Long-Term Capital	28	- 43	- 23	a/- 46	b/- 73	
C. Private Short-term Capital						
Sterling liabilities to foreign private:						
Sterling area	9	42	6	28	4	
Other	- 36	--	23	35	89	
Miscellaneous	123	- 29	7	10	3	
Total	96	13	10	73	88	
D. Net Errors and Omissions	80	- 15	87	- 24	24	
Surplus or Deficit(-)	223	36	16	8	81	n.a.
Financed by:						
E. Extraordinary Aid c/	--	--	--	--	89	- 89
F. Sterling Liabilities to Foreign Official						
Sterling area	- 72	73	30	12	42	n.a.
Other	- 12	- 26	20	11	47	n.a.
G. Reserve Movements (increase-)						
Drawing rights at IMF	- 91	- 90	196	2	--	+ 2
Gold and foreign exchange	- 48	7	230	5	3	36
Total Financing	-223	- 36	16	8	81	n.a.

a/ Includes subscription to IDA (-9), largely offset as rearranged here, by increases in sterling liabilities to IDA (+8).

b/ 1963 figures are not entirely comparable with those for earlier periods mainly because certain long-term securities are now classified as "long-term capital" rather than "sterling liabilities." The first-quarter net outflow on "long-term capital" was larger than it would have been under the old classification.

c/ Receipt and repayment (-) of foreign exchange from some Continental central bank

Source: U.K. Central Statistical Office Economic Trends, June 1963. Data have been rearranged by Federal Reserve Board Staff.

Table 4. United Kingdom: Foreign Exchange Rates and Reserve Movements, 1963

	Spot Rate (U.S. Cents per pound)	3-mo. fwd. Discount (-) (Per cent per annum)	Covered U.K.-U.S. Treasury Bill Differential (Per cent per annum)	Reserve Movements (Mn. U.S. dollars)
Jan. 4	280.34	-0.44	+0.16	
Mar. 15	280.01	-1.08	-0.62	a/ -183
29	279.96	-1.31	-0.55	
Apr. 11	280.07	-1.19	-0.48	+ 34
26	280.06	-0.89	-0.10	
May 17	280.94	-0.89	--	+ 81
31	280.01	-0.64	--	
Jun. 14	280.00	-0.4	-0.05	a/ + 34
28	280.06	-0.53	+0.13	
July				
12	280.11	-0.43	+0.10	+ 20
26	280.04	-0.36	+0.15	
Aug. 2	280.04	-0.36	+0.12	

a/ Adjusted for the receipt (March) and repayment (June) of \$250 million from some Continental central banks.

Table 5. United Kingdom: Foreign Trade, 1962-1963
(In millions of pounds; monthly averages; seasonally adjusted)

	1962		1963			
	Year	Apr.- June	Jan.- Mar.	Apr.- June	May	June
Imports, c.i.f.	-374	-373	-375	-395	-395	-401
Exports, f.o.b.	316	320	326	335	341	345
Re-exports, f.o.b.	13	14	12	13	13	14
Trade gap (-)	- 45	- 39	- 37	- 47	- 41	- 42

and to 0.36 per cent on July 26. At the same time, the covered differential in favor of the U. K. Treasury bill shifted from 0.55 per cent per annum on March 29 to 0.12 per cent on August 2.

As a precautionary measure, the United Kingdom secured a renewal of its \$1.0 billion stand-by with the International Monetary Fund on August 8. The Government thus has reaffirmed its policy not to let temporary balance of payments difficulties interfere with its program of domestic expansion.

Trade returns show that exports have expanded, but that imports have risen as well--partly because of the increased cost of sugar. The trade gap in the second quarter of 1963 is somewhat higher than for the year 1962. (See Table 5.) Exports rose by 4.7 per cent in the year ending June 1963 compared with 3.0 per cent achieved during 1962 and the National Economic Development Council's target growth rate of 5-1/2 per cent per annum.

On a commodity basis, exports of machinery and transport equipment expanded in the first quarter of 1963, but the "other manufactures" category accounted for most of the growth during the second quarter. Exports to the sterling area (Australia in particular) have increased in 1963 but the bulk of the export expansion has been to the EEC countries. (See Table 6.)

Exports, prices, and incomes

While exports have increased at a more satisfactory rate this year than in 1962, the Government still has an export growth target of 5-1/2 per cent per annum. Three factors limiting export expansion are highlighted in a study by the N.E.D.C., Export Trends, which seeks to explain why Britain's

Table 6. United Kingdom: Exports, 1958, 1961-63
(In millions of pounds; monthly averages; (seasonally adjusted)

	1958	1961	1962		1963	
			Jan. - June	Jul. - Dec.	Jan. - Mar.	Apr. - June
By Commodity Classes:						
Machinery and transport equipment	113	136	138	139	150	146
Other manufactures	107	122	124	125	122	130
Basic materials	9	11	12	12	13	14
Fuels	11	10	11	13	13	15
Other	<u>25</u>	<u>28</u>	<u>28</u>	<u>29</u>	<u>29</u>	<u>31</u>
Total exports	<u>265</u>	<u>307</u>	<u>314</u>	<u>318</u>	<u>327</u>	<u>335</u>
By Area:						
Sterling area	116	117	110	113	119	119
EEC	35	51	58	62	65	69
EFTA	29	40	42	43	44	45
U.S.A.	23	24	27	28	25	28
Canada	16	18	17	15	14	14
Other	46	57	60	57	60	60

Source: U.K., Board of Trade.

**Table 7. Indices of Wage Costs, Earnings and Productivity
in Manufacturing Industry**
(1958=100)

	1958	1960	1962
Earnings per hour			
U.K.	100	113	124
Other main exporters ^{1/}	100	109	124
Output per hour			
U.K.	100	111	113
Other main exporters ^{1/}	100	114	122
Wage costs per Unit of output			
U.K.	100	102	111
Other main exporters ^{1/}	100	96	102

^{1/} Belgium-Luxembourg, Canada, France, Germany, Italy, Japan, Netherlands, Sweden, and the United States.

Source: N.E.D.C., Export Trends (London: HMSO, 1963) p.21.

share in world trade in manufactures fell from 20 per cent in 1954 to 16 per cent in 1961. The reduction of discrimination in Britain's favor by sterling area countries is considered to be the main factor. In most instances this took the form of reduced import quotas, but awareness of other sources of supply (especially by the newly-independent countries) also played a role.

Secondly, the N.E.D.C. placed some blame on the relatively limited expansion in industrial capacity. The slow growth in domestic output may be attributed in part to the sluggish rate of growth of export orders but, at the same time, factory capacity was not adequate to service occasional spurts in export orders.

Finally, and more important for the future, there is the matter of a low rate of growth of productivity relative to wage increase. The problem of price-competitiveness of British exports is not that wages in Britain have risen faster than in other countries. The problem has been the failure of productivity to rise as rapidly. From 1958 to 1962, earnings per hour rose by 24 per cent in other countries exporting manufactured goods^{1/} as well as in the United Kingdom. However, output per hour rose only by 13 per cent in Britain in contrast to 22 per cent in the other countries. Accordingly, wage costs went up by 11 per cent in Britain and only 2 per cent elsewhere.

As for the future, the N.E.D.C. concludes that Britain faces two problems. First, it is necessary to achieve a more rapid rate of growth of

^{1/} Belgium-Luxembourg, Canada, France, Germany, Italy, Japan, Netherlands, Sweden, and the United States.

output and productivity so that the necessary supply of exports will be available. Secondly, since exports are to expand more rapidly than output (5-1/2 per cent vs. 4 per cent) exports obviously must expand at a faster rate than home-market sales. If this is to happen, exports must be relatively more profitable. Therefore, the past tendency of home market prices to rise faster than export prices must be reversed. Home market prices have risen by 8 per cent since 1958 as compared with only 5 per cent for export prices. (See Table 8.) It is this consideration which from time to time has prompted discussion in the British press about the desirability of a new sterling devaluation.

The Government continues its attempt to restrain price increases by its incomes policy. In the April 3 budget message, the Chancellor of the Exchequer asked for a voluntary restraint of incomes of 3 to 3-1/2 per cent per annum. Until July, the discussion of incomes policy has been entirely in terms of wage agreements. On July 23, however, the National Incomes Commission focused on profits in its second report on income stabilization. The Commission said that, even in industries experiencing productivity increases greater than the national average, wage increases must be restrained to the national average figure; the difference should be reflected in price cuts. In other words, if labor shows some self-restraint, then the additional productivity should not be reflected in higher dividends but be passed to the public in the form of reduced prices.

This report has had only a lukewarm reception. The financial press, while agreeing with the Commission that an incomes policy must be

Table 8. United Kingdom: Prices and Wages
(1958=100)

	<u>Weekly Wage Rates</u>	<u>Retail Prices</u>	<u>Wholesale Prices: Home Mkt. Sales</u>	<u>Export Prices</u>	<u>Import Prices</u>	<u>Terms of Trade</u>
1960-Dec.	107	103	103	101	99	102
1961-Dec.	111	<u>107</u>	106	103	97	106
1962-Mar.	112	108	107	103	97	106
June	113	111	107	103	97	106
Sep.	115	109	107	103	96	107
Dec.	116	110	108	104	97	107
1963-Jan.	116	111	108	105	97	107
Feb.	116	112	108	105	98	107
Mar.	116	112	108	105	99	106
Apr.	117	112	108	105	99	106
May	117	112	108	105	100	105
June	118	112	108	105	101	104

concerned with profits as well as wages, expressed fears that profits under the Commission's scheme will lose their effectiveness as tools for allocating resources. The industries affected by the inquiry refused to supply information to the Commission on pricing, profits, margins and dividend policy. However, the Federation of British Industry approved the report in principle and announced its intention of developing statistics on profits from its members for the N.I.C.

In spite of the broader view of incomes policy in the N.I.C.'s report, labor unions have not diminished their hostility. The general secretary of the T.U.C. told The Financial Times that "The T.U.C.'s objection to N.I.C. is that it is not competent to deal with either wages or profits or prices. . . .It is not a subject for irresponsible amateurs."

In recent months, prices have been stable. Home market goods have been unchanged in price since the end of 1962. Retail prices have not risen since February. Import prices have risen in May and June, mainly because of the rise in sugar prices. With export prices remaining unchanged, the terms of trade moved very slightly against Britain. Weekly wage rates did not increase in the winter months, but raises were experienced in April and June. June wage rates were 4.4 per cent above the June 1962 level, but the wage increases during the first half of 1963 were only at the rate of 3.45 per cent per annum.