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April 27, 1964

Recent Economic Developments in the United Kingdom:
January-March 1964

22 pages

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Summary

In late February, the British authorities shifted the emphasis of financial policy towards some restraint in an attempt to:

> "achieve a smooth transition from the recent exceptionally rapid rate of growth /estimated at 6 per cent per annum/ to the long-term growth rate of 4 per cent." 1/

To this end, the Bank of England raised discount rate from 4 to 5 per cent on February 27 and the budget for fiscal 1964-65 (introduced on April 15) provided for an additional £103 million in revenue from higher indirect taxes on tobacco and alcoholic beverages.

Even with the increase in taxes, the over-all budget deficit in this so-called restrictive budget is almost as large as the deficit in last year's so-called expansionary budget as proposed in April 1963 and some 30 per cent larger than the deficit which actually materialized in 1963-64. 2/ (See Table 1.)

Table 1. United Kingdom: Budget Estimates, April 1 to March 31, 1963-64 and 1964-65
(in millions of pounds)

	1963-64		1964-65
	Estimate	Outturn	Estimate
Revenue	6,839	6,890	7,455
Expenditure	6,929	6,817	7,388
Balance	- 90	+ 73	+ 67
Below-the-line net payments	597	551	858
Borrowing requirement	687	478	791

Source: Financial Statement (1964-65), April 14, 1964.

1/ Chancellor's budget statement, House of Commons Debates, April 14, 1964, c. 239.
2/ This calculation excludes the £165 million which the Treasury expects to raise on the market for subsequent lending to local governments.

With total borrowing requirements of £791 million, the Government recognizes that an added burden may be placed upon the gilt-edged market during the coming year. To ease this load, the Chancellor made certain forms of non-marketable debt more attractive to the public.

On the international side, the Chancellor declared that:

> "The combination of an increased capital outflow with a deterioration in the current account will mean a worsening of the over-all balance of payments this year."

He then went on to justify use of international credits for temporary finance of such needs and reviewed in detail the "very large first and second line reserves and other borrowing facilities which can be mobilized."

The Treasury's heavier cash requirements, uncertainties about the effectiveness of the budget in dampening the rate of business expansion and of inflation, and the expectation that Britain's external payments position will worsen over the coming months have contributed to a firming of the level of interest rates in British financial markets. The immediate impact of the budget on financial markets was to push up stock prices to a recent high (less than 4 per cent below the all-time peak in 1961) and to cause gilt-edged yields to climb sharply. Furthermore, The Economist has already advocated "a second rise in Bank rate" in order to safeguard confidence in sterling over the coming summer months which is seen as a period of external weakness for sterling and one in which exchange disturbance might occur in other European currencies which could affect the pound. (April 18, 1964, pp. 285-86.)

The shift in official policy in the direction of modest restraint underscores the rapidity of the business recovery in Britain since the previous cyclical trough in the first quarter of 1963. Since then, the expansion in business activity has been fully as rapid as it was in a comparable period in the 1959 recovery. But the current recovery is more heavily oriented than the 1959 expansion toward utilization of resources for home consumption and less directed toward improving Britain's external payments position or its competitive position in world markets. In 1963, for example, the growth in housing spending has exceeded investment expenditures by manufacturing and commercial enterprises.

There are two other adverse developments apparent from the statistics available at this time. In the first place, the labor market has tightened quite sharply and the increases in wages and prices since early 1963 have been more substantial than were the rises in the same cyclical stage in 1959-1960.

Secondly, the United Kingdom's over-all payments position has already deteriorated to a substantial extent. The deficit in the fourth-quarter of 1963, for example, was larger than the combined deficits for the three preceding quarters. Also in the fourth quarter of 1963, the outer sterling area countries ran down their sterling balances; earlier in 1963, reserve accruals by these countries helped ease exchange market pressures on the pound from Britain's own payments deficit. However, U.K. reserves were little changed in the first quarter of 1964, despite the continued adverse trade balance.

The deterioration in the payments position focuses attention once again on Britain's export outlook. The Chancellor was himself hopeful on this score. The export figures themselves show a rapid increase during the earlier part of 1963, a tendency to level off towards the end of 1963 and, finally, a shift to a higher level beginning in December and maintained through the month of March. Looking ahead, the National Economic Development Council has recently pointed out that exports may not be able to expand at the rate required by the over-all growth-rate target of 4 per cent per year unless British prices remain stable. Export developments remain a critical uncertainty in the U.K. economic outlook.

Rapid expansion of domestic output

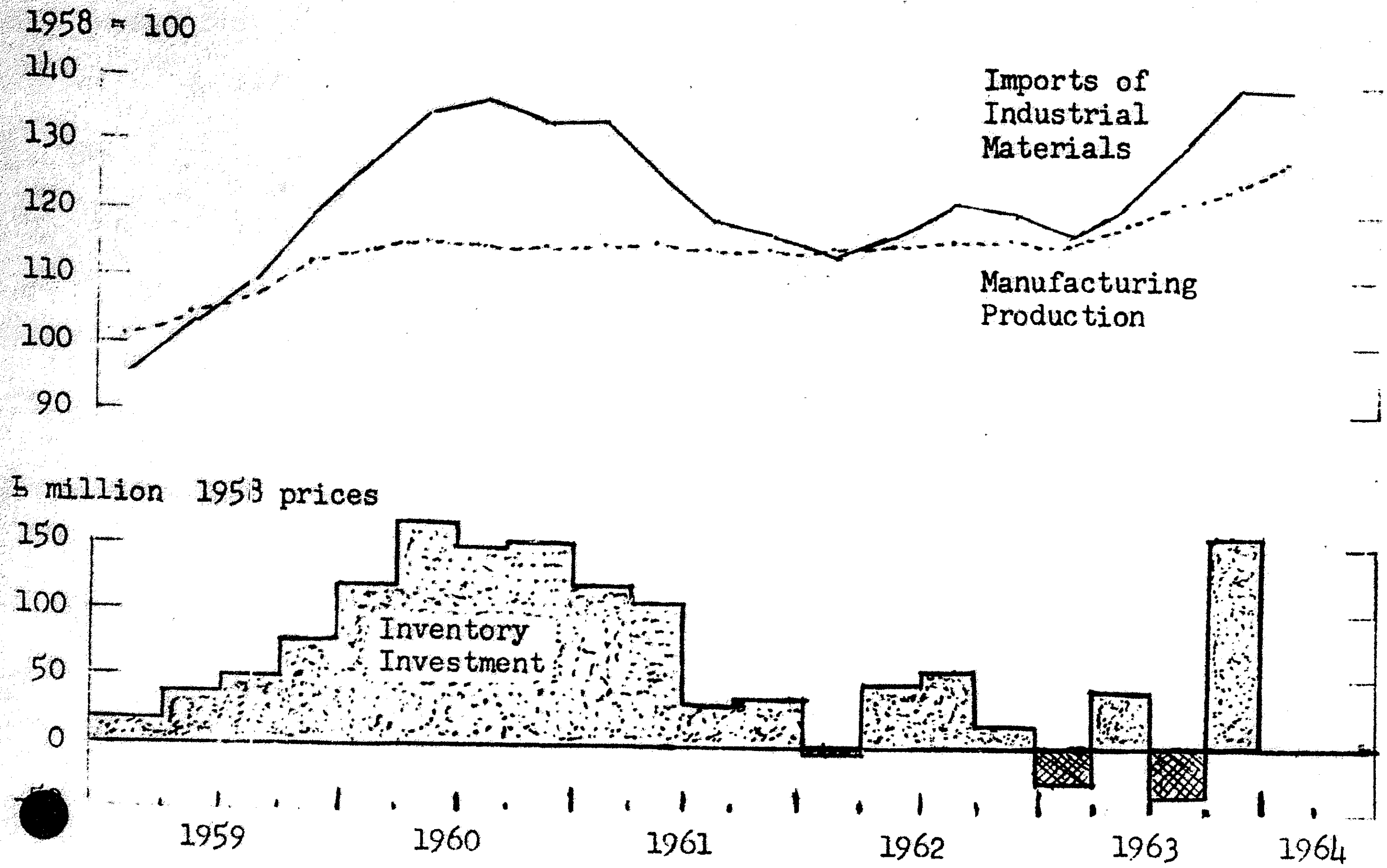
From the cyclical trough of the first quarter of 1963, the British gross domestic product had expanded in the current recovery by 9 per cent in the nine months to the end of the year. This rate of growth is approximately the same as that experienced in the nine-month period, April to December 1959 which was the first nine months of the preceding cyclical expansion 3/ between 1959 and 1961.

Since the autumn of 1963, the major turn-around in inventory investment reported in the fourth quarter has been the major significant development in the advance in business activity. In sharp contrast with the gradual quarter-to-quarter build-up in inventories during the 1959 upswing, inventories have fluctuated erratically during 1963: after increasing slightly in the second quarter they actually fell during the third quarter and then unexpectedly jumped in the fourth quarter to a level comparable with the quarterly peak accrual in the previous inventory cycle. (See Chart 1.) This sharp rise in inventories coincided with, and was partly responsible for, a sustained expansion in imports of industrial materials. (See Chart 1.)

Two main factors have contributed to the pattern of the 1963 recovery. First, the Government depended largely on tax cuts to stimulate personal consumption expenditure and additional government capital spending to get the recovery underway. This emphasis upon consumption and government projects was in part based upon the recognition of the sluggish outlook for private investment in Britain.

3/ The actual percentage of growth between April and December was 8 per cent in 1959 compared with 9 per cent for 1963 but adjustment must be made for the fact that output in the first quarter of 1963 was undoubtedly reduced by the abnormally severe winter weather.

Chart 1. U.K.: Inventory Investment, Manufacturing Production, and Industrial Material Imports, 1959-1964



Source: U.K. Treasury, Economic Report 1963

The speed with which the recovery materialized over the second and third quarters undoubtedly reflected the magnitude of the governmental efforts to inject new spending into the economy. Secondly, as the rate of increase in consumer and governmental expenditure flagged in the final quarter of 1963, the recovery was reinforced by an unexpectedly sharp rise in inventory investment. (See Chart 1.)

A comparison of the pattern of the business advance during 1959 and 1963 (as measured by changes in the major components of gross domestic product during the nine-month period, April through December) reveals that the expansionary factors during the 1963 recovery have been focused to a greater extent than in 1959 in providing goods for home consumption and fewer resources have moved into the sectors which add to Britain's export earnings or help to improve Britain's competitive position in world markets. For example, exports accounted for 21 per cent of the larger gross domestic product in 1959 and only 7 per cent in 1963; exports rose as much as imports in value during 1959 but were not sufficient to cover half the increase in imports during 1963. (See Table 2.)

Furthermore, the factors responsible for the protracted decline in private investment expenditures in plant and equipment of manufacturing and commercial concerns (which was perhaps the main feature of the recession from 1961 and 1963) continued to hold back private investment spending in the 1963 recovery. The unused plant capacity and uncertainties about the coming election undoubtedly helped to curtail corporate expansion planning. As a result, private investment expenditures in industry and commerce contributed only 5 per cent to the business expansion in 1963 compared with 11 per cent in 1959. In fact, spending on those types of investment most closely related to technological progress in British industry actually increased less during the 1963 recovery than did demand for private dwellings. (See Table 2.)

Table 2. United Kingdom: Comparison of Changes in Gross Domestic Product, April to December, 1959 and 1963 and actual fourth quarter 1963

	In millions of pounds 1/		In percent of total		Actual Values
	1959	1963	1959	1963	IV Qtr. 1963
Personal consumption	+216	+229	40	33	18,116
Government current spending	+ 26	+ 34	4	5	4,336
Gross domestic fixed investment:					
Government	+ 58	+119	11	17	2,128
Private:					
Dwellings	+ 18	+ 50	3	7	564
Other	+ 58	+ 35	11	5	2,128
Total private	+ 76	+ 85	14	12	2,692
Total fixed investment	+134	+204	25	29	4,820
Inventories	+ 57	+182	10	26	648
Exports of goods and services	+113	+ 49	21	7	5,636
Total expenditure (at market prices)	+546	+698	100	100	33,556
Less:					
Imports of goods and services	+ 99	+119			5,952
Adjustment to factor cost	+ 58	+ 78			3,300
Gross domestic product (at factor cost)	+389	+501			24,304

1/ Seasonally adjusted and revalued in 1958 prices.
2/ Actual fourth-quarter estimates at annual rate.
Source: United Kingdom, Central Statistical Office, *Economic Trends*.

From the point of view of the sustainability of the British recovery in 1963, the main queries are to be found in the performance of exports and in the outlook for private investment in plant and equipment and in inventories. During the first quarter of 1964, seasonally-adjusted exports advanced 2 per cent and imports about 7 per cent above fourth-quarter levels. New export orders for engineering and electrical goods have exceeded deliveries from April 1963 to January 1964, and the Chancellor, in his budget message, was hopeful for "another substantial increase /in exports/ this year." If the 1963 recovery follows the same inventory pattern which materialized during the 1959 expansion, then further substantial inventory accruals can be expected to add to demands in the British economy during 1964. (See Chart 1.)

At the same time, heavier spending on capital equipment in both private industry and in the government sector is to be expected over the coming year. A Board of Trade survey indicated that private capital spending in manufacturing during 1964 is expected to rise by 10 per cent above the 1963 level. Furthermore, the 1964-65 budget provides for heavier capital spending for most nationalized industries. The Electricity Council, in particular, is scheduled to receive an additional £114 million to expand the nation's electrical power generating capacity.

Tight labor market conditions are leading to rising wages and prices

The sharp rise in output has led to a rapid tightening in the labor market in a manner quite similar to that experienced in the 1959 expansion. In the fifteen months from the cyclical trough, the national average had declined from 2.4 per cent to 1.9 per cent in 1959 and from 2.5 per cent to 1.9 per cent in 1963. (See Table 3.) Labor shortages have been especially acute in the relatively prosperous Midlands and London and South-Eastern regions, where the unemployment rate is just over 1 per cent. At the same time, there is considerable unemployment in Scotland, Northern England and Wales.

Table 3. United Kingdom: Labor Market Indicators, 1958-1964

	1959-61 Expansion				1963-64 Expansion		
	Cyclical Trough: 1958 Dec.	1959 Dec.	1960 March	Cyclical Peak: 1961 July	1962 Dec.	1963 Dec.	1964 March
UNEMPLOYMENT							
National Average	2.4	1.9	1.9	1.2	2.5	2.0	1.9
London and South Eastern	1.4	1.1	1.1	0.7	1.5	1.2	1.1
Midlands	1.8	1.2	1.1	0.8	2.0	1.3	1.0
Northern	3.2	3.3	3.3	1.9	5.0	4.4	3.7
Scotland	4.4	4.3	4.3	2.7	4.7	4.2	4.2
RATIO OF UNEMPLOYED WORKERS TO UNFILLED VACANCIES (Seasonally adjusted)	3.3	1.7	1.5	1.0	3.4	2.1	1.2

Table 4. United Kingdom: Indexes of Wages and Prices
1959-60 vs. 1963-64
(Cyclical Trough=100)

	1959-60 Recovery				1963-64 Recovery			
	Cyclical Trough: Dec. 1958	1959 June	1959 Dec.	1960 Feb.	Cyclical Trough: Dec. 1962	1963 June	1963 Dec.	1964 Feb.
Weekly wage rates	100.0	100.5	101.1	101.6	100.0	101.6	104.2	104.7
Wholesale prices	100.0	99.6	100.8	100.8	100.0	100.2	101.4	101.8
Retail prices	100.0	99.2	100.0	99.7	100.0	101.6	101.9	102.4

Probably because of the tightening of labor markets in the South, the index of weekly wage rates has risen more rapidly during the 1963 recovery than in the 1959 expansion. In the fourteen months from the cyclical trough, weekly wage rates rose 4.7 per cent in 1963 compared with only 1.6 per cent in 1959. (See Table 4.)

Outside the wages field, both wholesale and retail prices have also advanced at a more rapid rate in the current recovery than in the earlier period. In the first fourteen months from the cyclical low point, for example, wholesale prices rose 1.8 per cent in 1963 and only 0.8 per cent in 1959; retail prices rose 2.4 per cent in 1963 and actually declined fractionally in the earlier period. (See Table 4.)

Wage and price advances have accelerated since the wage agreement in the engineering industry (which came into effect in December) added approximately 5 per cent to labor costs in that industry. A Financial Times survey (January 22, 1964, p. 1) reported that, after this agreement, producers in the engineering industry raised prices from 4-1/2 to 5 per cent, even though labor costs are thought to comprise something less than half total costs in that industry. Price adjustments began in many instances on the same day the labor contract was signed, and, reportedly, there has been less "give" in bargaining with customers over prices than had been true earlier.

Banks play smaller role in financing recovery

There are three major contrasts between the way the 1963 recovery and the 1959 expansion were financed. In the first place, the clearing banks have played a smaller role in financing the current upswing. Bank loans to the private sector increased only by £515 million in the year ending February 1964 compared with £777 million in the year ending February 1960. (See Table 5.) Business firms have been able to obtain their financing needs from new issues of market securities and from retained earnings than in the earlier period. Thus, the level of corporate new issues was substantially higher during 1962 and 1963 than it was in 1958 and 1959. (See Table 5.) New issue activity has continued to expand: in the first quarter of 1964, the volume reached £177 million or nearly half total flotations in the entire year of 1963.

In the second place, the bank credit expansion which has occurred in recent months has been heavily oriented toward consumer credit and personal loans. Thus, loans to hire-purchase firms and to individual borrowers comprised 46 per cent of the increase in credit in 1963-64 compared with 44 per cent in 1959-60. (See Table 6.) By contrast, only 10 per cent of the increase in credit was made up of loans to manufacturing industry in the most recent period compared with 15 per cent in 1959-60. Part of the explanation is due to the fact that banks have played a relatively more significant role in financing consumer expenditures in 1963 than in 1959. Installment credit grew by only £67 million in 1963 as compared with £293 million in 1959.

Finally, the entire expansion in bank loans and bank deposits created during the current expansion has been in transactions with the private economy. In the past two fiscal year, bank deposits have expanded by £724 million. At the same time, the London clearing banks expanded their advances to the private sector by a total of over £900 million. (See Table 6.) Loans to private firms and personal loans have comprised the bulk of these credit extensions.

The recent growth in the net deposits of the clearing banks have been encouraged by the monetary authorities. In fact, the authorities took steps in late 1963 to forestall the gradual pressure on bank liquidity growing out of the gradual reduction in the clearing banks holdings of Treasury bills: the

Table 5. United Kingdom: Financing the Recovery, 1959 vs. 1963
(In millions of pounds)

	February 1958-February 1959		February 1959-February 1960		February 1962-February 1963		February 1963-February 1964	
BANK LENDING								
Manufacturing industry	+ 89	(17%)	+119	(15%)	+ 92	(19%)	+ 51	(10%)
Hire purchase finance companies and other financial institutions	+ 67	(13%)	+174	(22%)	+ 73	(16%)	+ 91	(17%)
Retail Trade	+ 68	(13%)	+103	(13%)	+ 65	(14%)	+ 58	(11%)
Personal and professional	+117	(22%)	+171	(22%)	+124	(27%)	+151	(29%)
Other	+185	(35%)	+210	(27%)	+108	(23%)	+164	(31%)
Total	+526	(100%)	+777	(100%)	+462	(100%)	+515	(100%)
	Calendar Years:							
	1958		1959		1962		1963	
SELECTED OTHER FINANCING								
Corporate security issues (net)	+227		+386		+432		+429	
Installment credit	+ 75		+293		- 40		+ 67	

Table 6. London Clearing Banks: Deposit Liabilities and Selected Assets, 1959-60 through 1963-64 1/
(in millions of pounds)

	1959-1960	1960-1961	1961-1962	1962-1963	1963-1964
Deposit Liabilities (net)	+324	+ 71	+106	+276	+448
Claims on Public Sector					
Bonds	-448	-294	- 90	+137	- 42
Treasury bills and loans to the discount market	+124	-140	+ 44	-131	+ 12
Exchequer finance	-324	-434	- 46	+ 6	- 30
Loans to nationalized industries	- 1	- 11	+ 3	+ 11	- 8
Total claims	-325	-445	- 43	+ 17	- 38
Claims on Private Sector					
Advances (net)	+643	+359	+ 58	+453	+385
Other	+ 44	+ 40	+ 59	+ 38	+ 52
Total claims	+687	+399	+117	+491	+437
Special Deposits with Bank of England	--	+143	+ 77	-220	--
Liquidity Ratio (end of period)	31.0	30.4	32.6	30.5	29.7

1/ Fiscal year ending in March.

liquid asset ratios of the banks declined from 32.6 per cent of total deposits in 1961-62 to 30.5 per cent in 1962-63 and to 29.7 per cent in 1963-64. In October 1963 the Bank of England announced that the clearing banks would be permitted to reduce their liquid asset ratios to 28 per cent in place of the traditional level of 30 per cent.

The liquidity pressures on the banks reflected the fact that in recent years the Treasury's net borrowing needs have been quite small. In fact, in the two years 1961-62 and 1962-63, there was a negligible net surplus on the Treasury's budgetary and non-budgetary accounts, compared with deficits of £348 million in 1959-60 and £577 million in 1960-61. (See Table 7.) Since 1961-62, in fact, the banks have neither been large buyers or sellers of Treasury securities. By contrast, in the two earlier years, the banks made substantial sales of their government securities to finance the growth in their loans to the private sector; however, the Exchequer was able to cover the large borrowing requirements in both these years by sales of non-marketable and of marketable debt to non-bank (including foreign official) investors. Such sales amounted to £543 million in 1959-60 and to £886 million in 1960-61. (See Table 7.)

Unfortunately, it is impossible to make estimates of how the large budget deficit in 1963-64 was financed. The only figures available for the fiscal year indicate that no appreciable part of the funds was obtained from the London clearing banks. (See Table 7.) For the current year, the question arises as to how the Treasury will be able to obtain funds in the volume indicated without resort to borrowing from the banking system. To the extent that the clearing banks are short of Treasury bills, some easing of this position would ease their liquidity positions. However, it is expected that the Exchequer's borrowing needs will be larger in 1964-65 than it was in 1960-61, the second

Table 7. Exchequer Financing, 1959-60 through 1964-65 1/
(In millions of pounds)

	1959-1960	1960-1961	1961-1962	1962-1963	1963-1964	1964-1965
NET BORROWING REQUIREMENTS						
Budget deficit (-)	-333	-380	-236	- 56	-478	-791
Extra-budgetary funds	+ 99	+100	+193	+ 75		
Exchange Equalization Account	+175	- 67	-182	+359		
Other External	-289	-230	+255	-336		
Cash deficit (-)	-348	-577	+ 30	+ 42	n.a.	n.a.
FINANCING						
Notes and Bank of England 2/	+112	+266	+143	-236		
Sales of non-marketable debt	+297	+309	+ 84	+145		
Marketable debt held by:						
Non-bank public	+246	+577	-199	+ 66		
Banking sector 3/						
Bonds	-467	-306	- 63	+110	4/ - 42	
Treasury bills	+160	-269	+ 5	-127	4/ + 12	
Total banking sector	-307	-575	- 58	- 17	- 30	
Total financing	+348	+577	- 30	- 42	n.a.	n.a.

1/ The years are those between the London clearing banks' make-up dates (the third Wednesday of March).
2/ Notes in circulation and net indebtedness to the Banking Department.
3/ London clearing banks, Scottish banks, and the discount market.
4/ London clearing banks only.

Source: Bank of England, Quarterly Bulletin.

year of the earlier business expansion. During the earlier period, the Exchequer was able to obtain some £888 million of cash from non-bank investors, an amount sufficient to enable the banks to unload a very substantial volume of Treasury securities on the gilt-edged and Treasury bill markets without excessive effects on these two markets. It is in hopes of being able to expand sales of bonds to non-bank investors that prompted the Chancellor to make the non-marketable securities offered by the Treasury more attractive.

Balance of payments deteriorating

The export problem. The growth of wages and prices in recent months poses a threat to the competitive position of British exports. The National Economic Development Council (NEDC) has recently pointed out that if exports are to increase in volume by 5.1 per cent per annum (the growth rate required to keep the balance of payments in equilibrium while domestic output increases at 4.0 per cent per annum), Britain's share in world exports must not decline any further. 4/

If the competitive position of British exports is to improve, according to the NEDC, there must be ". . . a broad stability of prices in the United Kingdom." 5/ The NEDC believes that, abstracting from such imponderables as quality and marketing techniques, there actually was some gain in Britain's competitive position between 1961 and 1963--judging from the fact that British wage costs per unit of output in manufacturing have remained constant while costs on the Continent and Japan have risen by about 7 per cent. However, the NEDC notes that since France, Italy, Japan, and Germany have become much more "cost conscious" in recent months, Britain cannot assume that costs abroad will continue to rise faster than at home.

4/ NEDC, The Growth of the Economy, London: HMSO, March 1964.
5/ Ibid., par. 157.

<u>Trade balance: 1963 and the first quarter 1964</u>. The rise in exports during 1963 was above the NEDC target growth rate of 5.1 per cent per annum: it was 7.6 per cent in value and 5.6 per cent in volume. However, exports levelled off in the second half of 1963 although they rose by 1.7 per cent from December through March compared with the fourth-quarter average. 6/ (See Table 5.) Exports of manufactures, especially machinery and transportation equipment, have expanded steadily.

But the balance of trade has deteriorated during this period because imports have been rising faster than exports. In part, the steady rise in imports of fuel and industrial materials has been in response to the growth in manufacturing output. (See Chart 1, p. 5.) For the months of January and February, industrial materials and fuel imports appear to have leveled off (see Table 8), but at a level 20 per cent above that prevailing during the first quarter of 1963.

<u>Balance of payments in 1963</u>. The balance of payments deteriorated sharply during the fourth quarter. (See Table 9.) The deficit for that quarter (£108 million) was larger than the combined deficit for the preceding three quarters (£105 million). For the first three quarters, the surpluses of the outer sterling area was enough to offset Britain's own deficit; but in the fourth quarter, the outer sterling countries also moved into deficit as they began spending reserves accrued during the preceding period. In this quarter, however, a rise in sterling holdings of the central banks in non-sterling countries (£75 million) helped to reduce strains on the pound in the foreign exchange market. As a result of these developments, Britain's gold and foreign exchange reserves declined by only £53 million during 1963 despite an over-all payments deficit of £213 million.

6/ The export figures for January are not comparable with those for other months, owing to a change in statistical reporting procedures. Exporters were given more time to file reports on exports to non-sterling countries, and so the custom returns for January understate actual shipments.

Table 8. United Kingdom Trade by Commodity Class, 1962-64 1/
(In millions of pounds; seasonally adjusted monthly averages)

	1962	1963 Year	1963 1st Qtr.	1963 2nd Qtr.	1963 3rd Qtr.	1963 4th Qtr.	1963 Dec.	1964 Jan.	1964 Feb.	1964 March
EXPORTS, f.o.b.										
Manufactures										
Machinery and transport equipment	138	151	150	146	151	156	163	141	163	
Other	125	130	122	130	134	134	136	126	139	
Total	263	281	272	276	285	290	299	267	302	
Fuels and Industrial materials	24	27	26	29	28	27	29	25	27	
Other	29	32	29	30	33	31	34	34	40	
Total exports	316	340	327	335	346	348	362	2/326	369	373
Re-Exports, f.o.b.	13	13	12	13	13	13	12	11	11	13
IMPORTS, c.i.f.										
Food, beverages and tobacco	131	140	126	141	148	143	145	157	151	
Fuels and industrial materials	191	206	195	200	209	220	235	233	231	
Finished manufactures	50	54	52	54	55	57	61	66	66	
Total imports	374	402	375	395	412	422	442	457	450	451
Trade balance, customs returns	-45	-49	-36	-47	-53	-61	-68	2/-120	-69	-65
Trade balance, balance of payments basis	- 6	- 4	+ 7	- 2	- 9	-12	-13	2/ -72	-12	-17

1/ Details may not add to total, owing to rounding.
2/ The export figures, and therefore, the trade balance figures as well, for January 1964 are not comparable with those for other months, owing to a change in procedures of compilations.

Table 9. United Kingdom: Balance of Payments, 1962-63
(In millions of pounds)

	1962	1963 Year	1963 1st Qtr.	1963 2nd Qtr.	1963 3rd Qtr.	1963 4th Qtr.
A. CURRENT ACCOUNT	102	121	78	68	- 28	3
B. LONG-TERM CAPITAL	-89	-147	-53	5	-28	-71
C. TOTAL (A plus B)	13	- 26	25	73	-56	-68
D. PRIVATE SHORT-TERM CAPITAL 1/	91	- 58	-114	- 8	45	19
E. ERRORS AND OMISSIONS	86	-129	--	-50	-20	-59
Surplus or Deficit (-)	190	-213	- 89	15	-31	-108
F. NET RESERVE MOVEMENTS Foreign central bank assistance	--	18	101	-83	--	--
Drawing rights on IMF (Increase-)	-378	5	--	3	2	--
Sterling balances of: Non-sterling official	- 39	- 28	- 50	-45	- 8	75
Outer sterling area:						
Sterling acquired directly from U.K.	8	--14	- 14	11	-26	15
Sterling acquired thru non-sterling countries	36	179	55	63	71	-10
Gold and foreign exchange (increase-)	183	53	- 3	36	- 8	28
Total Financing	-190	213	89	-15	31	108

1/ Excluding net sterling balances held by sterling area residents, which are included in Group F.

Sterling steady in first quarter 1964. Between January and mid-April, the spot pound fluctuated between 279.75 and 279.90 cents per pound. Sterling weakened slightly in the week ending February 21, owing partly to some speculative movements out of London, but recovered with the rise in Bank rate on February 27. On March 31, 1964, gold and foreign exchange reserves stood at £950 million ($2,660 million).

Shift in focus of financial policies in late February

Bank rate increase. The February 27 increase in Bank rate from 4 per cent to 5 per cent marked a major shift in emphasis in financial policies in Britain from stimulation to cautious restraint. Because the move had been expected, financial markets adjusted quickly to the new Bank rate. As a result, short-term rates rose but not enough to push the covered interest arbitrage in Treasury bills in favor the U.K. bill. (See Table 10.) With the budget, the Chancellor acknowledged that the intent of official policies was to slow down the rate of business advance during 1964.

Securities markets unsettled. Prior to the Bank rate action, securities markets were unsettled. Bond yields rose from 20 to 40 points and stock prices reflected uncertainties about possible government actions. (See Table 7.) Following the bank rate increase, the bond market firmed and yields fell gradually through April 10, but the stock market remained sluggish. Short-term market yields rose about 50 to 75 basis points.

After the budget, however, stock prices rose sharply and bond prices fell.

An expansionary budget. The current budget provides for an additional £103 million in taxes, but the Treasury's deficit is almost as great and the borrowing needs are greater in this so-called restrictive budget than they were

Table 10. United Kingdom: Selected Money Market and Bond Yields, 1964

(In per cent per annum)

	January 3	January 14	February 14	February 26	February 28	March 20	April 10	April 17
MONEY MARKET								
Bank rate	4.00	4.00	4.00	4.00	5.00	5.00	5.00	5.00
Treasury bill (tender)	3.72	3.72	3.78	--	4.30	4.30	4.30	4.30
Local authority deposits	4.44	4.31	4.38	--	5.19	5.12	5.00	5.00
Euro-dollar deposits	4.12	4.00	4.00	4.06	4.12	4.25	4.25	4.25
COVERED ARBITRAGE (favor U.K.)								
U.K./U.S. Treasury bills	-.14	-.23	-.32	-.28	-.09	-.07	-.04	-.05
Local authority/Euro-$	+.08	-.04	-.07	--	.22	.16	-.07	
GOVERNMENT BOND YIELDS								
5% 1967	4.72	4.72	4.78	5.10	5.18	5.00	4.95	5.00
5% 1971	5.06	5.02	5.12	5.30	5.35	5.31	5.34	5.39
3-1/2% War Loan	5.95	5.98	6.05	6.18	6.20	6.06	6.02	6.12
STOCK PRICES (April 10, 1962=100)	117.9	111.6	111.4	111.9	111.6	113.2	113.5	116.9

in the so-called expansionary budget for 1963-64. The Government has permitted public expenditure to grow substantially. For the fiscal year 1964-65, they will be £713 million higher than in the preceding year. 7/ (See Table 1.)

The main change in tax rates was a 10 per cent increase in duties on tobacco and alcoholic beverages. At the same time, renewal of the "Regulator power" (enabling the Chancellor of the Exchequer to raise customs and excise duties by 10 per cent without having to secure Parliamentary approval) was requested. In particular, the Chancellor asked for the power to ". . . allow one or more of the four major blocks of indirect taxation. . . to be excluded from its use." This would enable the Chancellor to exempt tobacco and alcohol from higher tax rates if it should be necessary for him to use this power in the present fiscal year.

Borrowing requirements up. The estimated exchequer borrowing requirements of $791 million are the largest in recent years. Therefore, the Chancellor took steps to make non-marketable Treasury obligations more attractive to the public. A 5 per cent (formerly 4-1/2 per cent) five-year National Development Bond will be offered to the public commencing May 15, and the limit on the amounts that one person may hold of National Savings Certificates and Premium Bonds is being raised. Also, the Chancellor announced that the Treasury is working on a contractual savings program, which ". . . will give an incentive for sustained saving over a period of years."

Even if these efforts are successful, large sums may have to be raised through sales of marketable debt. The question is how much will the Exchequer be able to sell to the non-bank public.

7/ Covers the change in "above-the-line" expenditures and in net "below-the-line" expenditures, less the increase in loans to local authorities (£165 million).

<u>A second line of defense</u>. Should inflationary pressures develop, the Government is prepared to make use of two techniques to reduce demand. On the fiscal side, the Chancellor has asked for the renewal of the "Regulator power," which permits the Chancellor to raise excise and customs duties by 10 per cent at his discretion. The use of this power at budget time would have brought in about £200 million in additional revenue.

Secondly, the Bank of England could call for "special deposits" from the London clearing banks and from the Scottish banks to absorb the excess liquidity of the banking system. This could neutralize well over £150 million of Treasury bill sales to the banking system.