DIVISION OF INTERNATIONAL FINANCE

BOARD OF GOVERNORS
OF THE
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CAPITAL MARKET DEVELOPMENTS ABROAD

I. United Kingdom
II. Nine Charts on Financial Markets Abroad

I. United Kingdom: Money and Capital Markets in February

After official efforts were made in early February to resist market pressures to lower money rates, the Bank of England reduced Bank Rate from 6 to 5-1/2 per cent on March 8. The strength of sterling in the exchange market and a substantial inflow of foreign funds were primarily responsible for this decision, rather than domestic economic considerations.

However, this action appears only temporarily to have curtailed the foreign capital inflow. On March 14, the Financial Times reported a resumption of the inflow after a brief check, mainly "into the market for local authority loans and into the hire-purchase finance houses" which are both offering "above 6 per cent" for short-term money compared with about 5 per cent for Treasury bills.

The capital inflow from abroad produced an £80 million ($224 million) increase in official reserves during February even though Britain's foreign trade deficit was appreciable. This inflow has also pushed up the spot pound from 281.16 U.S. cents on January 26 to 281.53 cents on February 28 and to 281.58 cents on March 8. After the cut in Bank Rate, the spot rate climbed as follows:

March 9	281.61	March 14	281.69
12	281.69	15	281.78
13	281.74		

On March 14, the Financial Times stated that the "only reason why the pound did not go higher appears to be sales of sterling by the authorities."

Foreign funds have been attracted to London markets both by the high level of prevailing yields and by hopes for capital gains if interest rates move to lower levels. On a yield basis, funds moved into the local-authority market where rates were maintained throughout the period under review because of the continuing demand for credit by local government bodies. Foreign capital moved in directly and also indirectly when London institutions switched from Euro-dollar to sterling deposits to take advantage of the 25 to 46 basis point differential in favor of 3-month local authority deposits over Euro-dollar deposits (with the exchange risk of returning from pounds to dollars covered). Recent developments in the local-authority deposit market are discussed in the body of this report.

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Foreign funds have also flowed into the Treasury bill market, probably on the expectation of foreign banks and investors that Bank Rate would be reduced. Throughout February, the discount houses faced heavy "outside" competition at the weekly tender and were able to obtain only between 21 and 37 per cent of the bills offered in the five tenders prior to the Bank Rate action.

The appreciable rise in bond prices after mid-January may also have drawn foreign funds into the gilt-edged market in search of capital gains. Yields on long-term and undated securities were pushed down sharply by significant purchases by British institutions in early February. Yields on short bonds dropped sharply with the decline in the bill rate in early March. Recent changes in bond yields (in per cent per annum) were:

	Treasury bill (auction)	4-1/2% 1964	3% 1965-75	5-1/2% 1982-84	5-1/2% 2008-12	3-1/2% War Loan	2-1/2% Consols
Jan. 4	5.43	5.85	6.27	6.30	6.65	6.77	6.57
Feb. 1	5.22	5.71	6.25	6.35	6.50	6.63	6.44
March 1	5.67	5.51	6.22	6.30	6.35	6.45	6.26
12	5.02	5.20	6.20	6.25	6.30	6.40	6.25

Private credit expanded appreciably during February. The modest growth in private bank loans between mid-December and mid-January was followed by a substantial increase to mid-February. Installment credit showed a less than seasonal decline in January, reflecting a pick-up in motor vehicle sales since the first of this year. The private credit expansion, together with the high level of retail sales in the December-February period, suggests that the long-awaited upturn in domestic business activity may now be in process of occuring for the first time since restrictive financial measures were introduced in July 1961.

Britain's trade returns were less unfavorable in February than they were in January, largely because of a large drop in imports. However, exports recovered only slightly and shipments in the three months, December to February, were 1 per cent lower than the movement in the preceding three months.

Money market. Vigorous intervention by the Bank of England pushed up the after-tender market rate for Treasury bills from 5.16 per cent on February 2 to 5.44 per cent on February 16 where it remained until early March (see Table and Chart 2). After the March 9 reduction in Bank Rate, the market yield dropped to 5.03 per cent and bills were being traded at around 4.94 per cent on March 14.

During this period, the discount houses were able to obtain only part of their usual proportion of Treasury bills at the weekly tender, as the following percentage figures show:

Jan. 5	38	Feb. 2	33
12	25	9	22
19	63	16	28
26	61	23	21
		Mar. 2	37

Local authority deposit market. British local authorities continuously required funds, particularly at short-term, and rates on 7-day to 3-month deposits were maintained at around a 6-3/8 per cent level throughout the period under review. The seasonal credit tightness as a result of the tax inflow to the Exchequer and the fact that March is the last month of the fiscal year probably contributed to the continuing demand for short-term funds in this market.

Though the bulk of these funds is supplied by domestic lenders, foreign funds flowed directly into this market in amounts described by the press as "minor" and "to some extent." In addition, London institutions probably shifted Euro-dollar deposits into this market in some volume because the net advantage in favor of such deposits over Euro-dollar deposits (with the exchange risk of returning from pounds to dollars covered at market rates) has recently ranged between 25 and 46 basis points, as the following figures show (in per cent per annum):

Jan. 5	0.37	Feb. 9	0.34
12	0.20	16	0.44
19	0.37	23	0.25
26	0.31	Mar. 2	0.34
Feb. 2	0.46	9	0.32

The figures on which this incentive has been calculated may be found in the table at the end of this report.

Recent official estimates show that, even though their spending needs are largely for long-term purposes, British local authorities have built up a substantial mass of short-term debt since the 1955 decision which required them to borrow from the market rather than from the Treasury-financed Public Works Loan Board. Their total borrowings have grown only from £5.5 billion in March 1958 to £6.6 billion in March 1961 but virtually the entire growth has been in borrowings under one year in maturities as the following aggregate figures (in billions of pounds as of March 31) show:

	1958	1959	1960	1961
Less than 1 year	0.5	0.9	1.1	1.4
1 to 5 years	0.6	0.8	0.9	0.9
5 to 15 years	1.1	1.0	1.0	1.0
Over 15 years	3.2	3.2	3.2	3.2
Total	5.5	5.9	6.2	6.6

In 1961, about half the total borrowing of less than 1 year was in the form of call or 7-day notice deposits. The recent growth in these short-notice obligations may be seen in the following breakdown (in millions of pounds) by maturity:

	1958	1959	1960	1961	1962
Call or 7 days' notice	275	312	371	508	a/650
Up to 3 months	84	123	120	188	--
3 to 6 months	40	65	70	102	--
6 to 12 months	23	57	87	61	--
Other funds	66	90	108	150	--
Total	488	646	756	1,009	a/1,500

a/ Rough estimate by Paul Bareau in The Statist, February 9, 1962, page 410.

Mr. Paul Bareau, a leading journalist, has estimated total borrowings under 1 year in early 1962 at around £1,500 million with about £650 million on a call or 7-day notice basis. Within the call to 3-month range of maturities, a substantial amount of foreign money has been attracted to this market. Bareau has explained:

> "A number of banks and accepting houses have developed special skill in this business. They have borrowed foreign currencies, including dollars, guilders and Swiss francs, converted them into sterling, lent the sterling to local authorities, covered the exchange risk by an appropriate forward sale of sterling and purchase of the currency they borrowed and closed the transaction with a reasonable profit."

He went on to add:

> "This is hot money par excellence and the dependence of the local authorities on it puts them very much at the mercy of the most volatile type of capital that could be put at their disposal."

The extent to which this market has developed may be seen in the fact that the British press publishes every week a schedule of rates covering the following wide range of maturities of deposit receipts or mortgage lending in this market:

2 and 7 days' notice;
7 days' notice with minimum periods of 1, 3 and 6 months;
364 days' notice;
2 to 6 years (6 months' notice);
2 to 3 years; 3 to 5 years; 5 to 7 years; 10 to 12 years; 15 years; 20 years; 35 to 60 years; and
30 and 40 to 60 years, repayable half yearly.

Immediately after the Bank Rate reduction, rates on 7-day and 1-month funds dropped to about 6 per cent but other rates were maintained at about 6-1/4 and higher. As a result, the British press reported a resumption of the inflow of foreign funds into this market.

Gilt-edged market. Buying interest in government securities in the period under review brought gilt-edged yields substantially below early-January levels (see Table and Chart 6). British institutional investors, especially insurance companies and pension funds, entered as substantial buyers of long-term and undated bonds in early February to provide a firm underpinning for a move to a substantially lower level in bond yields during February.

On March 10, the lower longer-term yields reached in mid-February were still being maintained. The main immediate effects of the lower Bank Rate were found in reduced yields on short-term bonds.

A £12 million 6-1/4 per cent Government of Northern Ireland issue maturing in 1974 which was offered at 97-1/2 on February 14 moved slowly as 64 per cent of the bonds were left with the underwriters. The bond opened at 1/2 per cent discount and it was not until early March that the bond reached par.

London clearing banks. Recent changes in assets (in millions of pounds):

	Net deposits	Liquid assets: Amount	Liquid assets: Per cent	Loans to public sector: Govt. securities	Loans to public sector: Treas. bills	Loans to public sector: Total a/	Loans to private sector: Advances	Loans to private sector: Total b/
1960								
(March)	(6,073)	(2,217)	(31.5)	(1,368)	(941)	(2,937)	(2,933)	(3,086)
June	+ 103	+ 36	(31.4)	- 123	+ 17	- 122	+ 137	+ 129
Sept.	+ 101	+ 23	(31.6)	- 62	+ 24	- 4	+ 64	+ 51
Dec.	- 15	+ 123	(31.9)	- 24	+ 47	+ 25	+ 48	
1961								
March	- 118	- 212	(30.4)	- 85	- 216	- 349	+ 133	+ 191
June	+ 216	+ 207	(32.2)	- 102	+ 177	+ 83	+ 144	+ 158
Sept.	- 44	+ 128	(34.3)	- 36	+ 112	+ 72	- 180	- 151
Dec.	+ 24	+ 156	(35.3)	+ 6	+ 4	+ 129	- 75	- 77
1962								
Jan.	+ 133	+ 124	(36.1)	+ 3	+ 120	+ 104	+ 30	+ 43
Feb.	- 239	- 325	(32.2)	- 27	- 274	- 305	+ 93	+ 91

a/ Includes loans to nationalized industries and call loans.
b/ Includes commercial and other bills.

Installment credit. Installment credit outstanding declined by £17 million in January. This result reflected a largely seasonal fall in credit by household goods shops and a greater-than-seasonal expansion in new business of finance houses which accompanied a sharp rise in installment sales of motor vehicles in January. Recent monthly changes in credit in credit outstanding (in millions of pounds) were:

	Total for July	Monthly changes Aug.	Sept.	Oct.	Nov.	Dec.	Jan.
Shops	306	- 1	- 2	0	0	+ 6	- 5
Finance houses	662	+ 4	- 16	- 11	- 11	- 10	- 12
Total	968	+ 3	- 18	- 11	- 11	- 4	- 17

In early March, the largest finance house decided unilaterally to introduce a supplementary scale of commission payments which provides to dealers a total rebate of 20 per cent of credit charges instead of the present 10 per cent limit under an industry "code of practice." This step is likely to lead to "a reawakening of vigorous competition for car hire-purchase business."

Foreign trade. Britain's trade position improved somewhat over the unfavorable January figures as imports declined appreciably. The rise in exports brought shipments to the 1961 level. Recent seasonally-adjusted trade returns (monthly averages in millions of pounds) were:

	1960 Year	1961 I	II	III	IV	1962 Jan.	Feb.
Imports	380	385	363	357	363	380	363
Exports	296	309	305	309	305	300	307
Re-exports	12	12	13	15	13	12	11
Trade balance	- 72	- 64	- 45	- 33	- 45	- 68	- 45

Foreign exchange reserves. During February, Britain's official reserves (adjusted for a £75 million prepayment to the IMF) rose by £80 million ($224 million), one of the largest monthly reserve accruals for many years. The Financial Times attributes the rise to capital inflow "both because of high U.K. interest rates and because of a lack of confidence in the dollar" (March 3, 1962, page 1). The article does not expand further on the so-called "lack of confidence" of the dollar. But the decline in the gold price in the London bullion market during this period is a fact difficult to reconcile with any so-called confidence factor. In addition to high interest rates in London, the substantial rise in the sterling balances of the outer sterling countries reported by Britain for the fourth quarter suggests that higher export proceeds of these countries may have been contributing to some extent to the current strength of sterling. Recent monthly changes in reserves (in millions of pounds) have been:

	1961				1962	
	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.
Reported figure	+ 24	- 8	+ 9	- 85	+ 33	+ 5
Adjusted for special transactions	+ 107	+ 112	+ 59	- 18	+ 33	+ 80

Foreign exchange market. The pound showed sustained strength during the period under review. The spot rate rose from 280.96 U.S. cents on January 2 to 281.21 U.S. cents on January 31, to 281.54 U.S. cents on February 23 and to 281.78 U.S. cents on March 15 (see Table and Chart 8). The discount on the forward pound was reduced with the lower level of money rates in London (see Chart 9).

Bullion market. The flurry in demand for gold reported last month reached a peak in late January and early February and the gold price dropped rapidly after mid-February. By early March, the daily fixing price dropped below $35.08, the first time since July 1961 that the market price has been below the effective U.S. Treasury selling price. The financial press have attributed the price falls to "fairly large offerings of gold -- believed to be coming mainly from continental sources -- which met weak demand from buyers" and lessened demand for gold in London by foreign central banks. Greater confidence within France about the French political situation, reflected in the sharp falls in the price of gold coins in Paris and Zurich, has undoubtedly contributed to reduced private demand for gold during this period. Recent Friday prices at the London fixing (in U.S. dollars per ounce) have been:

Jan.	5	35.154	Feb.	16	35.127
	26	35.168		23	35.083
Feb.	2	35.163	Mar.	2	35.086
	9	35.149		9	35.078
				10	

Stock market. With activity on the quiet side, the index of industrial stock prices was unchanged in the first half of February (see Table and Chart 7). However, prices moved toward lower levels in mid-February and again in early March. Market reports indicated that uncertainty about a capital gains tax, disappointing profits reports and some pre-Budget profit-taking contributed to the easier trend in share prices.

Europe and British Commonwealth Section.

II. Nine Charts on Financial Markets Abroad

United Kingdom: Treasury Bill Yields and Exchange Rates

	3-mo. Treasury bill arbitrage calculation					Spot pound (U.S. cents)	London deposit rates	
	U.K. a/	U.S. a/	Difference	3-mo. pound b/	In favor U.K. bill c/		U.S. dollar (3-mo.)	Local authority (3 mo.)
1961-High	6.74	2.74	4.45	-0.79	1.13	281.62	4.00	7-1/2
Low	4.17	2.16	1.88	-4.36	-2.12	278.47	3.13	6
Dec. 29	5.28	2.67	2.61	-2.54	0.07	280.80	3.88	7
Jan. 5	5.34	2.74	2.60	-2.88	-0.28	280.97	3.50	6-3/4
12	5.34	2.76	2.58	-2.67	-0.09	281.15	3.58	6-1/4
19	5.22	2.71	2.51	-2.50	0.01	281.185	3.38	6-1/4
26	5.16	2.67	2.49	-2.56	-0.07	281.16	3.38	6-1/2
Feb. 2	5.16	2.67	2.49	-2.53	-0.04	281.27	3.38	6-3/8
9	5.34	2.72	2.62	-2.66	-0.04	281.45	3.38	6-3/8
16	5.44	2.83	2.61	-2.63	-0.02	28.155	3.31	6-3/8
23	5.44	2.69	2.75	-2.56	0.19	281.54	3.44	6-1/4
Mar. 2	5.44	2.69	2.75	-2.60	0.15	281.60	3.44	6-3/8(to 9/16)
9	5.03	2.76	2.27	-2.43	-0.16	281.61	3.44	6-3/16(to 1/4)

a/ Market quotation for Friday.
b/ Spread between spot and 3-month forward rate in per cent per annum. Discount equals (-).
c/ Net of difference in bill yield less discount on 3-month sterling.

United Kingdom: Selected Capital Market Yields

	U.K. Government bond yields					Share yield a/	Yield gap b/	Share prices a/
	4-1/2% 1964	3% 1965-75	5-1/2% 2008-12	3-1/2% War Loan	2-1/2% Consols			
1961-High	6.65	6.68	--	6.92	6.78	5.48	1.90	365.3
Low	5.15	5.95	--	5.95	5.70	4.22	0.86	287.7
Jan. 4	5.85	6.27	6.65	6.77	6.57	5.15	1.42	307.1
11	5.80	6.20	6.65	6.64	6.50	5.17	1.33	305.3
18	5.65	6.21	6.60	6.68	6.52	5.10	1.42	309.6
25	5.71	6.23	6.60	6.71	6.53	5.21	1.32	302.8
Feb. 1	5.71	6.25	6.50	6.63	6.44	5.18	1.26	304.9
8	5.67	6.18	6.35	6.40	6.20	5.19	1.01	304.4
15	5.65	6.19	6.35	6.43	6.26	5.22	1.04	303.4
22	5.58	6.19	6.30	6.42	6.25	5.17	1.08	299.4
Mar. 1	5.51	6.22	6.35	6.45	6.26	5.19	1.07	298.0
8	5.43	6.23	6.30	6.43	6.25	5.26	0.99	294.7

a/ Financial Times.
b/ Difference between yield on 2-1/2 per cent Consols and share yield.

Chart 1

INTEREST ARBITRAGE, UNITED STATES / CANADA

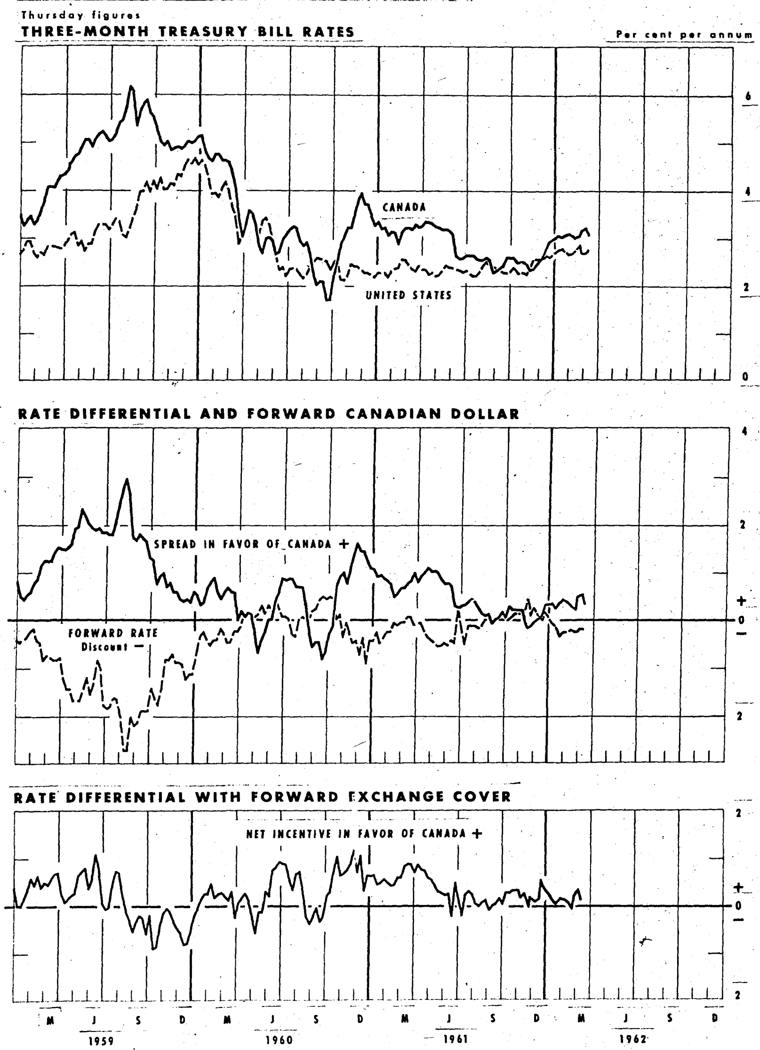

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Chart 2

INTEREST ARBITRAGE, NEW YORK/LONDON

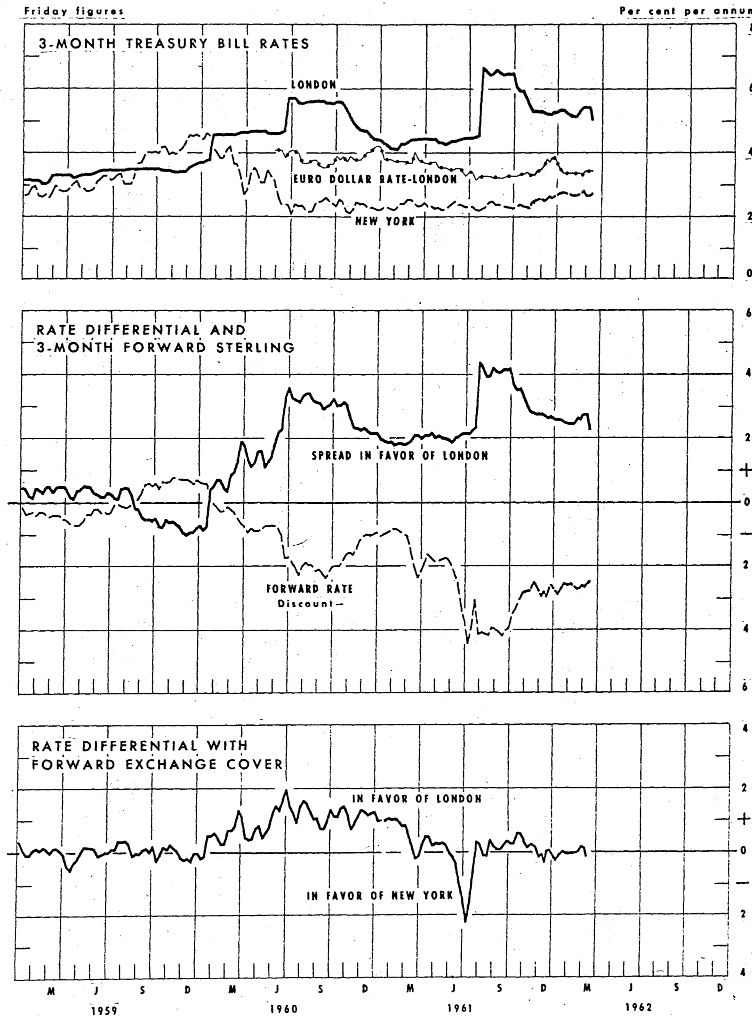
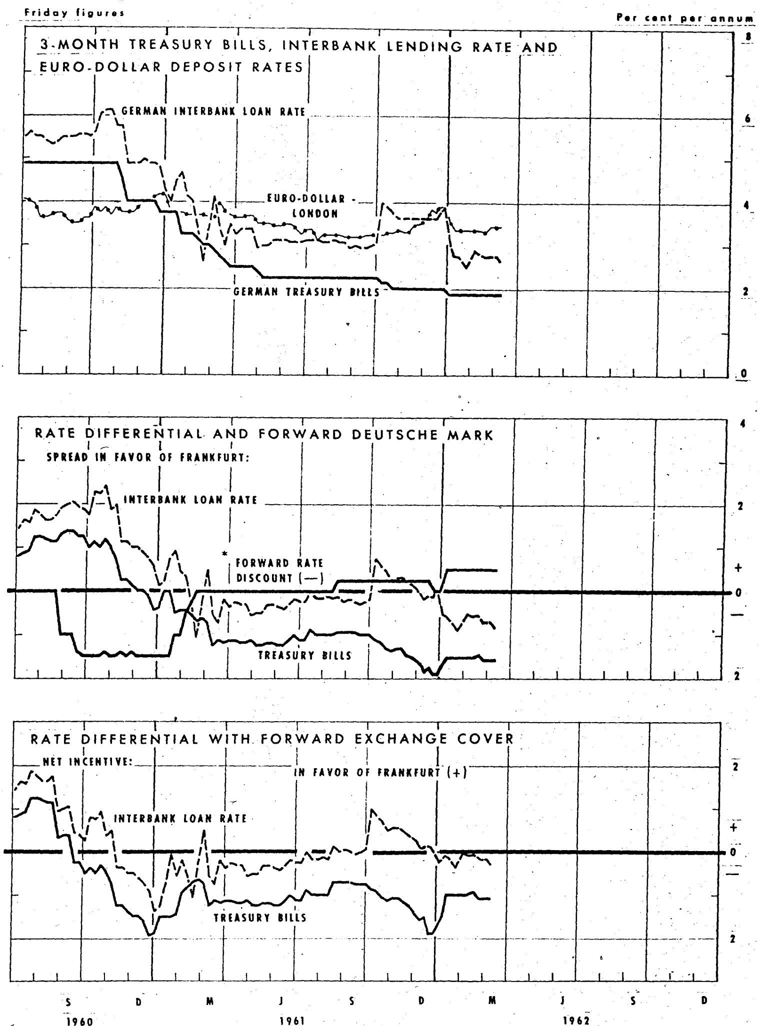


Chart 3
INTEREST ARBITRAGE FOR GERMAN COMMERCIAL BANKS



* Note: Special forward rate available to German commercial banks

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Chart 4
INTEREST ARBITRAGE, FRANKFURT / LONDON

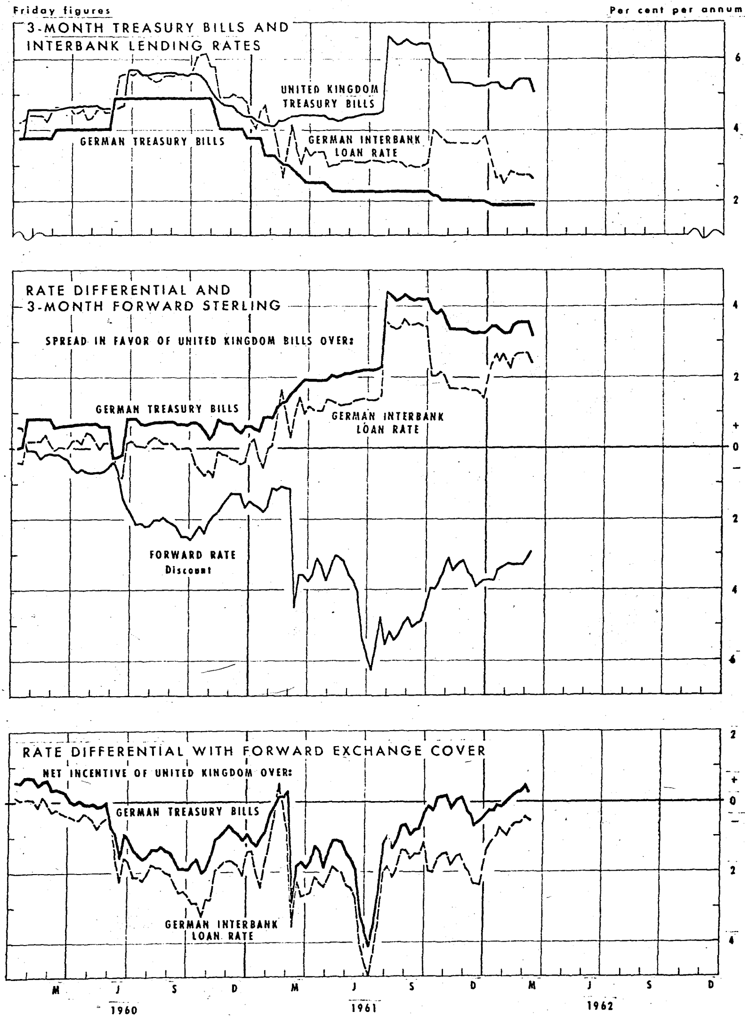

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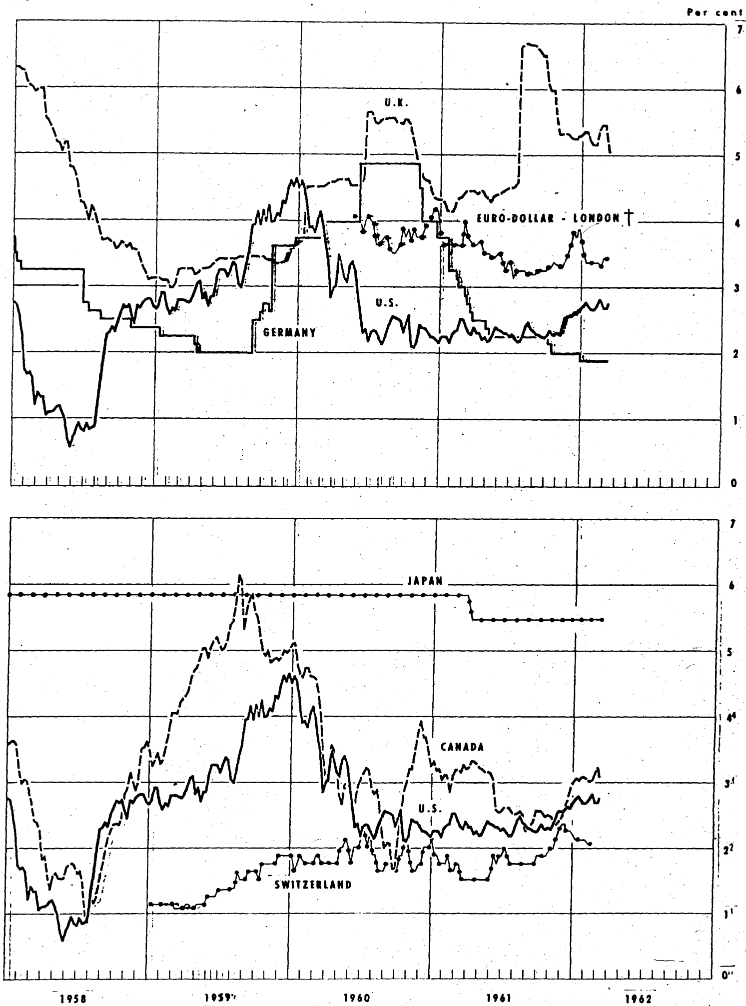
Chart 5

SHORT-TERM INTEREST RATES *



* 3-month treasury bill rates for all countries except Japan (3-month interbank deposit rate) and Switzerland (3-month deposit rate).

† 3-month rate for U. S. dollar deposits in London

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Chart 6

LONG-TERM BOND YIELDS

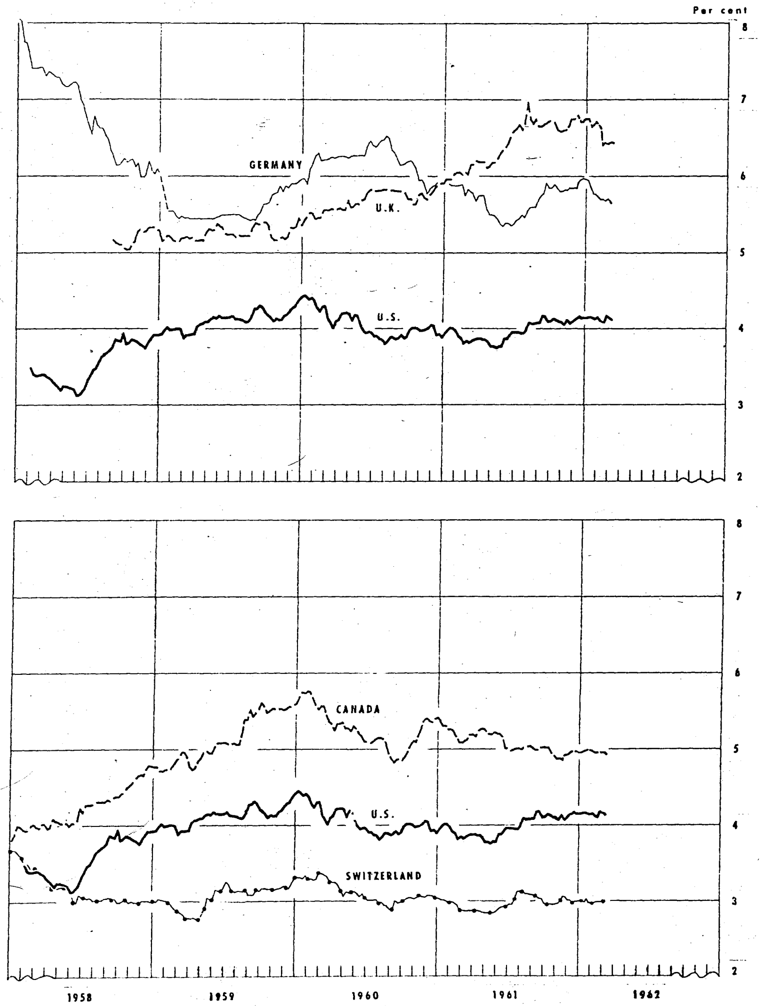
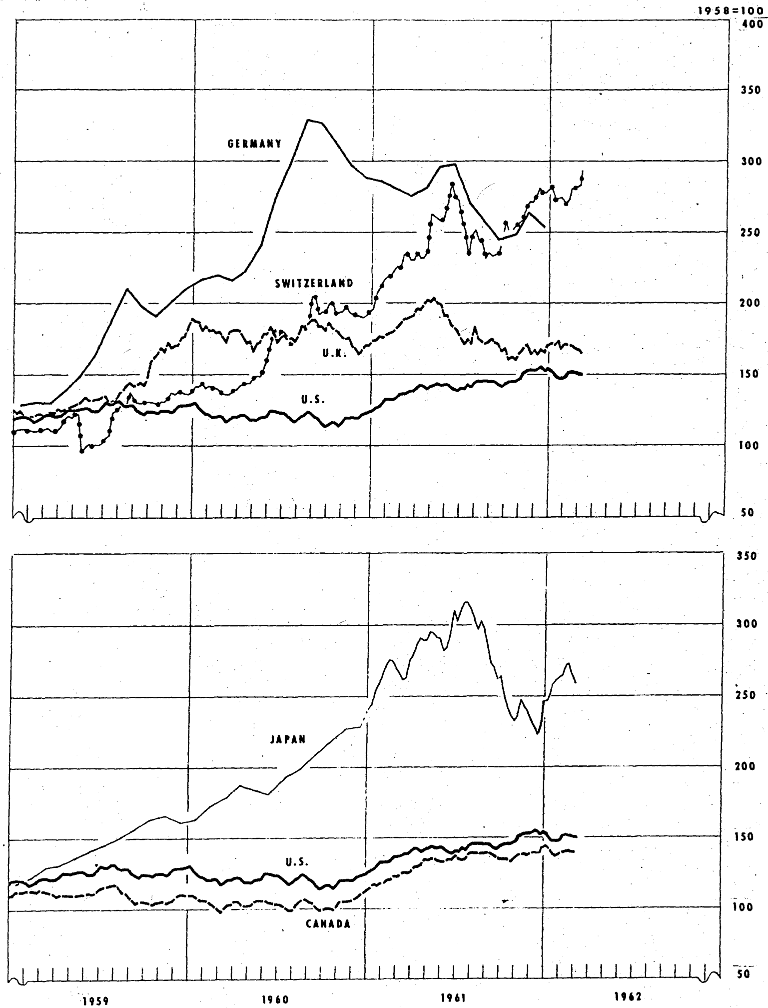


Chart 7

INDUSTRIAL STOCK INDICES*



*Note: Japan: Index of all stocks traded on Tokyo exchange.

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Chart 8

SPOT EXCHANGE RATES - MAJOR CURRENCIES AGAINST U.S. DOLLAR

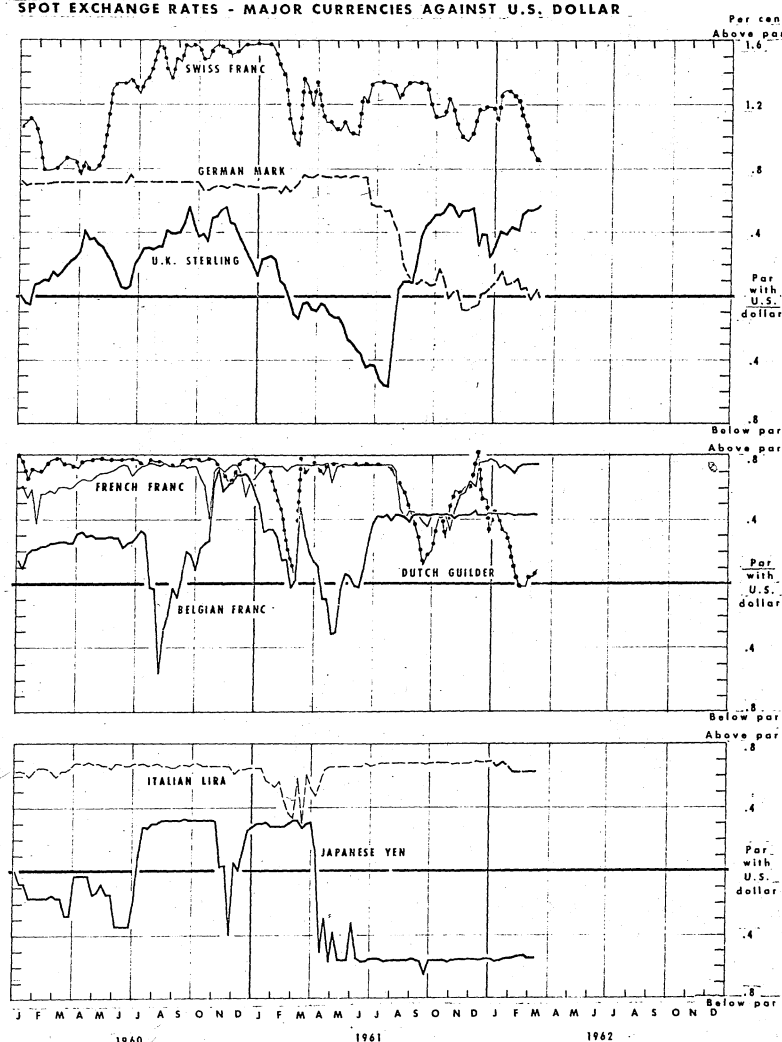

Chart 9
3-MONTH FORWARD EXCHANGE RATES