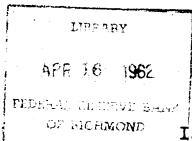


H.13
No. 55

April 13, 1962

CAPITAL MARKET DEVELOPMENTS ABROAD

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

I. United Kingdom: Money and Capital Markets in March

The one-half per cent reductions in Bank Rate on March 8 and 22 brought money rates in London financial markets to levels substantially below those in effect prior to the emergency measures of July 1961. The extent of these declines can be seen in these selected yields (in per cent per annum):

	1961		1962		
	July 7	Aug. 1	Jan. 4	Mar. 1	Mar. 29
Bank Rate	5	7	6	6	5
Treasury bills (tender)	4.54	6.74	5.43	5.61	4.40
Bonds: 4-1/2% 1962	4.98	6.18	--	--	--
4-1/2% 1964	5.68	6.50	5.85	5.51	5.18
3% 1965-75	6.36	6.65	6.27	6.22	6.25
5-1/2% 2008-12	6.43 ¹	6.73	6.65	6.35	6.30
3-1/2% War Loan	6.64	6.72	6.77	6.45	6.38
2-1/2% Consols	6.48	6.56	6.57	6.26	6.23

A heavy inflow of funds from abroad, attracted by high British interest rates and by prospects for capital gains if the gilt-edged market were to move to a lower level, was primarily responsible for the Bank Rate action. The capital flow continued after the March 8 reduction but seems to have slackened appreciably after the second cut. The foreign funds moved in volume into the local-authority market and as deposits with hire-purchase houses. By mid-March, however, the incentive to place funds as local-authority deposits was wiped out by the declining yields in that market (see Table).

In addition, a substantial flow of foreign funds also moved into the gilt-edged and stock markets. An indication of the unexpectedly heavy inflow of foreign funds into British securities is revealed in estimates of Britain's net private capital inflow for 1961 in the balance-of-payments White Paper released last month. Private investment flows from 1958 through the second half of 1961 (in millions of pounds) were:

	1958	1959	1960		1961	
			I	II	I	II
<u>Foreign investment in U.K.</u>						
Direct	+ 87	+146	+ 71	+ 64	+172	+ 53
Other	+106	+ 52	+ 12	+ 90	+ 26	+155
Total	+193	+198	+ 83	+154	+198	+208
U.K. investment abroad	-330	-344	-166	-170	-205	-162
Net private investment	-137	-146	- 83	- 16	- 7	+ 56

DECONTROLLED AFTER SIX MONTHS

According to these figures, Britain not only showed a net inflow of private investment in the second half of 1961 (despite a heavy volume of capital investment abroad) but the sizeable inflow came not as "direct" but as "other" investment. This "other" category combines (1) capital transactions of oil and insurance companies and (2) portfolio investments in British securities. The large surplus in the second half of 1961 must reflect chiefly substantial purchases of bonds and shares in London by foreign investors.

In addition to the international factors, domestic considerations also contributed to the decision of the authorities to reduce Bank Rate. Economic indicators for January and February showed a continued soft business situation. Industrial production fell one point further in January; hire-purchase credit and retail sales for February did not reflect any rise in demand for consumer durables.

The financial press has been reporting a widespread feeling of uncertainty and pessimism in British industry. Reports on conditions in the Midlands industrial belt have emphasized "the sharp fall in orders for new capital equipment from British firms, and the universal reluctance to carry large stocks." A survey among merchants (conducted for the first time by the Association of British Chambers of Commerce) reported that import and export merchants "have become more pessimistic about the general business situation" than four months ago and they also "take a gloomier view of export prospects." Most merchants expected to see little change in export orders or deliveries during the next four months. This pessimism in business circles led the Financial Times to write that "industry will continue to have little confidence in his /the Chancellor's/ policies" and to maintain that this "failure of confidence is itself largely responsible for the present stagnation of the economy" (April 5, 1962, page 10).

Against this background, the Chancellor made only limited changes in the over-all government budget for 1962-63. Even with a number of changes in tax rates, total budget receipts are to be reduced by £9.5 million for the year. The over-all deficit is estimated at £74 million for 1962-63 compared with the realized 1961-62 deficit of £211 million. The Chancellor expects to be able to cover this deficit from nonmarket sources of borrowing.

A summary of "Foreign Exchange Markets and Reserve Developments -- February-March" is available upon application to Division of International Finance, Room 2246, Board of Governors of the Federal Reserve System.

Money market. During the period under review, the after-tender market rate for Treasury bills dropped rapidly from 5.44 per cent on March 2 to 4.28 per cent on April 6 (see Table and Chart 2). Higher prices offered by the discount houses enabled them to obtain more adequate supplies of bills at the weekly tender than they did in February, as the following percentage figures show:

Feb. 2	23	March 2	37
	9	9	53
	16	16	41
	23	23	48
	21	30	57

Local authority deposit market. Rates on 3-month deposits with local authorities declined sharply after mid-March. By April 6, the quoted rate was about 5.5 per cent compared with a 6.47 per cent average (midpoint) for March 2 (see Table). The rapid fall in yields reflected, in part, reduced demand for short-term funds by the local governments as the fiscal year came to an end and as the pressures from tax payments on short-term credit supplies diminished.

By mid-March the yield on local authority deposits (with exchange risk covered) was actually fractionally below the rate on 3-month Euro-dollar deposits (see Table). In this situation, the inflow of foreign funds (direct and indirect) into this market came to an end. The net yield on local-authority deposits (with forward cover) compared with Euro-dollar deposits (in per cent per annum) was:

Jan. 5	+0.24	Feb. 2	+0.34	Mar. 9	+0.10
12	+0.09	9	+0.16	16	-0.01
19	+0.22	16	+0.31	23	-0.02
26	+0.13	23	+0.13	30	+0.05
		Mar. 2	+0.31	Apr. 6	-0.02

The figures on which this incentive has been calculated, found in the table at the end of this report, are substantially revised from the series shown in the United Kingdom "Capital Market Developments Abroad" for February (No. 51, March 16, 1962).

On April 7, the Treasury's Public Works Loan Board announced a reduction of one-eighth per cent in shorter-term loans to local authorities, as follows (in per cent):

	<u>1961</u>	<u>1962</u>
	<u>Nov. 11</u>	<u>April 7</u>
Up to 5 years	6-7/8	6-3/4
5 to 15 years	6-7/8	6-3/4
15 to 30 years	6-3/4	6-3/4
Over 30 years	6-3/4	6-3/4

These charges are still substantially above the rates on call and short-term credit in the local-authority market.

Gilt-edged market. Gilt-edged securities were in good demand in the first half of March and a sustained investment demand was reported. After mid-March, however, some selling, especially of longer-term issues

brought about higher yields. By the end of March, yields had returned to around the March 1 level (see Table and Chart 6).

During the past three months, gilt-edged yields in the short- and long-term sectors have declined substantially but those in intermediate maturities (where the Government Broker continues to hold substantial supplies of two issues on tap) showed only limited movements, as may be seen in the following selected yields (in per cent per annum):

	<u>Jan. 10</u>	<u>April 4</u>	<u>Change</u>
Treasury bills (tender)	5.42	4.40	-1.02
Bonds: 1964	5.53	5.10	-0.43
1966	5.99	5.54	-0.45
1965-75	6.21	6.23	+0.02
1982-84	6.32	6.29	-0.03
1999-2004	6.44	6.18	-0.26
War Loan	6.64	6.40	-0.24
Consols	6.50	6.23	-0.27

In the local-authority sector, the Northern Ireland Exchequer 1974 issue reached par in the general market advance in early March. A £20 million offering of a 6-1/4 per cent Bond, 1975-77 at 97-3/4 was announced on March 16 as the market began to turn and about 67 per cent of the offering was left with the underwriters. In late March trading, the bonds were quoted at a one-fourth to five-sixteenths of one per cent discount.

On March 24, the Treasury announced a one-fourth per cent reduction in return on Tax Reserve Certificates. The interest on these Certificates was cut from 3-1/2 to 3-1/4 per cent on November 25 and will now yield 3 per cent.

Budget for 1962-63. The budget deficit for 1962-63 is expected to be about £74 million compared with the realized deficit for 1961-62 of £211 million. The Chancellor expects to cover this deficit from sources of borrowing other than sales of marketable bonds. The budget figures for 1961-62 and 1962-63 (in millions of pounds) are:

	<u>1961-62</u>		<u>1962-63</u>
	<u>Forecast</u>	<u>Realized</u>	<u>Forecast</u>
Revenue	6,508	6,645	6,797
Expenditure	<u>6,002</u>	<u>6,235</u>	<u>6,364</u>
Current surplus	+ 506	+ 410	+ 433
Below-line expenditure	<u>- 575</u>	<u>- 621</u>	<u>- 507</u>
Over-all balance	- 69	- 211	- 74

The tax changes introduced for the coming year will reduce total tax receipts by only £9.5 million. The major tax changes were:

1. The 10 per cent temporary excise taxes imposed last July are to be removed but additional excise taxes on special items are to replace the revenue lost by the tax reduction;
2. Short-term capital gains on securities within six months or on land within three years are to be subject to usual income and profits taxation;
3. Alterations of purchase tax rates including new 15 per cent tax on confectionery and soft drinks;
4. The special tax on owner-occupiers who must now compute equivalent income for their housing is to be eliminated over the next few years.

London clearing banks. Advances of the 11 London clearing banks rose by £38 million between mid-February and mid-March. However, press reports stress that the heavier borrowings seem to reflect the need of credit for tax payments rather than any marked expansion of consumer demand. At 32.60 per cent of deposits, the banks' liquidity ratio was substantially above the 30 to 30.5 per cent range which is to be expected in mid-March at the end of the tax season.

Recent changes in assets (in millions of pounds)

	Net deposits	Liquid assets		Loans to public sector			Loans to private sector	
		Amount	Per cent	Govt. secu- rities	Treas. bills	Total a/	Advances	Total b/
<u>1960</u>								
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	
<u>1961</u>								
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
<u>1962</u>								
Jan.	+133	+124	(36.1)	+ 3	+120	+104	+ 30	+ 43
Feb.	-239	-325	(32.2)	- 27	-274	-305	+ 93	+ 91
Mar.	- 18	- 50	(32.6)	+ 1	-133	- 79	+ 46	+ 54

a/ Includes loans to nationalized industries and call loans.

b/ Includes commercial and other bills.

Installment credit. Installment credit declined further in February to £598 million, the lowest monthly total since March 1960. The decline reflects the sluggish recovery in evidence in purchases of consumer durables. Automobile sales showed some rise in February but were substantially below year-ago levels. Credit by household goods shops which cover a wide range of durable goods also fell slightly. In February the volume of retail sales were about at the level for January and for the preceding nine months. Rising prices accounted for most of the rise in the value of retail sales which occurred in December. Recent monthly changes in credit outstanding (in millions of pounds) were:

	Total for July	Monthly changes						
		Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.
Shops	306	- 1	- 2	0	0	+ 6	- 5	- 3
Finance houses	662	+ 4	-16	-11	-11	-10	-12	- 8
Total	968	+ 3	-18	-11	-11	- 4	-17	-11

A commission war between finance houses on automobile financing is spreading. Last month, the largest hire-purchase firm breached the 10 per cent limit agreed within the industry on commissions paid on automobile paper by offering 20 per cent. Other major finance houses are now offering 20 per cent and there are fears that even higher rates may be offered unless the houses come to agreement on a new limit.

Foreign trade. Britain's trade position showed some further improvement in March as exports rose and imports declined to a small extent. As a result, the seasonally-adjusted trade deficit was the smallest since August 1961. Recent seasonally-adjusted trade returns (monthly averages in millions of pounds) were:

Year	1961				1962		
	I	II	III	IV	Jan.	Feb.	Mar.
Imports	380	385	363	357	363	363	359
Exports	296	309	305	309	300	307	312
Re-exports	12	12	13	15	12	11	11
Trade balance	-72	-64	-45	-33	-45	-68	-36

Foreign exchange reserves. For the third consecutive month, the United Kingdom reported a substantial rise in official reserves in March. Adjusted for a £62 million repayment by Australia to the Fund, official reserve accruals amounted to £72 million. Foreign funds flowing into British financial markets accounted for the reserve accruals. After the second reduction in Bank Rate on March 22, the inflow of foreign funds slackened and the flow into the local-authority market may have terminated. Recent monthly changes in official reserves (in millions of pounds) have been:

	1961				1962		
	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.
Reported figure	+ 24	- 8	+ 9	-85	+33	+ 5	+10
Adjusted for special transactions	+107	+112	+59	-18	+33	+80	+72

Germany has agreed to make special purchases amounting to DM 600 million (£54 million or \$150 million) in the United Kingdom during both 1962 and 1963 to help Britain meet the foreign exchange costs of the British Army of the Rhine. Britain's army costs about £73 million and, thus far, German purchases have been about £15 million a year. With the new purchases, the foreign exchange cost of British troops will be reduced to £20 million. The German commitment, which is to cover actual payments rather than orders to be placed, will finance military purchases in Britain and rent for German use of British facilities in Germany. Some civilian procurement by the German Government is also expected.

Foreign exchange market. The pound showed sustained strength during the period under review. The spot pound remained above \$2.81-1/2 until the second reduction in Bank Rate and then moved to a level between \$2.81-1/4 to 1/2 through the early part of April (see Table and Chart 8). The discount on the forward pound narrowed from 2.60 per cent per annum on March 1 to 1.89 per cent on April 6 (see Chart 9).

Bullion market. The price of gold at the fixing moved generally downward in March to a low of \$35.071 on April 5, the lowest quotation reported since mid-1961. Recent Friday prices at the London fixing (in U.S. dollars per ounce) have been:

Feb. 23	35.083	Mar. 23	35.087
Mar. 2	35.086	30	35.083
9	35.078	Apr. 6	35.074
16	35.095		

Stock market. The stock market was generally quiet during March and prices tended to ease somewhat. The index of industrial shares which was at 309.6 in mid-January reached a bottom of 292.6 on March 30 (see Table and Chart 7). The approaching budget, fears of a capital gains tax to be introduced and the competition from many new issues contributed to the weak market.

In early April, however, prior to the budget, a surge of buying brought sharp price rises. On one day the stock price index rose 4.9 points. By April 10, after the budget, the index stood at 306.6

Europe and British Commonwealth Section.

II. Nine Charts on Financial Markets Abroad

United Kingdom: Treasury Bill Yields and Exchange Rates

	<u>3-mo. Treasury bill arbitrage calculation</u>					<u>Spot pound (U.S. cents)</u>	<u>London deposit rates</u>	
	<u>U.K. a/</u>	<u>U.S. a/</u>	<u>Difference</u>	<u>3-mo. pound^{b/}</u>	<u>In favor U.K. bill^{c/}</u>		<u>U.S. dollar (3-mo.)</u>	<u>Local authority (3 mo.)</u>
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
Jan. 5	5.34	2.74	2.60	-2.88	-0.28	280.97	3.63	6.50
12	5.34	2.76	2.58	-2.67	-0.09	281.25	3.56	6.32
19	5.22	2.71	2.51	-2.50	0.01	281.185	3.56	6.28
26	5.16	2.67	2.49	-2.56	-0.07	281.16	3.56	6.25
Feb. 2	5.16	2.67	2.49	-2.53	-0.04	281.27	3.50	6.38
9	5.34	2.72	2.62	-2.66	-0.04	281.45	3.56	6.38
16	5.44	2.83	2.61	-2.63	-0.02	281.55	3.44	6.38
23	5.44	2.69	2.75	-2.56	0.19	281.54	3.56	6.25
Mar. 2	5.44	2.69	2.75	-2.60	0.15	281.60	3.56	6.47
9	5.03	2.76	2.27	-2.43	-0.16	281.61	3.69	6.22
16	4.81	2.72	2.09	-2.45	-0.36	281.71	3.69	6.13
23	4.38	2.70	1.68	-2.08	-0.40	281.32	3.63	5.69
30	4.34	2.75	1.59	-1.93	-0.34	281.39	3.69	5.69
Apr. 6	4.28	2.70	1.58	-1.89	-0.31	281.38	3.63	5.50

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>U.K. Government bond yields</u>					<u>Share yield a/</u>	<u>Yield gap b/</u>	<u>Share prices c/</u>
	<u>4-1/2% 1964</u>	<u>3% 1965-75</u>	<u>5-1/2% 2008-12</u>	<u>3-1/2% War Loan</u>	<u>2-1/2% Consols</u>			
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	5.27	0.98	294.7
15	5.28	6.23	6.25	6.30	6.15	5.19	0.96	298.8
22	5.08	6.24	6.25	6.33	6.16	5.25	0.91	295.2
29	5.18	6.25	6.30	6.38	6.23	5.37	0.86	292.6
Apr. 5	5.27	6.25	6.30	6.38	6.22	5.21	1.01	301.5

a/ Financial Times.

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

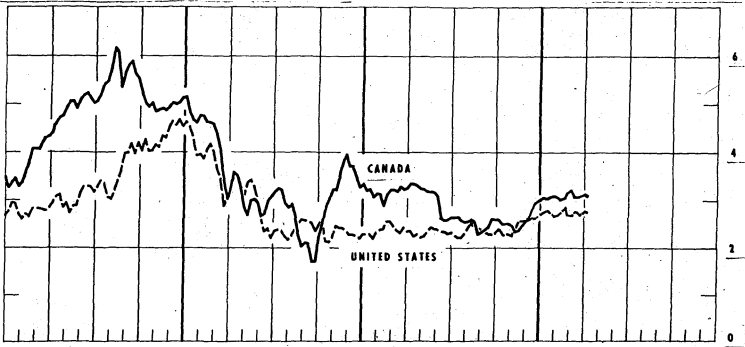
Chart 1

INTEREST ARBITRAGE, UNITED STATES / CANADA

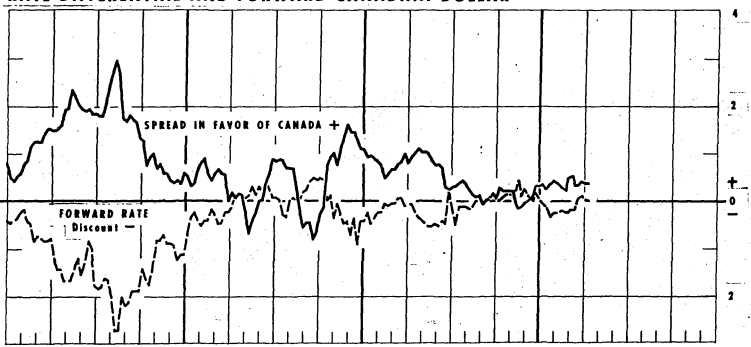
Thursday figures

THREE-MONTH TREASURY BILL RATES

Per cent per annum



RATE DIFFERENTIAL AND FORWARD CANADIAN DOLLAR



RATE DIFFERENTIAL WITH FORWARD EXCHANGE COVER

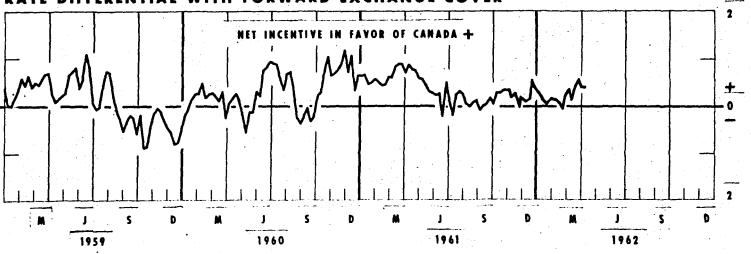
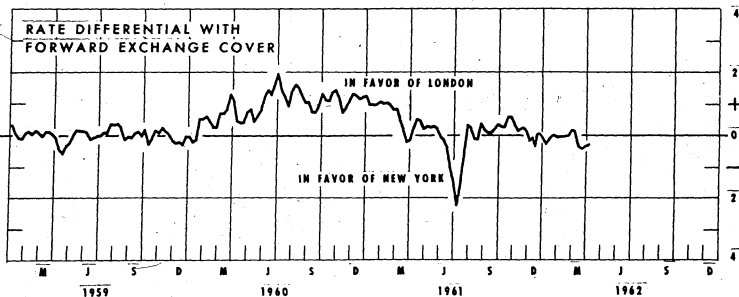
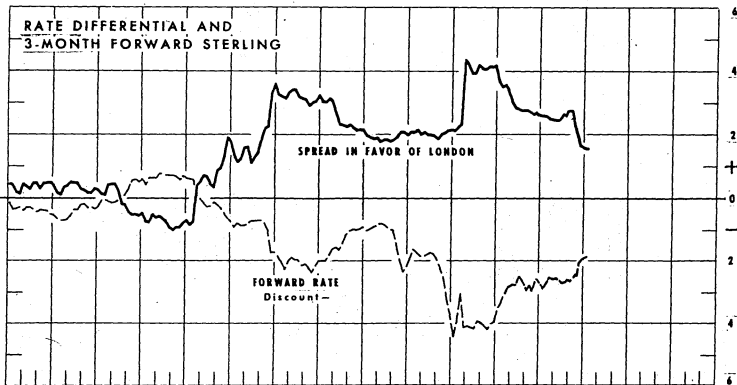
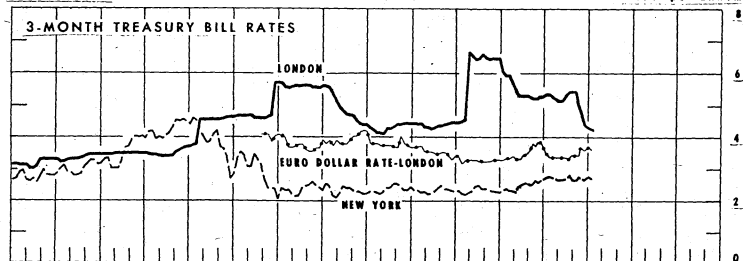


Chart 2
INTEREST ARBITRAGE, NEW YORK/LONDON

Friday figures

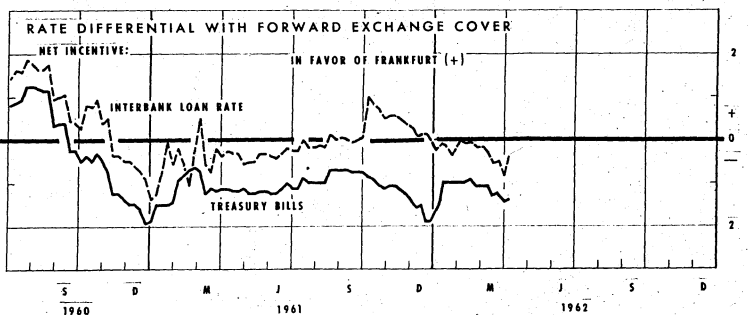
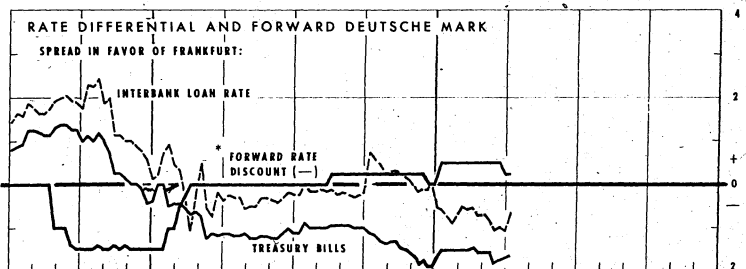
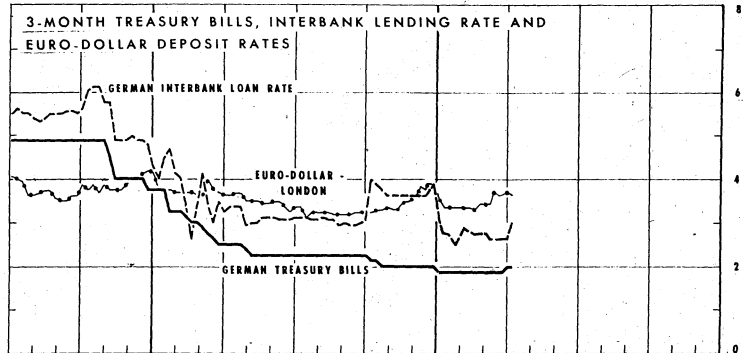
Per cent per annum



INTEREST ARBITRAGE FOR GERMAN COMMERCIAL BANKS

Friday figures

Per cent per annum



Note: Special forward rate available to German commercial banks

Chart 4
INTEREST ARBITRAGE, FRANKFURT / LONDON

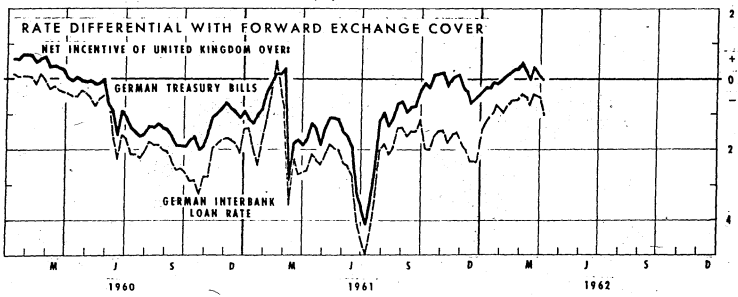
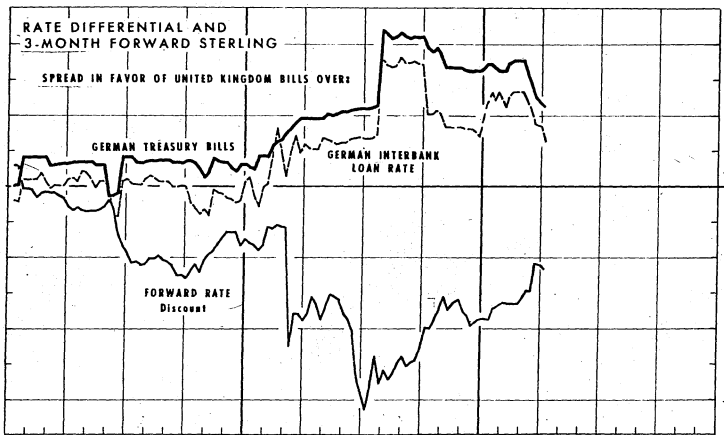
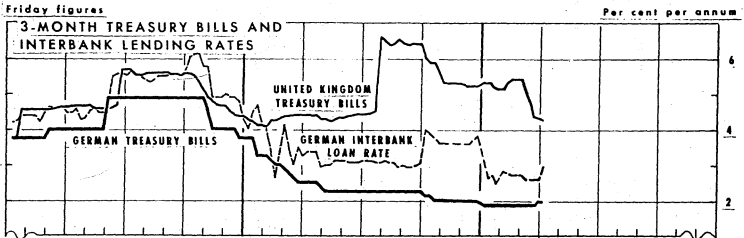
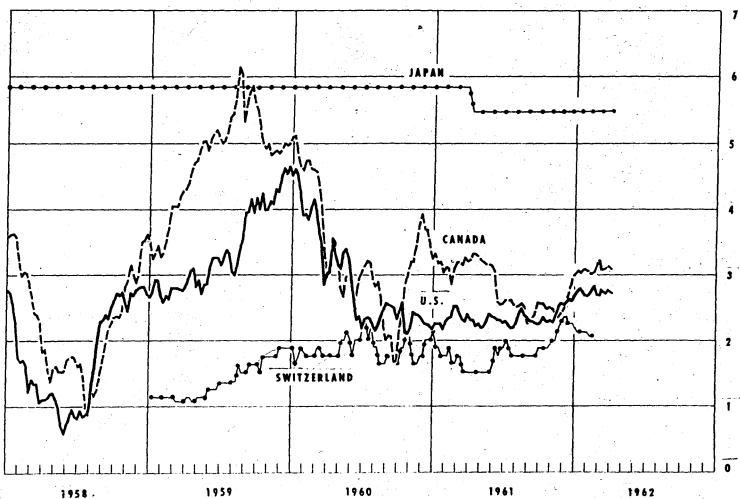
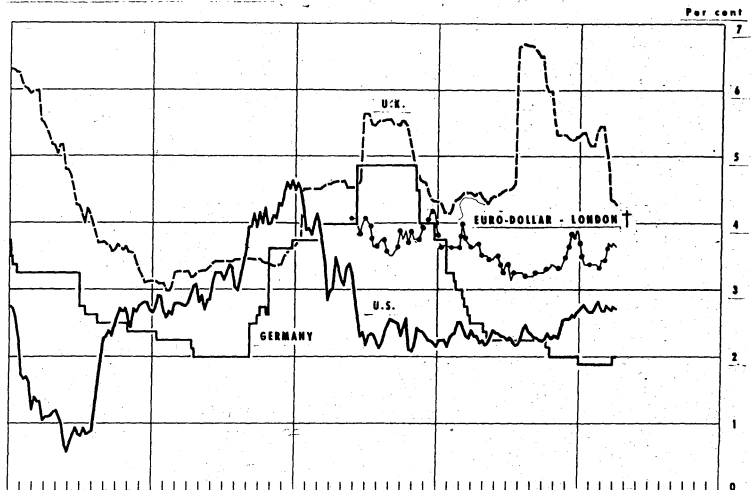


Chart 5
SHORT-TERM INTEREST RATES *



* 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.

Chart 6

LONG-TERM BOND YIELDS

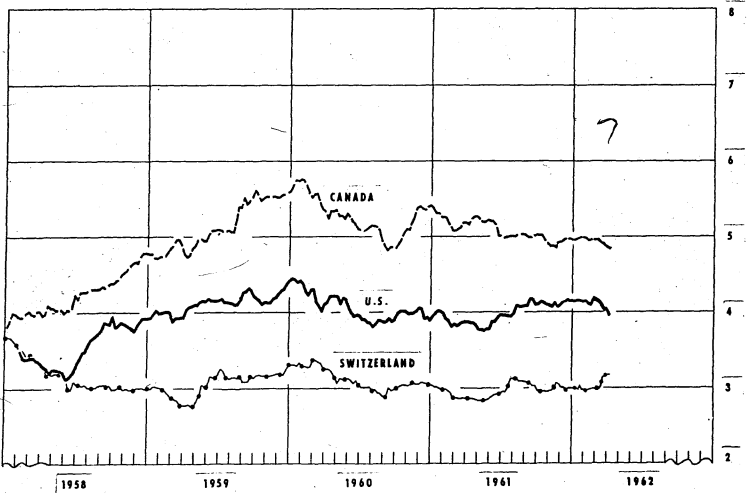
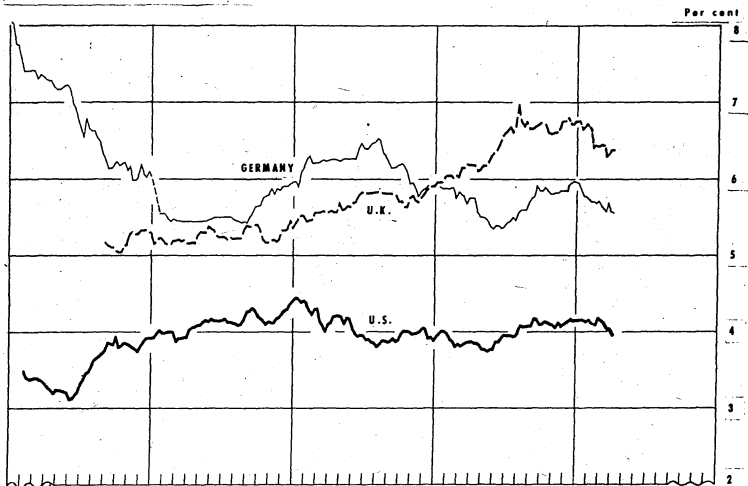
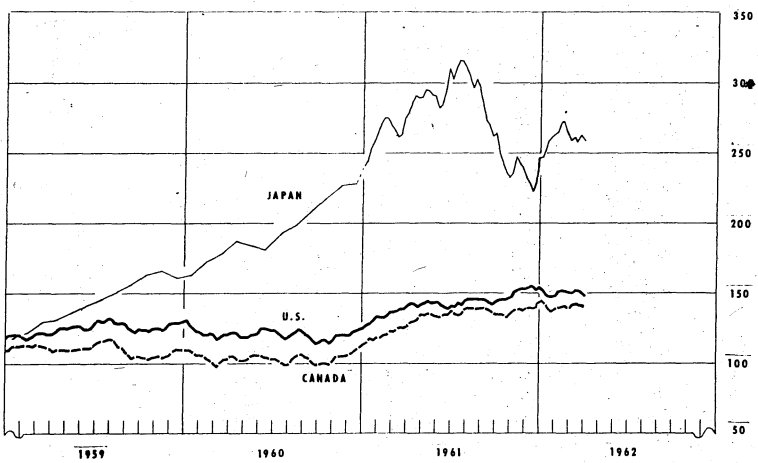
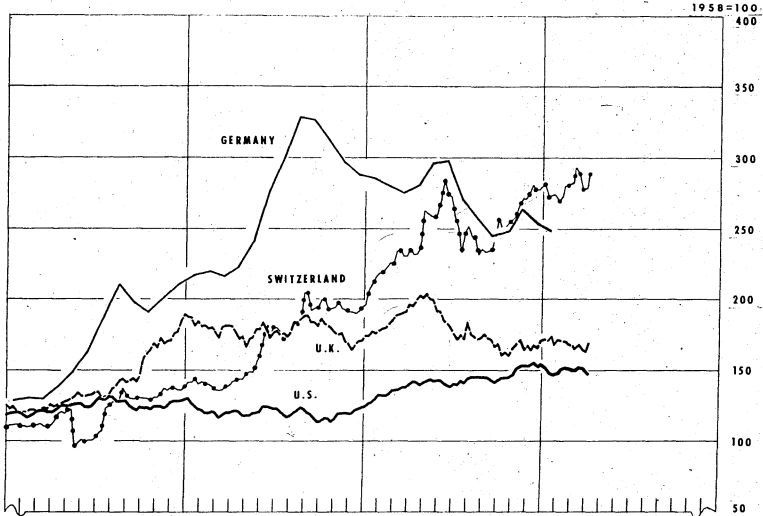


Chart 7
INDUSTRIAL STOCK INDICES*



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

Chart B

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

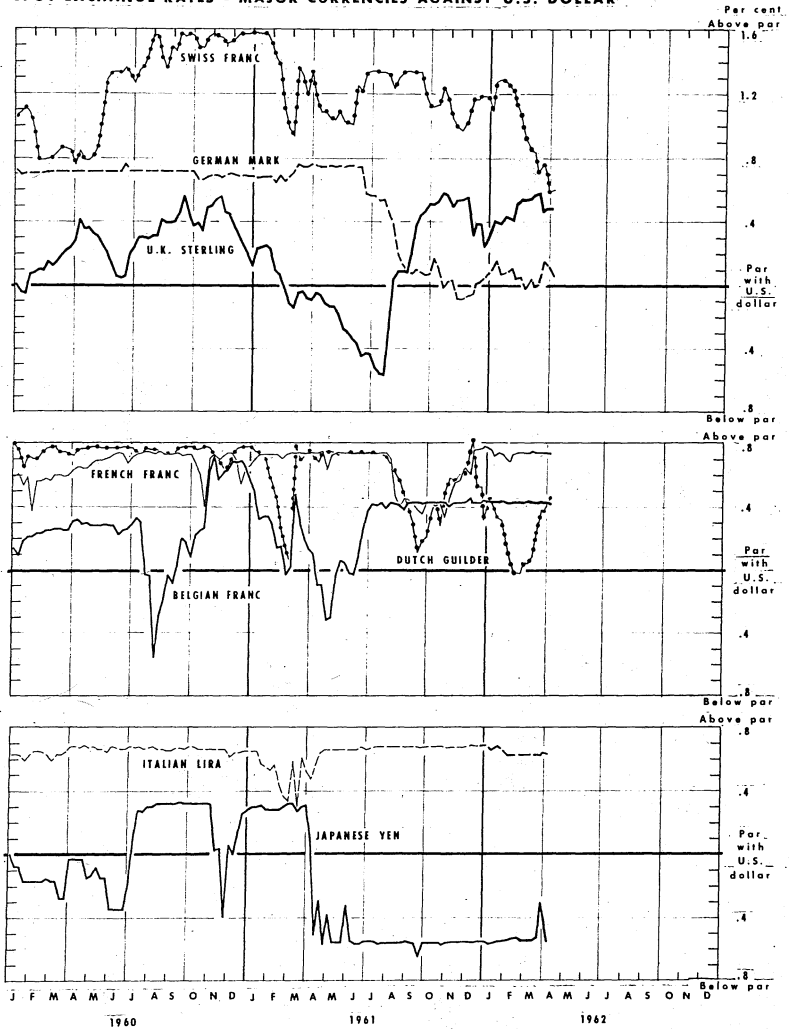


Chart 9
3-MONTH FORWARD EXCHANGE RATES

