DIVISION OF INTERNATIONAL FINANCE



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

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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 October

Money and capital markets in the United Kingdom were affected only to a limited extent by reactions to the Cuban crisis. From October 22 through 24, the prices of stocks and bonds dropped sharply. Stock prices had recovered their pre-crisis level by October 29, but bond prices had still not reached their earlier peaks as of November 9. On the foreign exchange market, the spot rate was hardly affected, and there were no press reports of significant official support operations. The forward discount on the pound narrowed appreciably and created arbitrage possibilities which induced a small flow of funds from the United States in late October. There was heavy demand for gold for a few days, and the rates on Euro-dollar deposits rose.

On the domestic economic front, the British authorities announced in October and early in November a series of credit and fiscal relaxations to spur the lagging British business recovery. In October, the commercial banks required Special Deposits with the Bank of England were again reduced (from 2 to 1 per cent for the London clearing banks and from 1 to 1/2 per cent for the Scottish banks). In addition, the Bank of England informed all financial institutions that all existing qualitative controls on lending were withdrawn. Bank advances rose in response to these measures.

The new fiscal measures announced in Parliament were described as "a giant step off the path of orthodoxy" by the Manchester Guardian Weekly (November 8, 1962, p. 2) sufficiently pervasive in their economic effects to be considered the equivalent of "an autumn budget." The principal measures include:

1) Public investment is to be increased by £70 million during the next 18 months;

2) Some £42 million in World War II tax credits were released;

3) Purchase tax on automobiles was reduced from 45 to 25 per cent; and

4) Tax benefits on increases in investment spending were advanced from 20 to 30 per cent on new equipment and from 10 to 15 per cent on new industrial building.

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These fiscal measures constitute a shift in the emphasis of economic policy from a cautious use of credit relaxation to the recourse to direct tax and spending measures to spur domestic activity. Beginning in March, seven months ago, British interest rates began to drop rapidly as the authorities sought to accelerate business recovery through monetary relaxation. There were two stages in the fall in market interest rates. Between March 1 and June 21, rates in the short-term sector fell sharply, accompanied by three reductions in Bank rate to slow down the inflow of foreign funds. (See Table 1.) Thereafter, short- and long-term bond yields dropped sharply; by October, undated yields had fallen to 5.75 per cent for the first time since November 1960.

Table 1. United Kingdom: Selected Security Yields
(in per cent per annum)

| | March 1 | June 21 | October 4 | Changes: March 1 to June 21 | Changes: June 21 to October 4 |
|---|---|---|---|---|---|
| Treasury bills | 5.44 | 3.78 | 3.55 | -1.66 | -0.23 |
| 4-1/2% Conversion stock, 1964 | 5.51 | 4.62 | 4.03 | -0.89 | -0.59 |
| 3% Savings bonds, 1965-75 | 6.22 | 6.22 | 4.79 | -- | -0.43 |
| 5-1/2% Treasury stock, 2008-12 | 6.35 | 6.20 | 5.75 | -0.15 | -0.45 |
| 3-1/2% War loan | 6.45 | 6.36 | 5.75 | -0.09 | -0.61 |

Money market. The seven-month decline in short-term interest rates, at least for the moment, came to an end on October 19, when the discount houses lowered their bid at the Treasury bill tender. The after-tender market rate on that day was 3.69 per cent in contrast to 3.53 per cent on the previous Friday. On the following Friday (October 26) the Treasury bill rate rose to 3.78 per cent and was at 3.72 per cent on November 9. (See Table 9.)

In the wake of the Cuban crisis, a large covered arbitrage opportunity in favor of U.K. Treasury bills developed when the U.K. bill rate rose and the forward discount on sterling declined. (See Chart 2 and Table 7.) Some covered movements of funds have been reported during the last few days of October and in early November.

Rates on Euro-dollar deposits in London rose sharply at the time of the Cuban crisis. Rates on the entire range of time periods from call to 180-day deposits increased by between 1/4 and 1/2 per cent. (See Table 2.)

Several factors contributed to the higher level of rates. Because of the crisis, funds which would ordinarily have been loaned in this market were shifted into gold or into Swiss francs. Secondly, European banks were less willing to tie up funds over the year-end period when normally large shifts are made from Euro-dollars for window-dressing. Thirdly, German banks brought back funds in October for liquidity purposes and, after the deposit rates rose, were discouraged by the Bundesbank from making short-term deposits maturing during December. Finally late in October, Italian banks activity shifted from Euro-dollars into lira assets to improve domestic credit availabilities.

By November 8, rates on the whole range of Euro-dollar maturities had once again approached the October 19 level. (See Table 2.)

Table 2. Interest Rates on U.S. Dollar Deposits in London
(per cent per annum)

| | September 27 | October 19 | November 1 | November 8 |
|---|---|---|---|---|
| Call | 3-1/4 | 3-3/8 | 3-3/4 | 3-3/8 |
| 7-day | 3-1/2 | 3-5/8 | 3-3/4 | 3-1/2 |
| 30-day | 3-3/4 | 3-5/8 | 3-13/16 | 3-3/4 |
| 90-day | 3-15/16 | 4 | 4-5/16 | 4-1/8 |
| 180-day | 4-3/16 | 4-1/4 | 4-7/16 | 4-1/4 |

In the local authorities funds market, a decline in demand for these funds, together with the Cuban crisis, caused some foreign funds to shift into Euro-dollar deposits, in part because the yield on Euro-dollar funds exceeded the yield on local-authority deposits with exchange risk covered (in per cent per annum) by these amounts:

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| August | 24 | +0.05 | September | 21 | -0.20 | October | 19 | -0.26 |
| | 31 | -0.03 | | 28 | +0.19 | | 26 | -0.18 |
| September | 7 | -0.06 | October | 5 | -0.07 | November | 2 | -0.12 |
| | 14 | -0.13 | | 11 | -0.28 | | 9 | -0.27 |

Gilt-edged market. A break in bond prices on October 9, which brought to an end a three-month upward movement, was followed by a recovery in response to substantial buying on October 18 and 19 (See Table 10 and Chart 6.) However, these gains, which brought the index of price of government securities to a level slightly above the recent peak on October 4, were short-lived. On the following Monday, Tuesday and Wednesday (October 22 to 24) a general wave of selling, which took place during the Cuban crisis, brought the gilt-edged price index to 83.2 compared with 86.8 on October 4. As a result, the yield on 2-1/2 per cent Consols rose above the yield on industrial shares late in October. (See Table 10.)

Just prior to the Cuban crisis, bond sales by the Government Broker had exhausted the £500 million tap of a 2008-12 bond issue only six weeks after it had been opened. A large part of the demand for this issue represented switching from medium dated bonds. When the end of this tap issue was announced, there was considerable speculation in the British financial press as to whether the Government would attempt to control the long-end of the market with the medium-dated bonds it had acquired, or whether a new tap issue would be announced. It appears that the sluggish state of the market following the Cuban crisis has lessened the importance of this question.

Stock market. Stock prices were relatively stable during October, with the Financial Times Industrial Ordinary index remaining between 275 and 276 for most of the month. However, there was a percipitous drop in stock prices on October 22 and 23 as a result of the Cuban crisis. The loss of value on these two days was 5 per cent. However, at the end of that week, prices recovered to the pre-crisis level.

A rally on the stock exchange took place early in November after the new depreciation allowances for business were announced. Most of the buying was concentrated in the industries which are likely to benefit from an expansion in private fixed capital formation. Buyers still appear to be cautious. The Economist pointed out (November 10, 1962, p. 592) that "Investors may well wait for definite signs that production and capital expenditures are picking up again before going back to equities in any great number. And having learnt about the fallacy of automatic growth the hard way they are unlikely to buy equities with blind abandon." The stock market index for recent weeks may be seen in Table 10.

London clearing banks. Bank advances increased in the month ending October 17, in response to the release of special deposits on September 27 and to the ending of restrictions on bank lending to finance real estate development and personal consumption. According to The Economist (October 27, 1962, p. 388), the increase in advances ". . . seem to confirm that there were a number of proposals on the banks' books merely waiting for the removal of the restraint on property, personal, and hire purchase lending." It is not known if there has been any increase in industrial borrowing as well. There is still room for further increases in lending, as the liquidity ratio stood at 33.5 per cent on October 17.

The banks increased their holdings of gilt-edged securities in this month by £83 million. A substantial part of these purchases are believed to be the new Treasury 4 per cent 1965 bonds.

Installment credit. The Board of Trade announced that, after allowing for seasonal influences, installment credit appeared to have diminished in September. The net credit extended by finance houses fell by more than was expected for this time of the year, and credit extended by household goods shops did not expand as much as might be expected. This indicates, according to the Board of Trade, that the stimulus given by the reduction in minimum deposits (on such articles as washing machines, refrigerators, vacuum cleaners and television and radio sets) on June 5th was no longer leading to an expansion. The amount of installment credit extended for the purchase of new cars fell in September to 5-1/2 per cent below the August level.

Table 3
London Clearing Banks: Net Deposits and Selected Assets, 1962 1/

(In millions of pounds)

| | Changes | | | | | | Out-standing October |
|---|---|---|---|---|---|---|---|
| | Jan.-Mar. | Apr.-June | July-Sept. | Aug. | Sept. | Oct. | |
| Net Deposits | - 90 | +142 | +77 | -51 | +47 | +86 | 6,555 |
| Liquid Assets | | | | | | | |
| Cash | - 16 | + 16 | - 3 | +10 | -13 | +22 | 645 |
| Call money | + 33 | - 29 | -18 | -24 | - 9 | +43 | 735 |
| Treasury bills | -287 | +124 | +50 | - 4 | +72 | -25 | 943 |
| Other bills | + 21 | + 3 | -- | + 2 | -11 | - 3 | 273 |
| Loans and other investments | | | | | | | |
| Gilt-edged | - 23 | + 91 | +48 | + 1 | +20 | +83 | 1,206 |
| Other market investments | -- | -- | -- | -- | -- | -- | 112 |
| Advances: | | | | | | | |
| Nationalized industries | - 3 | - 29 | +19 | + 6 | - 6 | + 3 | 58 |
| Other (net) | +169 | + 54 | + 8 | - 9 | -29 | +42 | 3,414 |
| Special deposits with Bank of England | - 1 | - 71 | + 1 | + 1 | - 1 | -75 | 75 |
| Selected assets as percentage of gross deposits (end of period) | | | | | | | |
| Total liquid assets | 32.6 | 33.4 | 33.7 | 33.1 | 33.7 | 33.5 | |
| Cash | 8.2 | 8.3 | 8.2 | 8.4 | 8.2 | 8.3 | |
| Special deposits | 3.0 | 2.0 | 2.0 | 2.0 | 2.0 | 1.0 | |

1/ Figures are for the close of business on the third Wednesday of each month.

Table 4. United Kingdom: Changes in Hire Purchase Credit
(in millions of pounds)

| | Changes 1962 | | | | | | Outstanding September 1962 |
|---|---|---|---|---|---|---|---|
| | Jan.-Mar. | Apr.-June | July-Sept. | July | Aug. | Sept. | |
| Shops | -13 | - 2 | + 6 | + 1 | + 2 | + 3 | 300 |
| Finance houses | -26 | + 1 | - 3 | + 4 | - 4 | - 3 | 590 |
| Total | -39 | - 1 | + 3 | + 5 | - 2 | -- | 890 |

To compete more effectively for the diminishing automobile installment credit business, the members of the Finance Houses Association on October 23 reduced their minimum down-payment requirements from 25 to 20 per cent for those customers who can be regarded "as exceptionally good credit risks." The members of this Association, which normally account for three-quarters of the automobile installment credit business, have been losing business to smaller, non-member finance houses which have been requiring as down-payments only the statutory minimum 20 per cent. This move has been criticized by the financial press because the larger finance houses do not have adequate facilities for checking the credit-worthiness of potential borrowers.

Foreign trade. Exports, which had made no advances since June, rose in October; but this gain was offset by an even larger increase in imports. The stagnation of exports in the third quarter can be explained by the decline in exports of aircraft and ships, which was not offset by increases in exports of machinery, metals, and motor vehicles. The rise in imports during the third quarter may be attributed to the increases in imports of industrial materials and fuel.

Table 5. United Kingdom: Seasonally Adjusted Foreign Trade
(monthly, or monthly averages, in millions of pounds)

| | Jan.-Mar. | Apr.-June | July-Sept. | July | Aug. | Sept. | Oct. |
|---|---|---|---|---|---|---|---|
| Imports c.i.f. | -367 | -369 | -385 | -390 | -387 | -378 | -393 |
| Exports f.o.b. | 306 | 319 | 320 | 327 | 309 | 325 | 336 |
| Re-exports f.o.b. | 12 | 14 | 13 | 14 | 12 | 12 | 13 |
| Trade balance | - 49 | - 36 | - 52 | - 49 | - 66 | - 41 | - 44 |

Foreign exchange reserves. Gold and convertible foreign exchange reserves increased by £11 million in October. There were no "special transactions" during October, so this figure stands as the largest adjusted reserve accrual since May, when reserves (after adjustment for special transactions) increased by £26 million. (See Table 6.)

Table 6. United Kingdom: Foreign Exchange Reserves
(in millions of pounds)

| | Changes 1962 | | | | | | Outstanding |
|---|---|---|---|---|---|---|---|
| | Jan.-Mar. | Apr.-June | July-Sept. | Aug. | Sept. | Oct. | October 1962 |
| Reported figure | + 48 | - 7 | -229 | - 24 | - 20 | + 11 | 1,008 |
| Adjusted for special transactions | +185 | +61 | - 13 | + 4 | - 13 | + 11 | -- |

Foreign exchange market. Despite international political developments, spot sterling fluctuated over a narrow range between October 1 and November 9. The rate ranged around $2.8024 during the middle of October. (See Table 7.) During the Cuban crisis, the spot rate fell from $2.8022 on October 22 to only $2.8010 on October 24. The demand for forward sterling increased, reducing the forward discount from 0.54 per cent on October 19 to a low of 0.27 per cent on October 24. This made possible some covered arbitrage movements of funds from the U.S., as has been pointed out above. The forward discount remained low, in relation to the U.K. - U.S. Treasury bill interest differentials, and provided an incentive to move funds to London in the early part of November.

Security sterling, which had remained steady at $2.79875 throughout September and early October, declined by one cent during the Cuban crisis. It recovered to $2.79250 on October 30 and remained at that level through November 8.

Bullion market. In the first three weeks of October, the market was generally quiet, but very heavy purchases of gold were made between October 22 and 24, the critical days of the Cuban crisis. The Financial Times (November 3, 1962) estimates turnover in the London gold market to have been about 60 tons or roughly $60 million on these days. There was substantial official support of the market on these days. The demand for gold subsided on October 25 and 26; and on October 29, there was almost complete absence of trading. The market was quiet in the first two weeks of November.

Table 7. United Kingdom: Fixing Price for Gold Bullion
(in U.S. dollars per fine ounce)

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| August | 24 | 35.127 | September | 21 | 35.138 | October | 19 | 35.138 |
| | 31 | 35.127 | | 28 | 35.126 | | 26 | 35.177 |
| September | 7 | 35.129 | October | 5 | 35.130 | November | 2 | 35.123 |
| | 14 | 35.158 | | 11 | 35.137 | | 9 | 35.100 |

Prices and wages. During the third quarter, British wholesale and export prices remained at the end of June level while the cost of living and import price indexes actually declined by 1 point. (See Table 6.) The fall in food prices over the summer months from the abnormal levels reached last spring was partially offset by higher costs for housing and durable consumer goods. Automobile manufacturers have recently announced minor increases in new model cars. On the wage front, weekly wage rates rose from 113 in June to 115 in September or about 4-1/2 per cent above the level for September 1961. (See Table 8.)

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

| | Wholesale Prices: Home Market Sales | Cost of Living | Export Prices | Import Prices | Terms of Trade 1/ | Weekly Wage Rates |
|---|---|---|---|---|---|---|
| 1960 - Sept. | 102 | 101 | 102 | 99 | 103 | 106 |
| Dec. | 103 | 103 | 101 | 99 | 102 | 107 |
| 1961 - Mar. | 104 | 103 | 102 | 98 | 104 | 109 |
| June | 104 | 105 | 102 | 99 | 103 | 110 |
| Sept. | 105 | 106 | 102 | 96 | 106 | 110 |
| Dec. | 106 | 107 | 103 | 97 | 106 | 111 |
| 1962 - Mar. | 107 | 108 | 103 | 97 | 106 | 112 |
| June | 107 | 111 | 103 | 97 | 106 | 113 |
| July | 107 | 110 | 103 | 96 | 107 | 114 |
| Aug. | 107 | 110 | 103 | 96 | 107 | 115 |
| Sept. | 107 | 110 | n.a. | n.a. | n.a. | 115 |

1/ The ratio of export prices to import prices.

Europe and British Commonwealth Section.

II. Nine Charts on Financial Markets Abroad

Chart 1 - Interest Arbitrage, United States/Canada
Chart 2 - Interest Arbitrage, New York/London
Chart 3 - Interest Arbitrage for German Commercial Banks
Chart 4 - Interest Arbitrage, Frankfurt/London
Chart 5 - Short-term Interest Rates
Chart 6 - Long-term Bond Yields
Chart 7 - Industrial Stock Indices
Chart 8 - Spot Exchange Rates -- Major Currencies Against U.S. Dollar
Chart 9 - 3-month Forward Exchange Rates

Table 9. United Kingdom: Treasury Bill Yields and Exchange Rates

| | | 3-mo. Treasury bill arbitrage calculation | | | | | Spot pound (U.S. cents) | London deposit rates | |
|---|---|---|---|---|---|---|---|---|---|
| | | U.K. | U.S. | Difference | 3-mo. pound a/ | In favor U.K. bill | | U.S. dollar (3-mo.) | Local authority |
| 1961 - | High | 6.74 | 2.74 | 4.45 | -0.79 | 1.13 | 281.62 | 4.00 | 7.50 |
| | Low | 4.17 | 2.16 | 1.88 | -4.36 | -2.12 | 278.47 | 3.13 | 6.00 |
| Aug. | 3 | 3.75 | 2.82 | 0.93 | -0.76 | +0.17 | 280.56 | 3.81 | 4.62 |
| | 10 | 3.69 | 2.83 | 0.86 | -0.77 | +0.09 | 280.51 | 3.78 | 4.56 |
| | 17 | 3.69 | 2.83 | 0.86 | -0.73 | +0.13 | 280.48 | 3.72 | 4.44 |
| | 24 | 3.69 | 2.82 | 0.87 | -0.61 | +0.26 | 280.26 | 3.72 | 4.38 |
| | 31 | 3.69 | 2.80 | 0.89 | -0.63 | +0.26 | 280.18 | 3.81 | 4.38 |
| Sept. | 7 | 3.66 | 2.79 | 0.87 | -0.60 | +0.27 | 280.14 | 3.84 | 4.38 |
| | 14 | 3.63 | 2.78 | 0.85 | -0.51 | +0.34 | 280.12 | 3.93 | 4.31 |
| | 21 | 3.63 | 2.73 | 0.90 | -0.57 | +0.33 | 280.11 | 3.94 | 4.31 |
| | 28 | 3.56 | 2.74 | 0.82 | -0.56 | +0.26 | 280.11 | 3.81 | 4.56 |
| Oct. | 5 | 3.55 | 2.76 | 0.79 | -0.57 | +0.22 | 280.10 | 3.81 | 4.31 |
| | 11 | 3.53 | 2.77 | 0.76 | -0.62 | +0.14 | 280.24 | 3.91 | 4.25 |
| | 19 | 3.69 | 2.74 | 0.95 | -0.54 | +0.41 | 280.24 | 3.91 | 4.19 |
| | 26 | 3.78 | 2.73 | 1.05 | -0.31 | +0.74 | 280.04 | 4.13 | 4.31 |
| Nov. | 2 | 3.78 | 2.83 | 0.95 | -0.41 | +0.54 | 280.12 | 4.19 | 4.31 |
| | 9 | 3.72 | 2.80 | 0.92 | -0.40 | +0.52 | 280.15 | 4.06 | 4.31 |

a/ Market quotation for Friday.

Table 10. 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 |
| June | 21 | 4.62 | 6.22 | 6.20 | 6.36 | 6.21 | 5.98 | 0.23 | 261.4 |
| Aug. | 16 | 4.12 | 5.68 | 5.95 | 5.97 | 5.82 | 5.54 | 0.28 | 281.5 |
| | 23 | 4.12 | 5.65 | 5.95 | 5.92 | 5.79 | 5.50 | 0.29 | 283.8 |
| | 30 | 4.10 | 5.64 | 5.85 | 5.83 | 5.70 | 5.59 | 0.11 | 279.4 |
| Sept. | 6 | 4.03 | 5.52 | 5.85 | 5.80 | 5.65 | 5.64 | 0.01 | 276.4 |
| | 13 | 4.03 | 5.49 | 5.85 | 5.88 | 5.73 | 5.69 | 0.04 | 274.0 |
| | 20 | 4.02 | 5.22 | 5.80 | 5.75 | 5.55 | 5.66 | -0.11 | 275.3 |
| | 27 | 3.98 | 4.98 | 5.80 | 5.70 | 5.51 | 5.78 | -0.27 | 269.8 |
| Oct. | 4 | 4.03 | 4.79 | 5.75 | 5.75 | 5.56 | 5.59 | -0.03 | 278.7 |
| | 11 | 4.10 | 4.80 | 5.75 | 5.80 | 5.61 | 5.65 | -0.04 | 275.8 |
| | 18 | 4.14 | 4.82 | 5.65 | 5.69 | 5.51 | 5.65 | -0.14 | 276.0 |
| | 25 | 4.26 | 5.16 | 5.80 | 5.91 | 5.77 | 5.76 | 0.01 | 270.7 |
| Nov. | 1 | 4.21 | 5.03 | 5.75 | 5.81 | 5.70 | 5.64 | 0.06 | 276.2 |
| | 8 | 4.12 | 5.00 | 5.70 | 5.76 | 5.63 | 5.46 | 0.17 | 285.3 |

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

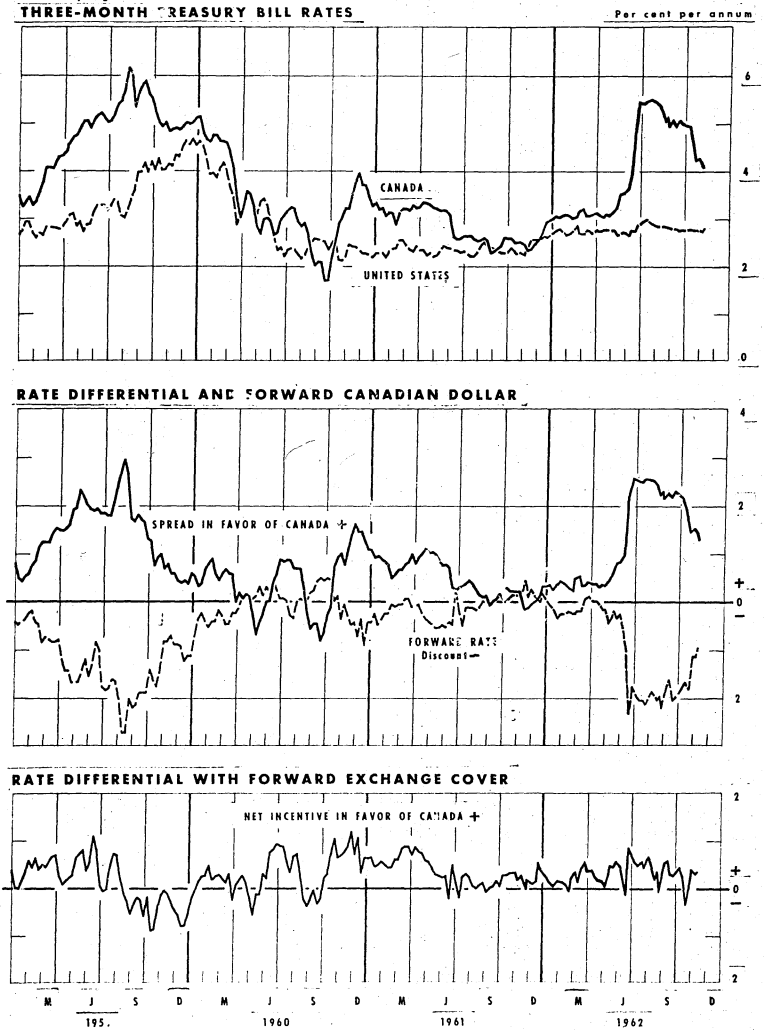


Chart 2

**INTEREST ARBITRAGE, NEW YORK/LONDON**

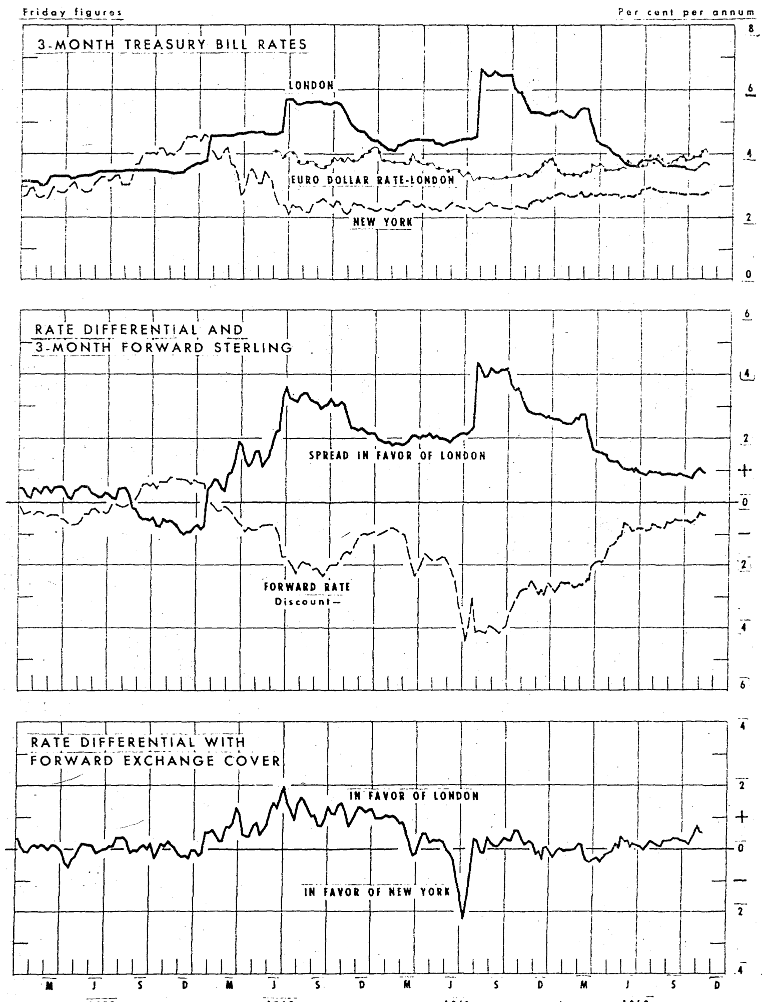
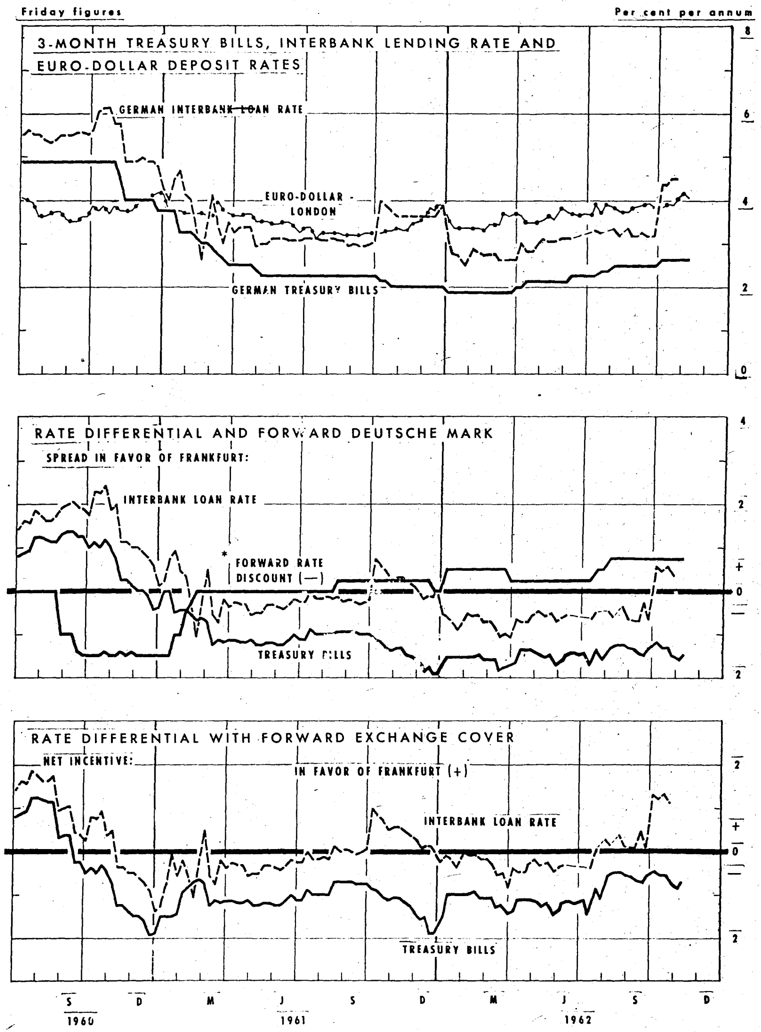


Chart 3

**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**

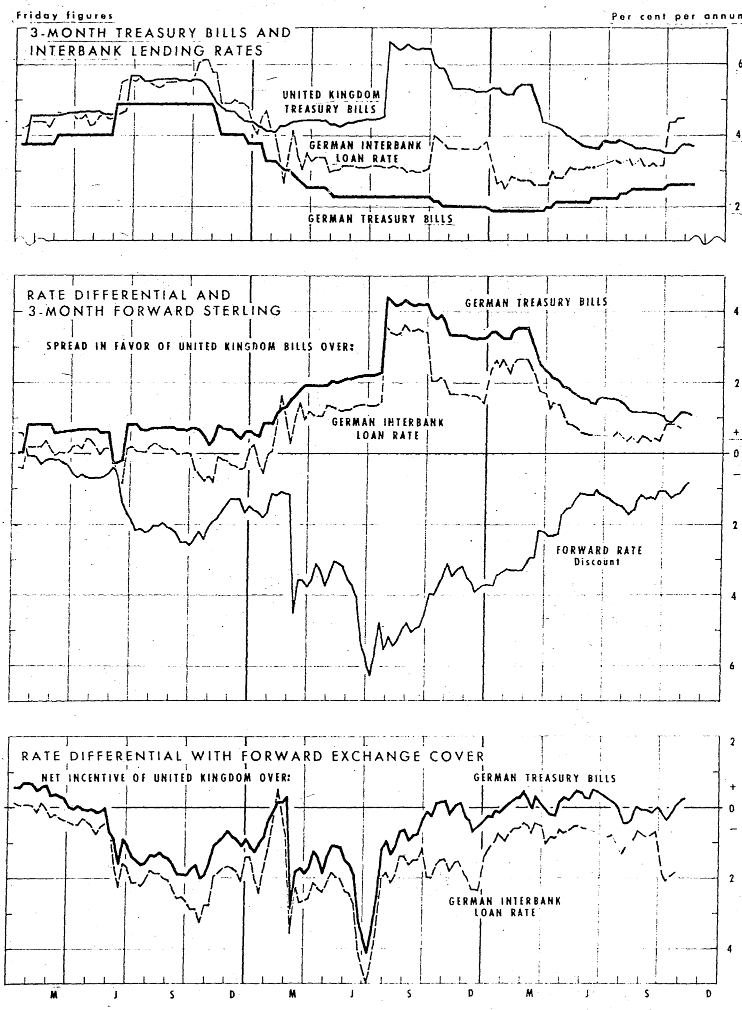
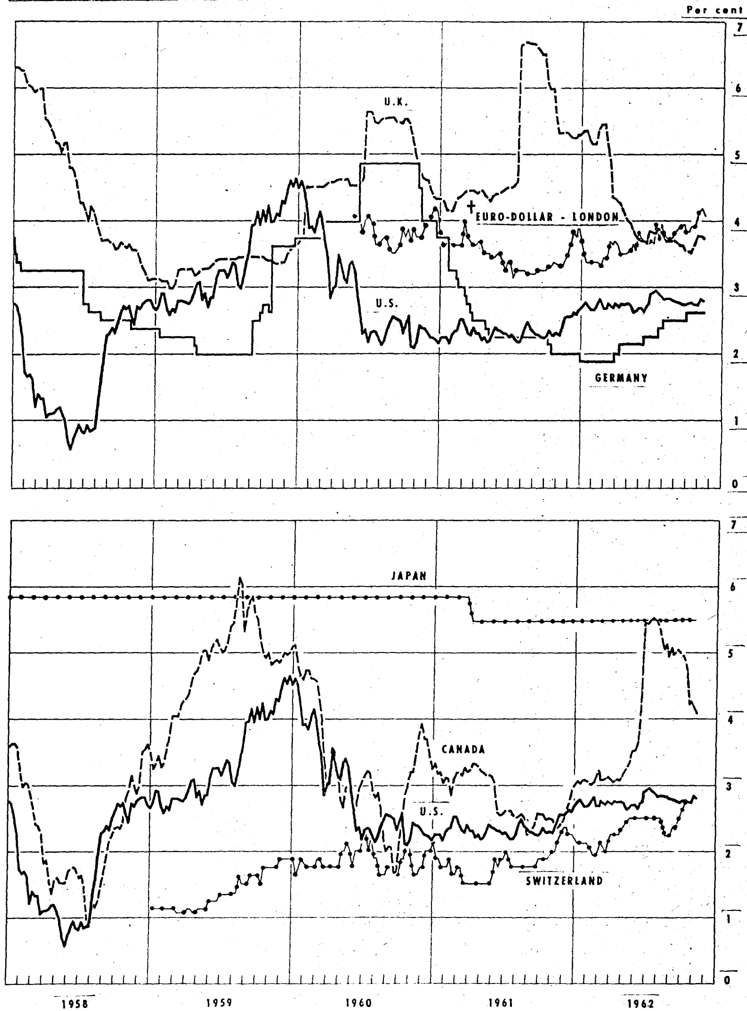


Chart 5

**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**

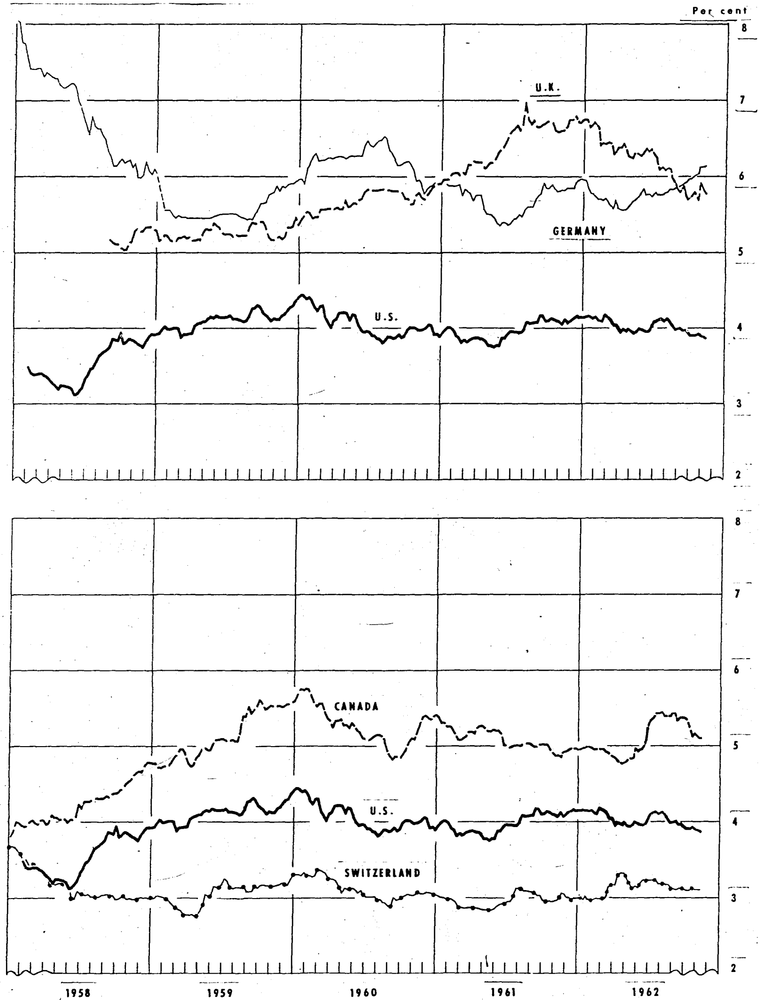
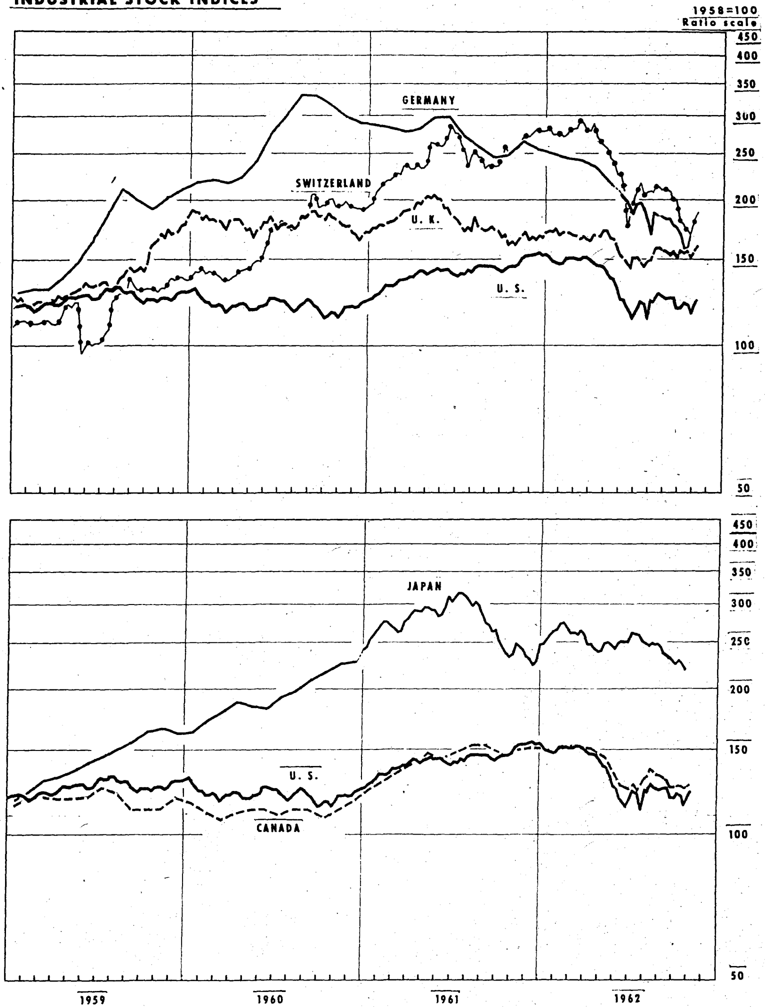


Chart 7

**INDUSTRIAL STOCK INDICES***




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

Chart 8
SPOT EXCHANGE RATES - MAJOR CURRENCIES AGAINST U.S. DOLLAR

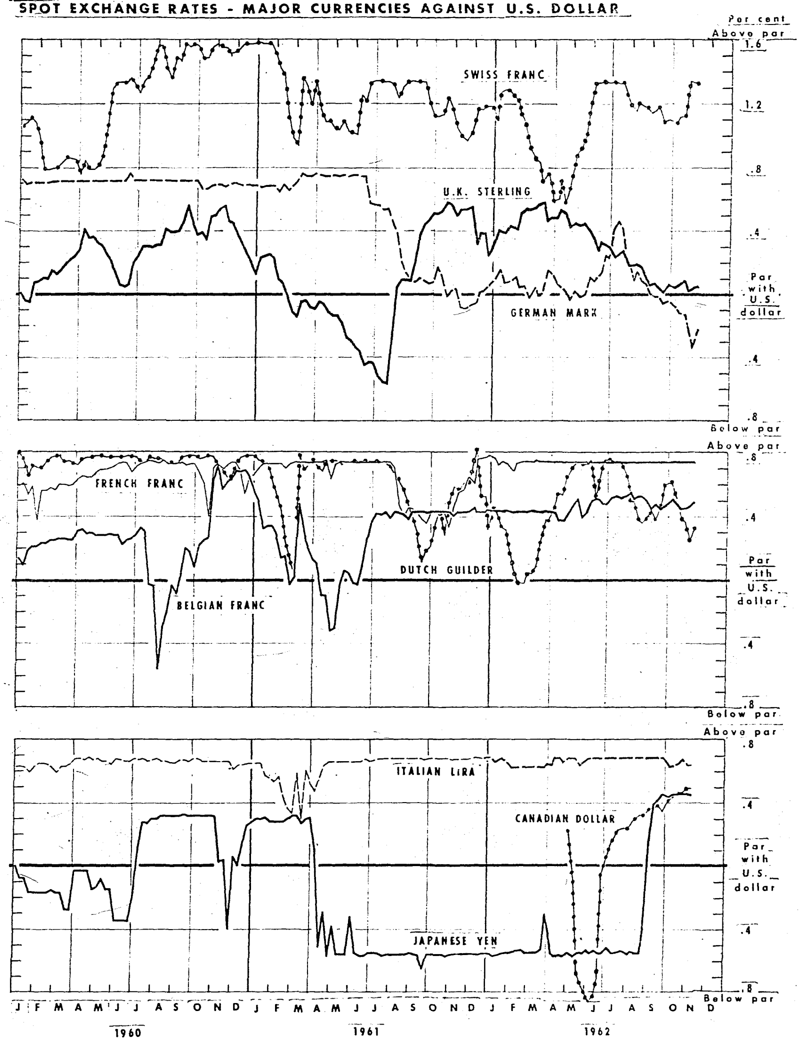


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Chart 9

## 3-MONTH FORWARD EXCHANGE RATES