

MAY 31 1963

H. 13
No. 107

FEDERAL RESERVE BANK
OF RICHMOND

May 22, 1963

CAPITAL MARKET DEVELOPMENTS ABROAD

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

I. United Kingdom: Money and Capital Markets in April and Early May, 1963

Financial markets in Britain in April and early May responded favorably to the expansionary budget introduced on April 3. Despite prospective Treasury borrowing requirements of £687 million for the coming 12 months, yields in the Treasury bill and government bond markets eased appreciably. On May 20, in fact, the Bank of England sought to counter the decline in the Treasury bill rate by forcing some discount houses to borrow moderate sums at Bank rate (but not at the new "penalty" lending rate). Between mid-March and mid-May, yields on government bonds declined between 15 and 41 basis points.

Table 1. United Kingdom: Selected Securities Yields, 1963
(per cent per annum)

	Change in yields		Yields
	Jan. 3 to March 7	March 7 to May 16	May 16, 1963
Treasury bills a/	-0.21	b/-0.16	a/3.56
4-1/2% Conversion stock 1964	+0.06	-0.15	3.93
3% Savings Bonds 1965-75	+0.35	-0.24	5.15
5-1/2% Treasury stock 2008-12	+0.30	-0.28	5.63
3-1/2% War loan	+0.62	-0.41	5.65

a/ Friday, after tender market rate.

b/ May 22. The bill rate rose from 3.31 to 3.72 per cent from March 18 to March 22 in response to the Bank of England's lending to the discount houses on March 19 at a rate 1/2 per cent higher than Bank rate.

On an adjusted basis, Britain reported reserve accruals of \$26 million in April compared with losses of \$300 million for February and March. In the foreign exchange market, the spot pound fluctuated narrowly around \$2.80 but the discount on the 3-month pound declined from 1.31 per cent (per annum) on March 29 to 0.69 per cent on May 17. Favorable export figures for March were followed by a drop in export sales and a much wider foreign-trade deficit in April.

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The British authorities took further steps in April and May to attract foreign funds to London markets as an integral part of the program to finance the 1963-64 Treasury deficit. The Bank of England announced a £400 million 5 per cent bond, 1976-78, at a price of 96 on April 17; this issue is exempt from withholding tax for non-residents and is available in bearer form. This flotation may help to pump additional funds into financial markets because two large issues, with a combined par value of nearly £1,000 million, mature in mid-June:

June 14: £341 million of a 3 per cent bond, 1962-63
June 15: £653 million of a 4-3/4 per cent bond, 1963

After these maturities, the next Treasury bonds to be refinanced are:

1964 May 14: £505 million 4-1/2 per cent bond, 1964
May 14: £274 million 2-1/2 per cent bond, 1963-64
1965 Feb. 1: £391 million 4 per cent bond, 1965
Aug. 15: £713 million 3 per cent bond, 1955-65.

At the same time, the Treasury has made non-marketable small savers bonds more attractive to private investors by offering a 4-1/2 per cent Defense Bond to holders of a 3-1/2 per cent Bond maturing in September. Sales of non-marketable Treasury bonds amounted to £180 million in 1962-63 and to just over £250 million in 1961-62.

The authorities also authorized three measures which will help to build up London's role as an international capital market and as a market for U.S. dollar financing:

a. A consortium of British investment banks was permitted to make a \$20 million 5 per cent loan to the Belgian government maturing in 1966. This loan was made with short-term Euro-dollar deposits. This was the first foreign currency loan made in London since World War II.

b. A British investment trust, British Assets Trust, was given permission to borrow \$10 million in New York for investing in U.S. securities. This arrangement represents a major change in British policy towards portfolio investment outside the sterling area. Until now, funds for this purpose were available only by drawing on the supplies of the "investment dollar," which has been depleted since May 1962 by withdrawals for direct investment abroad. Consequently, sterling has been at a discount of up to 10 per cent in this market. After this borrowing arrangement was approved, the investment dollar premium fell from 10 to 7-1/4 per cent.

c. The London capital market was opened to all EFTA countries. However, since the Scandinavian countries previously had access to the London market and Switzerland and Sweden are unlikely to make use of these facilities, market reports suggest that the only additional potential new customers may be Austria and Portugal.

Money market. The Treasury Bill rate fell to 3.65 per cent at the May 17 tender after remaining above 3.73 per cent since the latter part of March. (See Table 8 and Chart 2.) This tender rate was the lowest since the discount houses were forced to borrow from the Bank of England at 1/2 per cent above Bank rate on March 19. The higher bid by the market undoubtedly reflected the competition for bills from other investors: between April 26 and May 10, the discount houses averaged about 20 per cent of bills allotted compared with a more normal figure of over 40 per cent. Probably to counter the easing in yields, on May 20 the Bank of England forced some discount houses to borrow a moderate amount at Bank Rate.

In the local authorities funds market, the three-months deposit rate remained at 4.56 per cent throughout April, some 20 basis points above the rate prevailing at the beginning of the year. (See Table 8.) In part this was due to strong demand for funds during most of the month. Treasurers had to compete for funds with finance houses which were at times offering 4-3/4 per cent. The supply of funds at the end of March and during the first half of April was reduced owing to the rates for sterling deposits in Paris rising above 5 per cent. Towards the end of April, when the Euro-sterling rate weakened, there was a return of funds to London. (See Table 2.) In May, the short-term rates eased to 4.44 per cent on May 17. During this period, there was no covered incentive for shifting funds from Euro-dollar deposits in London to local authorities deposits, even after the forward discount on sterling was reduced.

The rates on Euro-dollar deposits rose steadily from the latter part of April through mid-May, going from 3.60 per cent on April 19 for three-month funds to 3.84 per cent on May 17. (See Table 8 and Chart 5.) According to The Times (May 7, 1963, p. 16), this reflected tight money market conditions in various European financial centers and a renewed demand for Euro-dollar loans by Italian banks.

Table 2. Euro-Sterling Deposit Rates as Compared
With U.K. Local Authorities Deposit Rates
(in per cent per annum)

	<u>Mar. 22</u>	<u>Apr. 5</u>	<u>Apr. 11</u>	<u>Apr. 26</u>	<u>May 17</u>
Sterling deposit rate in Paris (3-month)	5.38	4.94	4.82	4.63	4.63
Local authorities deposit rate in London (3 months)	<u>4.44</u>	<u>4.56</u>	<u>4.56</u>	<u>4.56</u>	<u>4.44</u>
Differential on favor of Paris	+0.94	+0.38	+0.26	+0.07	+0.19

Gilt-edged market. Confidence that the Government will be able to carry out its program of economic expansion without inflation or recourse to a high-interest policy to preserve the balance of payments is reflected in a steady rise in government securities prices since mid-March. On May 7, the Financial Times government securities prices reached the early-January level of 86.3 from the recent bottom of 82.1 touched during the March speculative flurry against sterling. The yield on consols and some long-dated issue fell by 30 basis points from April 4 to May 16. (See Table 9 and Chart 6.)

Stock market. Stock prices declined in April for a week after the budget message, partly in reaction to the sudden spurt in prices in the preceding week and partly owing to genuine disappointment among many investors that the budget was not as expansionary as had been expected. (See Table 8 and Chart 7.) However, prices rose sharply just before and after the Easter holiday. Trading was slow during the first week in May, but the market remained firm with the Financial Times industrial ordinary index fluctuating around 312. On May 3 it rose to 315, the highest level since August 1961.

London clearing banks. The rate of increase in bank advances to the private sector slowed down in the month ending April 17. Advances, other than to the nationalized industries, rose by only £28 million in contrast with the large increases for February and March. (See Table 3.) The Banker reports that ". . . the banks are now tending to assume that . . . tax transfers and some technical factors must have been responsible for a much bigger part of the February and March movement than had been supposed at the time!" (May 1963, p. 300). Bank liquidity remained a problem in mid-April: the Bank of England had to give its tacit approval to two banks for liquidity ratios of less than 30 per cent. The liquidity ratio for the clearing banks as a whole remained at 30.5 per cent for the second consecutive month.

Table 3. United Kingdom: London Clearing Banks, Net Deposits and Selected Assets
(in millions of pounds)

	C h a n g e s					Outstanding Apr. 17, 1963
	1961-62 ^{a/}	1962-63 ^{a/}	1 9 6 3			
			Feb.	Mar.	Apr.	
<u>NET DEPOSITS</u>	+106	+258	-203	+ 9	- 62	6,446
<u>SELECTED ASSETS</u>						
1. Claims on Public Sector	+ 33	+ 30	-387	-151	- 20	2,592
Government securities	- 90	+137	- 76	- 35	- 33	1,088
Treasury bills and call loans	b/+120	-118	-332	-105	+ 28	1,443
Loans to nationalized industries	+ 3	+ 11	+ 21	- 11	- 15	61
2. Claims on Private Sector	+117	+491	+180	+146	+ 31	4,217
Advances (net)	b/ 58	+453	+164	+117	+ 28	3,791
Other	59	+ 38	+ 16	+ 29	+ 3	426
3. Special Deposits at Bank of England	+ 77	-220	--	--	--	
<u>LIQUIDITY RATIO</u>	c/33.6	33.0	31.5	30.5	30.5	

a/ Fiscal years ending mid-March. Bank balance sheets are normally prepared for the third Wednesday of each month.

b/ Adjusted for the reclassification of £40 million from advances to money on call in October 1961.

c/ Monthly averages.

Installment credit. New credit extended by hire purchase finance companies rose sharply in March after being depressed by the bad weather in January and February. (See Table 4.) Credit extended for the purchase of new cars rose by 45 per cent. The new business of household goods shops expanded in March, but it is not clear whether this was entirely a seasonal development. Total outstanding installment debt rose by £3 million to £875 million.

Table 4. United Kingdom: Installment Credit

	1962		1963			Outstanding January 1963
	Jan.- June	July- Dec.	Jan.	Feb.	Mar.	
	New credit extended, index of value (1957=100)					
Household goods shops	99	123	98	93	99	--
Finance houses	147	133	115	116	164	--
Credit outstanding (In millions of pounds)						
Household goods shops	- 15	+ 24	- 2	- 3	- 2	311
Finance houses	- 25	- 24	- 7	- 3	+ 5	564
Total	- 40	--	- 9	- 6	+ 3	875

Foreign trade. While the April trade returns were not expected to be as favorable as those for March, the widening of the trade gap to £56 million was regarded as disappointing. (See Table 5.) Exports dropped to the third quarter 1962 level while imports rose slightly. However, the average of the February through April figures show that exports are approximately 3 per cent above the third quarter 1962 level. The sharp rise in March exports is attributed mainly to machinery and transportation equipment.

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

	1962			1963		
	Apr. June	July Sept.	Oct. Dec.	Feb. Apr.	Mar.	Apr.
	Imports c. i. f.	-373	-385	-374	384	-384
Exports f. o. b.	319	320	318	330	349	320
Re-exports f. o. b.	14	12	14	13	12	13
Balance	- 40	- 52	- 42	- 41	- 23	- 56

Foreign exchange market. Speculative pressure on sterling eased in the six weeks from early April through mid-May. This is evidenced by a closing of the forward discount from 1.09 per cent on April 5 to 0.69 per cent on May 17. (See Table 8 and Chart 8.) The spot rate fluctuated narrowly around \$2.80.

The premium on the "investment dollar" (foreign-currency assets held by U.K. residents that is available for purchases of foreign securities) fell on May 15 and 16 from around 10 per cent to around 7-1/4 per cent after the British Asset Trust was given permission to borrow in New York to finance the purchase of securities in the New York stock exchange. There was substantial selling of investment dollars when investors realized that it is now possible, under certain conditions, for investment trusts to avoid the investment dollar market by borrowing in New York. The current investment dollar premium is the lowest since mid-February.

The "security" sterling rate remained fairly stable during April and the first half of May, fluctuating around 279.25 cents per pound.

Gold and foreign exchange reserves. With the ending of speculative pressure on sterling, official reserves rose by \$34 million. (See Table 6.) Reserves in April would have increased by an additional \$5 million in the absence of the Argentine sterling drawing from the IMF, but they would have increased \$13 million less in the absence of the Australian repurchase from the IMF. Reserves, adjusted for these sterling transactions of the IMF, increased by \$26 million.

The May issue of the U.K. Treasury's release Financial Statistics shows gold holdings at the end of year since 1955 and quarterly for 1961 and 1962. On December 31, 1962, 92 per cent of Britain's reserves was in gold.

Table 6. United Kingdom: Gold and Foreign Exchange Reserves
(in millions of U.S. dollars)

	1962		1963				Outstanding Apr. 30, 1963
	Jan.- June	July- Dec.	Jan.	Feb.	Mar.	Apr.	
Gold and convertible currency	+115	-626	+59	- 67	+ 17	+34	2,644
Adjusted for special transactions	+690	- 20	+59	-117	-183	+26	--

Bullion market. The demand for gold eased in April, as is indicated by the decline in the fixing price for gold. (See Table 7.) There was some buying before the long Easter weekend, but the rate dropped appreciably around April 17. Some Russian sales also served to depress the market during the latter part of the month. From May 14-20, there was some speculative purchases of gold, but the ultimate source of the demand is unknown. However, the fixing price on May 17 remained well below the early March level, the previous period of speculative gold purchases.

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

March 1	35.075	March 29	35.111	April 26	35.082
8	35.102	April 5	35.103	May 3	35.076
15	35.108	11	35.120	10	35.076
22	35.101	19	35.091	17	35.083

Europe and British Commonwealth Section.

Table 8. United Kingdom: Treasury Bill Yields and Exchange Rates

	3-mo. Treasury bill arbitrage calculation					Spot pound (U.S. cents) ^{b/}	London deposit rates	
	U.K.	U.S.	Difference	3-mo. pound ^{a/}	In favor U.K. bill		U.S. dollar (3-mo.)	Local authority
1962 - High	3.78	2.73	1.05	-0.31	0.74	281.75	4.13	4.87
	Low	4.25	2.74	1.51	-1.92	279.97	3.44	4.19
Feb. 1	3.37	2.91	0.44	-0.71	-0.25	280.37	3.56	4.31
	8	3.41	2.93	0.48	-0.69	280.33	3.56	4.31
	15	3.34	2.92	0.42	-0.67	280.29	3.53	4.25
	21	3.34	2.86	0.48	-0.79	280.30	3.44	4.31
Mar. 1	3.34	2.90	0.44	-0.53	-0.11	280.25	3.53	4.31
	8	3.31	2.86	0.45	-0.81	280.05	3.63	4.31
	15	3.31	2.85	0.46	-1.08	280.01	3.72	4.44
	22	3.72	2.88	0.84	-1.29	280.00	3.69	4.44
Apr. 5	3.66	2.90	0.76	-1.31	-0.55	279.96	3.69	4.50
	11	3.66	2.89	0.77	-1.09	280.09	3.69	4.56
	19	3.59	2.88	0.71	-1.19	280.07	3.69	4.56
	26	3.59	2.87	0.72	-1.13	280.10	3.66	4.56
May 3	3.66	2.87	0.79	-0.89	-0.10	280.06	3.72	4.56
	10	3.66	2.87	0.79	-0.73	280.97	3.73	4.56
	17	3.63	2.89	0.74	-0.74	280.90	3.81	4.50
		3.56	2.88	0.68	-0.69	280.94	3.84	4.44

a/ Market quotation for Friday. b/ These figures, assembled for arbitrage calculations, are the premiums on the U.S. dollar.

Table 9. 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			
1962 - High	5.85	6.28	6.35	6.77	6.57	5.15	1.42	309.6
	Low	3.90	5.00	5.45	4.80	5.51	-0.27	261.3
Feb. 7	3.83	5.19	5.80	5.90	5.80	5.34	0.46	288.4
	14	3.82	5.25	5.85	5.96	5.83	0.62	295.9
	21	3.84	5.36	5.93	6.04	5.92	0.74	298.2
	28	3.86	5.44	6.00	6.12	5.98	0.94	306.2
Mar. 7	3.85	5.39	5.95	6.06	5.91	5.07	0.84	304.5
	14	3.89	5.42	5.95	6.05	5.91	0.86	305.4
	21	3.97	5.38	5.90	5.95	5.82	0.71	302.0
	28	4.05	5.37	5.87	5.93	5.80	0.75	305.6
Apr. 4	4.01	5.32	5.85	5.90	5.76	5.03	0.73	303.3
	10	3.87	5.27	5.83	5.87	5.72	0.63	304.3
	18	3.80	5.21	5.70	5.75	5.60	0.67	311.3
	25	3.75	5.27	5.73	5.77	5.62	0.71	313.1
May 2	3.65	5.25	5.73	5.74	5.59	4.89	0.70	314.2
	9	3.72	5.23	5.68	5.70	4.95	0.61	310.5
	16	3.70	5.15	5.63	5.65	4.94	0.52	314.1

a/ Financial Times.

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

Chart 1

INTEREST ARBITRAGE, UNITED STATES / CANADA

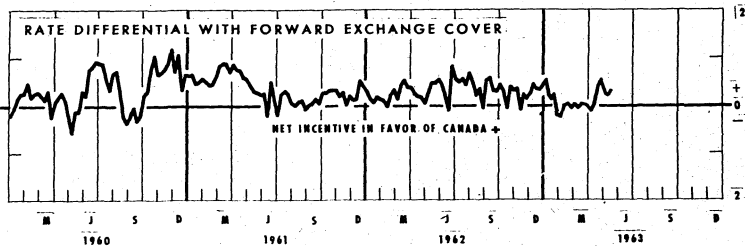
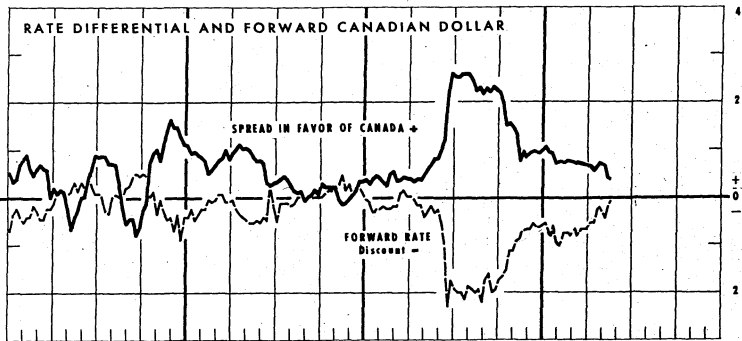
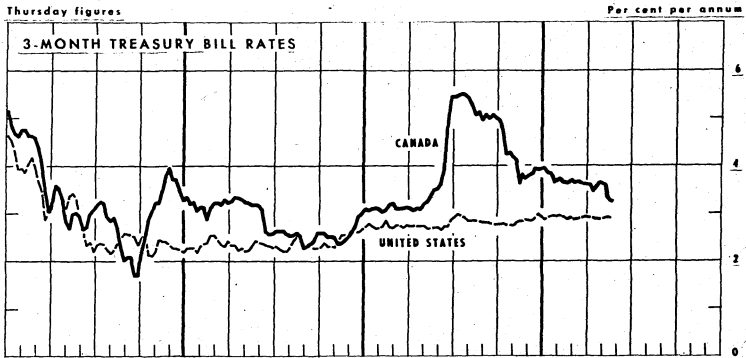


Chart 2
INTEREST ARBITRAGE, NEW YORK/LONDON

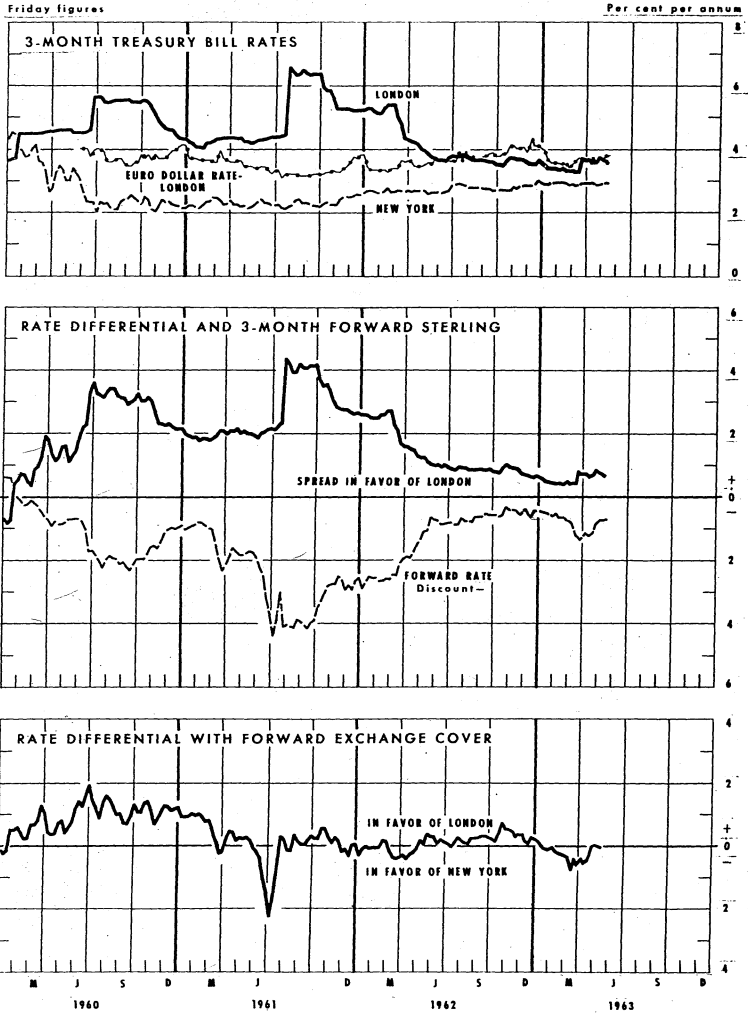
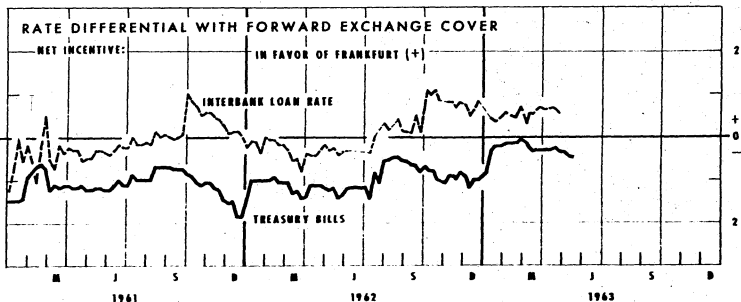
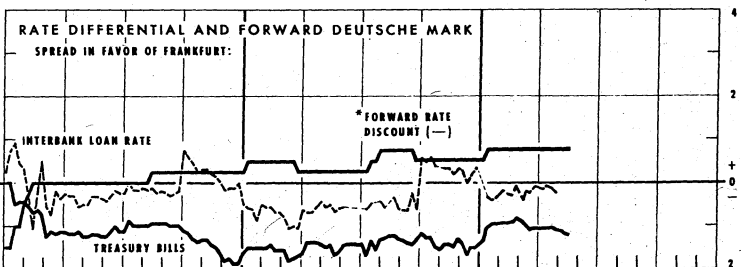
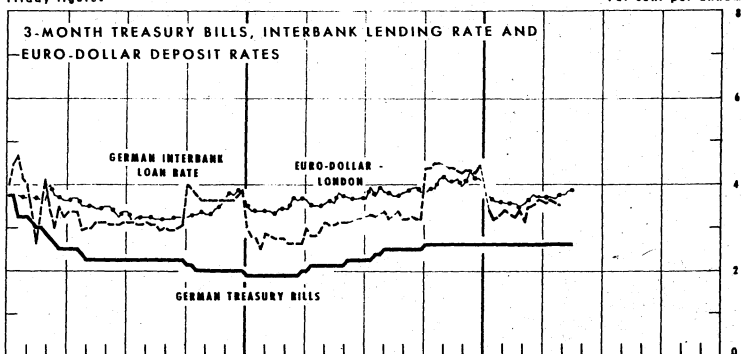


Chart 3

INTEREST ARBITRAGE FOR GERMAN COMMERCIAL BANKS

Friday figures

Per cent per annum



*Note: Special forward rate available to German commercial banks

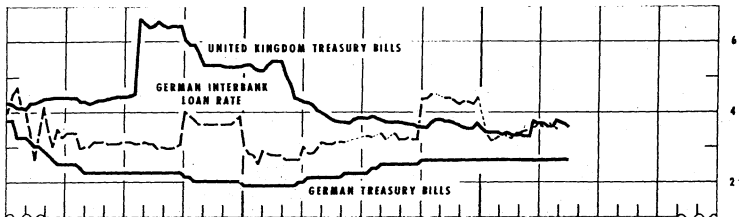
Chart 4

INTEREST ARBITRAGE, FRANKFURT / LONDON

Friday figures

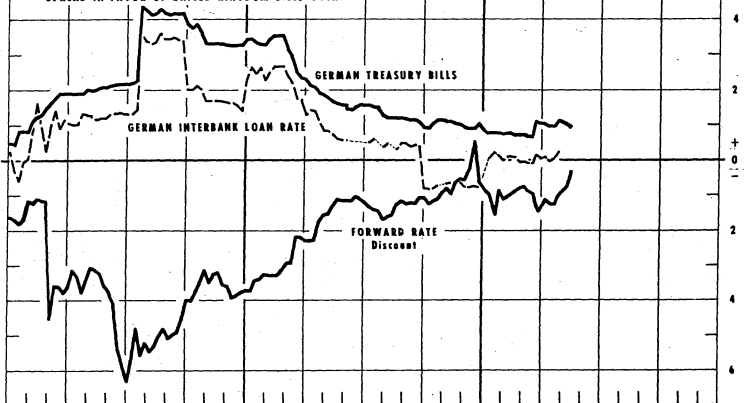
3—MONTH TREASURY BILLS AND INTERBANK LENDING RATES

Per cent per annum



RATE DIFFERENTIAL AND 3—MONTH FORWARD STERLING

SPREAD IN FAVOR OF UNITED KINGDOM BILLS OVER:



RATE DIFFERENTIAL WITH FORWARD EXCHANGE COVER

NET INCENTIVE OF UNITED KINGDOM OVER:

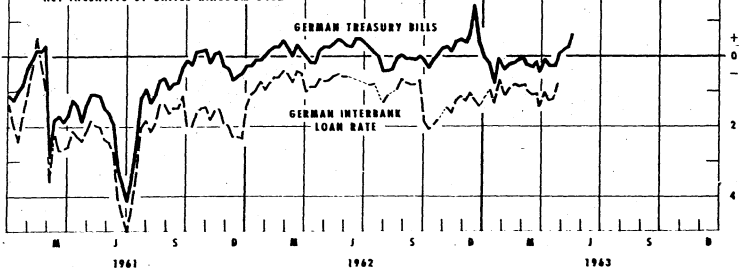
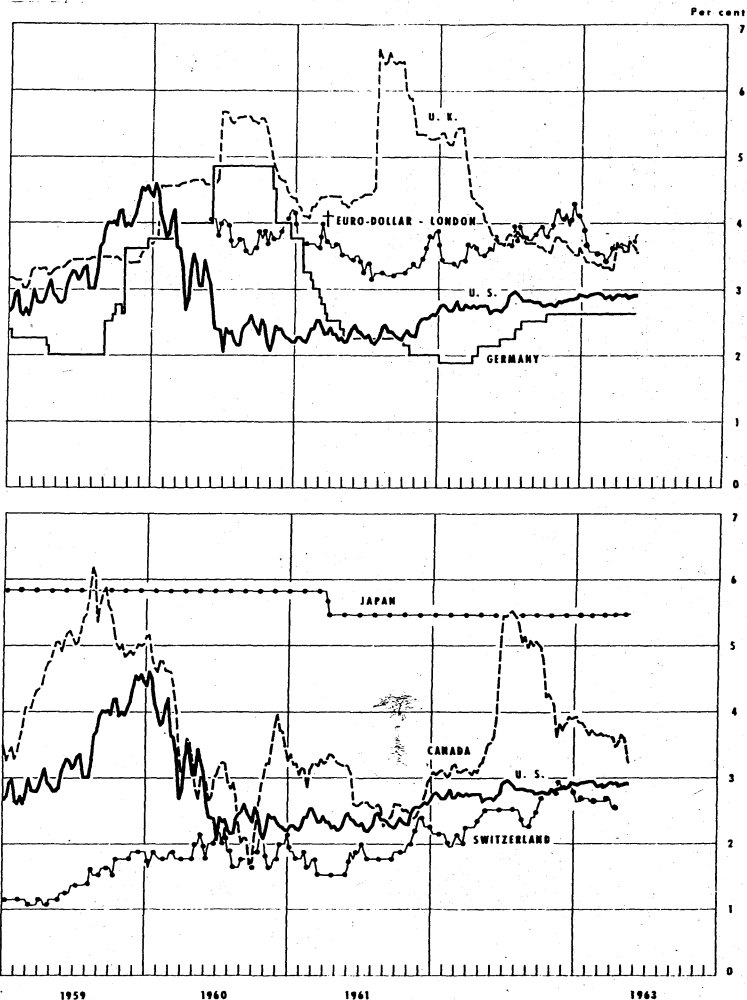


Chart 5
SHORT-TERM INTEREST RATES *



* 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

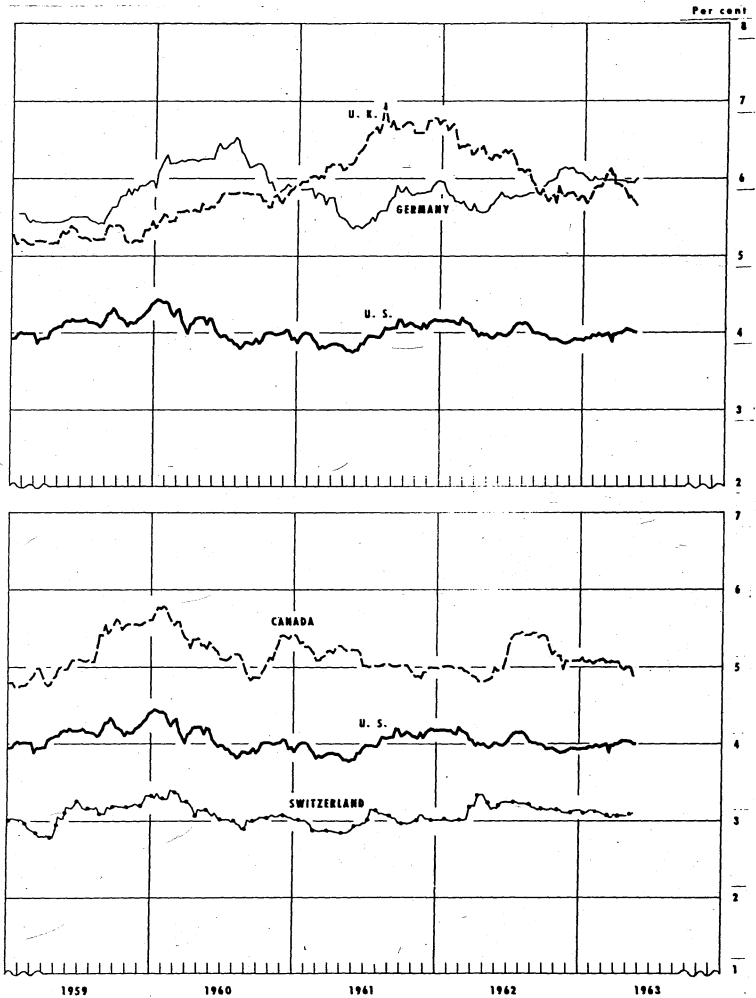
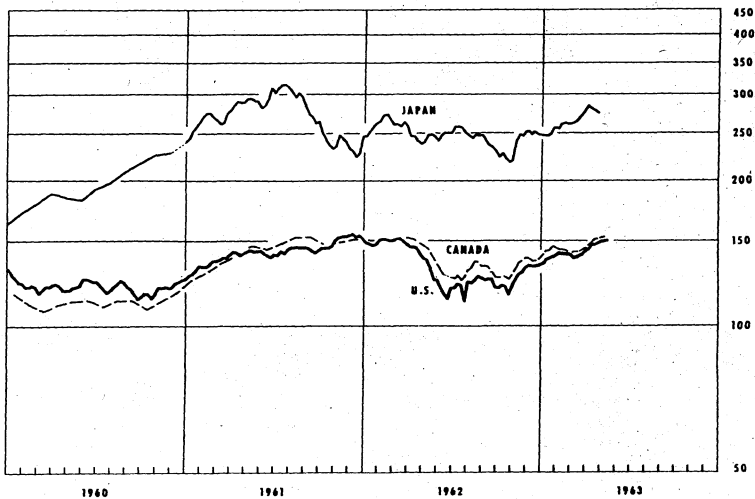
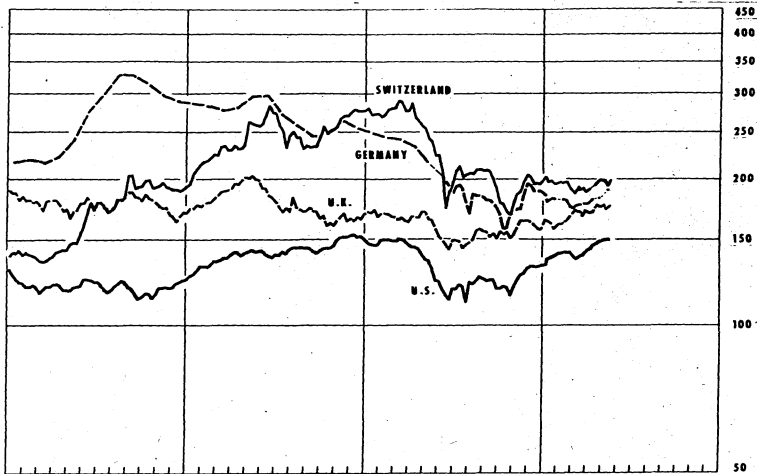


Chart 7

INDUSTRIAL STOCK INDICES*

1958 = 100
Ratio scale



*Note: Japan: index of 225 industrial and other stocks traded on the Tokyo exchange.

Chart 8

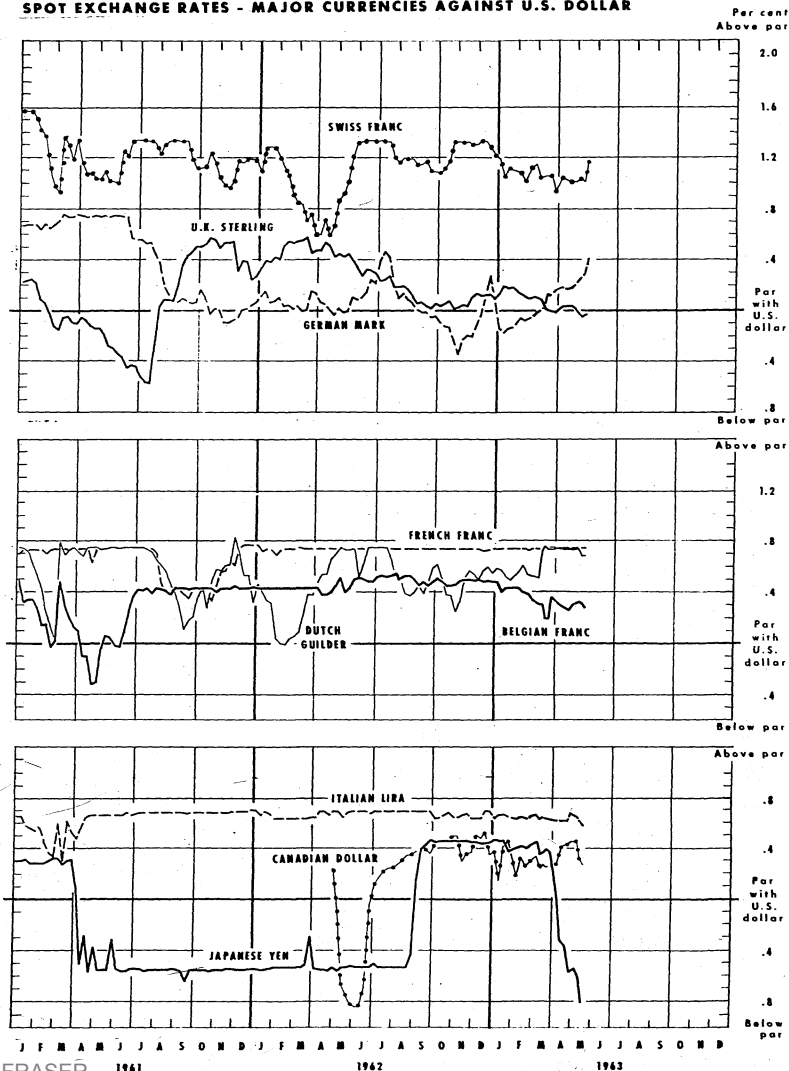
SPOT EXCHANGE RATES - MAJOR CURRENCIES AGAINST U.S. DOLLAR

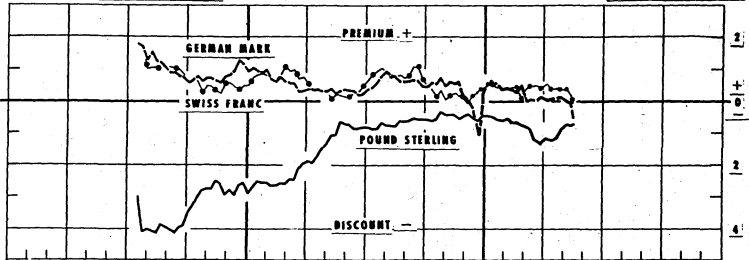
Chart 9

3-MONTH FORWARD EXCHANGE RATE

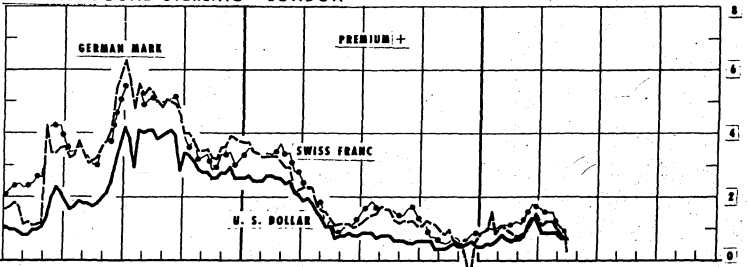
Friday figures

AGAINST U. S. DOLLARS

Per cent per annum



AGAINST POUND STERLING - LONDON



AGAINST POUND STERLING - LONDON

