

H. 13

No. 214

CAPITAL MARKET DEVELOPMENTS ABROAD

- I. United Kingdom  
 II. Nine Charts on Financial Markets Abroad  
 III. Latest Figures Plotted in H.13 Chart Series, 1965

I. United Kingdom: Money and Capital Market Developments  
July-September 1965

During July, renewed pressures on the pound produced a further deterioration of conditions in major British financial markets; but in early August, the demand for gilt-edged securities began to improve and this change in sentiment broadened into a major reversal of trends in other financial markets during September. (See Table 1.) In the shifts of trend between August 6 and September 17, bond yields recovered, in a period of 6 weeks, nearly all the ground lost in the 36 weeks since late November, 1964, when Bank rate was raised to 7 per cent on an emergency basis. Between September 3 and 17 spot sterling advanced 0.66 (U.S. cents) and the prices of industrial stock prices strengthened noticeably.

Table 1. United Kingdom: Selected Financial Market  
Indicators November 1964-September 1965

	Change from				Actual	
	Nov. 27- 1964- Aug. 6- 1965 (36 weeks)	Aug. 6- Sept. 3 (4 weeks)	Sept. 3- Sept. 10 (1 week)	Sept. 10- Sept. 17 (1 week)	Nov. 27 1964	Sept. 17 1965
Interest rates <u>a/</u>						
Bank rates	-100	--	--	--	7.00	6.00
Treasury bills	-108	-3	--	--	6.63	5.52
Government bonds <u>b/</u>						
5% 1971	+90	-28	--	-9	6.02	6.55
3-1/2% 1979-81	+52	-3	-29	-10	6.15	6.25
5-1/2% 2008-12	+50	-22	-13	-12	6.27	6.30
3-1/2% War Loan	+52	-26	-10	-13	6.32	6.35
Stocks <u>b/c/</u>						
Price index	-8.18	-0.40	+0.78	+2.59	109.80	104.59
Share yield <u>a/</u>	+81	+4	-5	-14	5.05	5.71
Exchange rates						
Spot (U.S. cents)	-0.11	+0.16	+0.25	+0.41	279.13	279.84

a/ Changes in interest rates in basis points.

b/ Dates are for the days previous to the ones shown.

c/ Financial Times 500 industrials.

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The first sign of a turnaround in general market sentiment appeared in early August when long-term bond yields began to fall. Yields on the undated War Loan and on the longest dated issues declined rapidly throughout the month. (See Table 1.) This movement probably reflected the anticipated effects of the special measures announced by the authorities on July 27--designed to slow down the growth of public and private investment spending--and the favorable July trade returns. Between August 6 and September 3, prices for the longest dated bonds had recovered almost half the losses registered from the previous November to August 6. However, the tone of the stock and foreign exchange markets remained quite weak until early September.

The improved tone of the gilt-edged market spread to the foreign exchange and industrial stock markets after the Labor government announced on September 2 plans to obtain Parliamentary authority to introduce an "early warning" system on price and wage increases. Under the new legislation, the government would be given authority:

- (a) To require notification of intended price advances and to require notification of claims relating to pay, hours, or other major improvements and prospective terms of settlement;
- (b) To refer such proposed price or wage increases for review by the National Board for Prices and Incomes; and
- (c) To require that such proposed price or wage increases be deferred until after the Board has reported its findings.

Bond yields continued to fall rapidly between September 3 and 10 and there was an improvement in both the price index of industrial stocks and in the spot exchange rate. (See Table 1.)

Conditions in all three markets continued to improve in the following week after the Bank of England announced on September 10 that international central bank credits would be available to support the pound in the event of a future sterling crisis. Both the stock price index and the spot exchange rate rebounded sharply in this week, and bond yields declined further. (See Table 1.)

In other developments, the credit squeeze continues to help keep the cost of short-term funds high and there are some signs that high cost together with reduced availability are restraining the growth of actual credit extensions. Through August, the increase in bank advances--seasonally adjusted--was well within the 5 per cent per year growth limit set by the Bank of England last May and loans by the building societies continued to decline. In July, installment credit extensions eased from the high monthly average for the second quarter. Finally in July, August and September several local authorities temporarily suspended the granting of loans for new house purchases.

Money market conditions remain tight. Money market rates showed mixed movements during the period under review, but market conditions generally remained on the tight side. (See Table 2 and Charts 1 and 5.)

Table 2. United Kingdom: Selected Money Market Rates, July-September 1965  
(per cent per annum)

	August			September		
	<u>30</u>	<u>13</u>	<u>27</u>	<u>3</u>	<u>10</u>	<u>17</u>
Call money	5.38	5.56	5.50	5.56	5.50	5.50
Deposit rates						
Less than 3 days						
Local authority	6.06	6.13	6.31	6.31	6.12	5.94
Euro-\$	4.06	4.12	4.00	4.00	4.00	4.00
90-day						
Local authority	6.50	6.63	6.63	6.56	6.56	6.31
Euro-\$	4.63	4.63	4.44	4.38	4.44	4.44
Treasury bill (market rate)	5.54	5.44	5.47	5.44	5.44	5.44

Call money was in short supply during most of August and the first part of September and rates were continually above their end July levels. The Bank of England periodically made large purchases of Treasury bills to ease market conditions and permit the discount houses to balance their banks. However, loans at Bank Rate were also common, especially in the latter part of August and early September.

The decision to make Bank Rate effective was based upon an easing in the Treasury bill rate. By mid August, the market rate on Treasury bills had slipped from 5.54 to 5.44 per cent and the authorities, not wishing to see the rate fall further, forced the discount houses to borrow at Bank Rate. This action succeeded in pushing the Treasury bill rate to 5.47 per cent on August 27. However, in the following week, the rate fell back to the 5.44 per cent level when the discount houses attempted to raise the proportion of bills allotted to them at the weekly tender.

Local authority deposit rates showed a rising tendency during the period under review, although there was some decline in mid-September. (See Table 2 and Chart 3.) Recently, the authorities have become very active in the market for short-term funds because alternative sources of supply are less adequate now than they were in the April-June period. During the second quarter cash receipts from local taxes were seasonally high; in addition, the authorities borrowed heavily at the Public Works Loan Board--50 per cent of the £360 million allocated for the entire 1966 fiscal year. Although tax receipts data for recent months are not available, they are traditionally lower in the third quarter. Also, the rate of borrowing from the Public Works Loan Board has eased appreciably under the governments program to space out the remaining £180 million over the next three fiscal quarters.

In July and August only £69 million was loaned by the PWLB. Finally, capital issues by local authorities totalled only £14.1 million in July-August compared to £64.5 million for the second quarter.

Owing to the shortage of funds, several local authorities--notably the Greater London Council--have temporarily suspended the granting of new loans for new home purchases. Such suspensions were undertaken around the turn of the year when the authorities were particularly hard hit by foreign deposit withdrawals during the run on sterling.

Conditions in the Euro-dollar market were relatively quiet during the period under review with call rates showing only fractional movements, and rates on 90-day deposits easing slightly. (See Table 2 and Chart 5.)

Capital markets conditions much improved. The tone of British capital markets improved greatly during the period under review. (See Table 1 and Chart 6.) Between August 6 and September 17, government bond yields fell from 37 to 47 basis points and trading activity was much more active than during previous months. In the market for equity shares, the Financial Times index of 500 industrials rose 3.05 points--4.33 points between September 3 and 17--; however trading volume in this market remains at a low level.

The improvement in market sentiment for gilt-edged issues seems to have been started by the governments' measures of July 27, and the favorable trade returns for July. The proposed "early warning system" for price and wage increases, further international support for the pound and the substantially better market confidence in sterling all contributed to the maintenance of this favorable change. Rising stock prices seem to be related much more to the rising fortunes of sterling than to these other developments. Stock prices did not show any inclination to move up until after sterling picture had brightened somewhat.

Private sector borrowing continues to show easing tendency. The growth of borrowing by the private sector continued to ease during the period under review reflecting the tight conditions imposed by the credit squeeze. (See Table 3.)

Bank advances (seasonally adjusted) continue to fluctuate widely from month to month, but it is now clear that the average monthly increase for the second and third quarters of 1965 will be substantially below the increases recorded during the same period in 1964. The total rise since mid-March is well within the five per cent growth ceiling imposed by the Bank of England last May.

Loans by the building societies, on the other hand, have declined steadily since January and the monthly rate this year is appreciably below that for the same period in 1964. The low monthly rate for 1965, is due to the much reduced inflow of net new deposits that the societies experienced early this year. However, this inflow picked up considerably in the June-September period and as a result new loans by the societies can be expected to jump sharply in the remaining months of 1965.

Table 3. United Kingdom: New Borrowing by the Private Sector 1964-1965  
(£ m: monthly or monthly average)

	1964			1965			
	II	III	IV	I	II	July	Aug.
Bank advances <u>a/</u>							
Actual	25	45	35	58	-4	82	-54
Seasonally adj.	35	70	70	-12	5	82	-14
Installment credit <u>b/</u>	18	14	10	8	18	12	n. a.
Net issues of U.K. corp. <u>c/</u>	46	42	27	29	31	52	39
Advances by building societies	90	95	91	78	73	70	67

a/ London clearing banks

b/ Finance houses and department stores.

c/ Net of redemptions.

The growth of consumer credit seems to be responding to the higher minimum downpayment requirements imposed by the Board of Trade last June. Total installment credit outstanding grew by only £12 million in July compared to an average monthly increase of £18 million for the second quarter. A further slow down is to be expected on the basis of reduced maximum repayment periods--from 36 to 30 months--established last July.

In response to the reduced availability of bank credit, U.K. corporations are turning increasingly to the capital market to satisfy their cash needs. New issues net of redemptions grew appreciably in July and August compared to the first two quarters of the year. (See Table 3.)

Foreign trade picture shows little change. Despite record exports in July and August, Britain's foreign trade picture changed little, as these gains were largely offset by further increases in imports. The average monthly trade deficit for these two months (seasonally adjusted on a balance of payments basis) showed no improvement over that for the first 6 months of the year. (See Table 4.)

For the first eight months of 1965, the average monthly rate of exports was 5 per cent higher and imports unchanged compared to all of 1964.

Foreign exchange reserves decline through August. Britain's official holdings of gold and foreign exchange reserves fell by a reported \$207 million in the July-August period, reflecting in large measure the intense selling pressure against sterling during these two months. (See Table 5.) However, during each of these two months the Bank of England utilized an undisclosed amount of assistance under the swap arrangement with the Federal Reserve System.

Table 4. United Kingdom: Foreign Trade 1964-1965  
(£ m: seasonally adjusted; monthly or month average)

	1964	1965				1st 8 months
		I	II	July	Aug.	
Imports (c.i.f.)	475	458	483	484	500	476
Exports (f.o.b.) <u>a/</u>	381	396	393	434	406	400
Difference	-84	-62	-90	-50	-94	-76
Trade balance <u>b/</u>	-46	-13	-40	-1	-51	-26

a/ Includes re-exports.

b/ Adjusted to balance of payments basis.

Table 5. United Kingdom: Official Holdings of Gold and Foreign Exchange 1965  
( \$ m )

	I	II	July	Aug.	Total holdings	
					Aug. 31, 1965	June
Gold and foreign exchange	+14	<u>a/+462</u>	-140	-67.2	2,584.4	-67.2

a/ Of which \$343 m represents residuals of IMF and Swiss credits after repayment of "Basle" type aid.

Sterling exchange rates show sharp improvement. Conditions in the foreign exchange markets for sterling improved greatly throughout September, after periodic and at times quite heavy selling pressure during the previous two months. Between August 27 and September 17, spot sterling rose 82 points to a level of 279.84 (U.S. cents) and the forward discount narrowed sharply from 2.49 to 1.88 per cent per annum. (See Table 6 and Charts 8 and 9.)

Table 6. United Kingdom: Exchange Rates and Arbitrage  
Calculations, July-September, 1965

	July	August		September		
	23	6	27	3	10	17
Exchange Rates						
Spot (U.S. cents)	279.01	279.02	279.02	279.18	279.43	279.84
Fwd. (p.c. p.a.)	-1.98	-2.54	-2.49	-2.59	-2.09	-1.88
Three month yields and yield spreads						
Treasury bills						
U.K. (covered)	3.48	2.92	2.90	2.93	3.27	3.48
U.S.	3.79	3.82	3.83	3.84	3.87	3.86
Difference	-0.31	-0.90	-0.93	-0.91	-0.60	-0.38
Deposit rates						
Local authority (covered)	4.46	4.15	4.14	3.97	4.47	4.43
Euro-dollar	4.56	4.75	4.44	4.38	4.44	4.44
Difference	-0.10	-0.60	-0.30	-0.41	+0.03	-0.01
Euro-dollar <u>a/</u>	4.75	4.69	4.50	4.44	4.44	4.44
New York C.D.'s <u>a/</u> <u>b/</u>	4.28	4.29	4.28	4.31	4.34	4.35
Difference	+0.47	+0.40	+0.21	+0.13	+0.10	+0.09

a/ Previous Wednesday.

b/ New York negotiable certificates of Time deposits.

The substantially better tone of the foreign exchange market seems to be related to two factors. First, on September 2 George Brown, First Secretary of State for Economic Affairs announced that he would propose at the next session of Parliament laws establishing an "early warning" system: for price and wage advances. Secondly, on September 10, the Bank of England announced that it had arranged for further international support for the pound in the event of a future sterling crisis. The significant strengthening of incomes policy together with a multilateral commitment for the support of sterling, should the need arise, apparently squelched devaluation rumors which were wide spread during July and much of August and led to the notable increase in the demand for sterling.

The significant narrowing in the discount on forward sterling in September led to marked changes in arbitrage calculations. (See Table 6.) The covered differentials on Treasury bills favored New York by only 38 basis points on September 17 compared to 90 basis points or more during much of August. In the market for 90-day deposit funds, Euro-dollars were earning anywhere from 30 to 60 basis points more than covered local authority deposits in August; by September 10 the covered differentials actually favored local authority deposits.

In other developments, there was a distinct narrowing in the interest differential between Euro-dollars and New York certificates of deposit. Although the differential still favors Euro-dollars it has declined from 47 basis points on July 23 to 9 basis points on September 17.

Prices of gold fluctuates in the London market. There were wide movements in the London fixing price of gold during the period under review. (See Table 7.)

Table 7. United Kingdom: London Fixing Price for Gold, July-September 1965

	<u>July</u>		<u>Aug.</u>		<u>September</u>		
	<u>2</u>	<u>30</u>	<u>6</u>	<u>20</u>	<u>3</u>	<u>10</u>	<u>17</u>
Dollar price per fine ounce	35.1067	35.1722	35.1939	35.1067	35.1330	35.1368	35.1324

The demand for gold rose sharply between July 2 and August 6 and the price climbed by about 9 cents per ounce to a level of \$35.1939. During this period repeatedly large purchases by Communist China contributed to the price rise.

Throughout much of August the fixing price fell in response to an easing of demand and new supplies, some of which came from the Soviet Union in connection with their wheat purchases from Canada. By August 20 the London price reached \$35.1067.

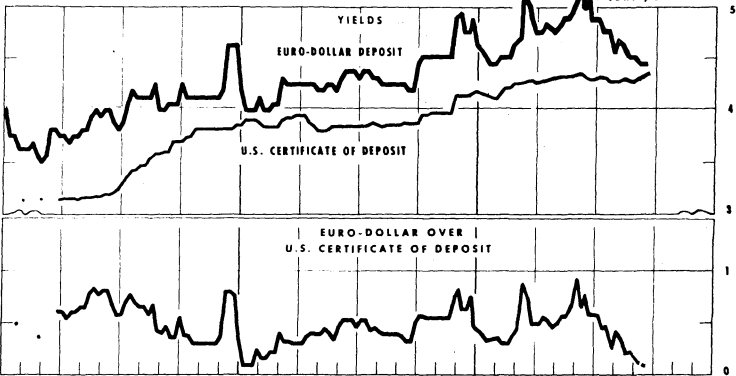
Market conditions were relatively quiet at the end of August and in early September, but the India-Pakistan conflict then stimulated demand and by September 17 the London fixing price had risen to \$35.1324.



Chart 1

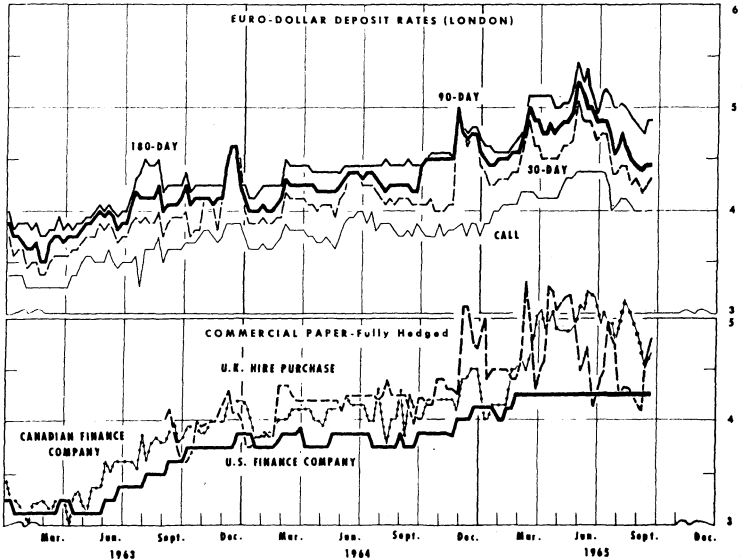
INTERNATIONAL MONEY MARKET YIELDS FOR U.S. DOLLAR INVESTORS

3-MONTH EURO-DOLLAR DEPOSIT VS. CERTIFICATE OF DEPOSIT



SELECTED INTERNATIONAL MONEY RATES

Friday figures



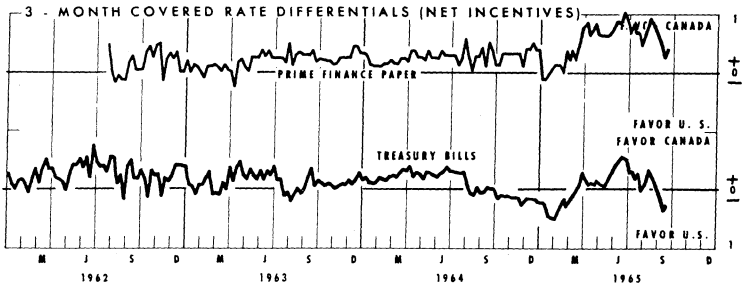
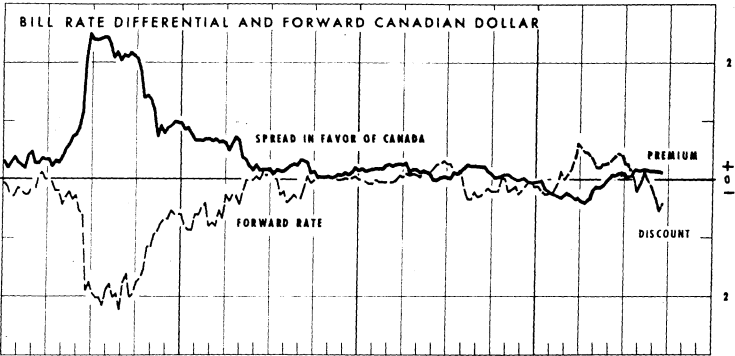
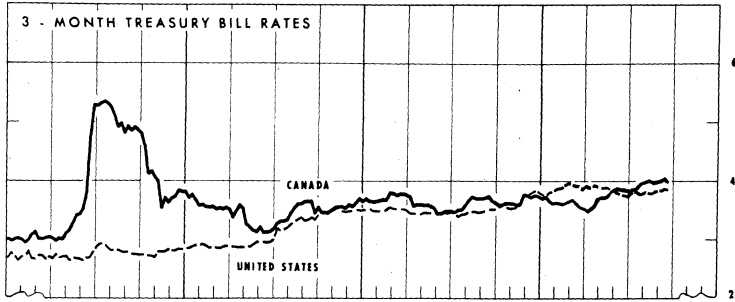
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Chart 2

### INTEREST ARBITRAGE, UNITED STATES / CANADA

Friday figures\*

Per cent per annum

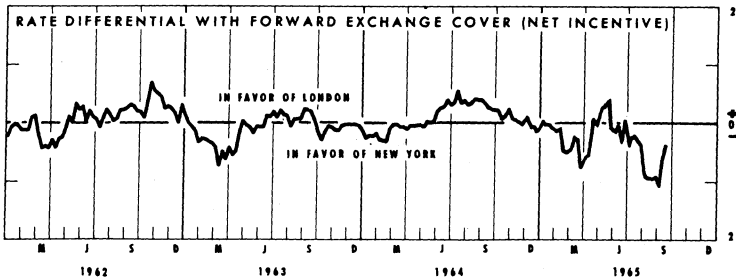
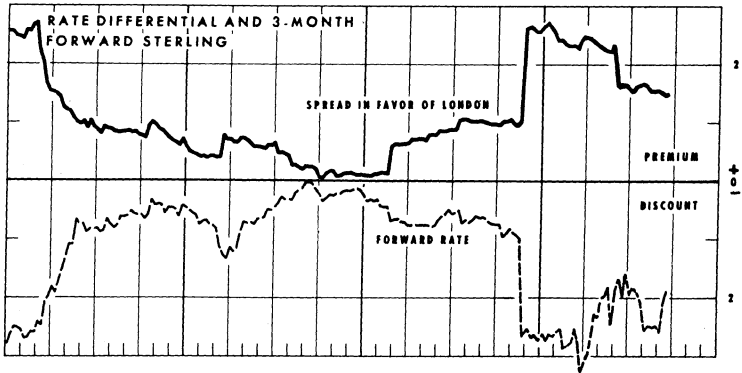
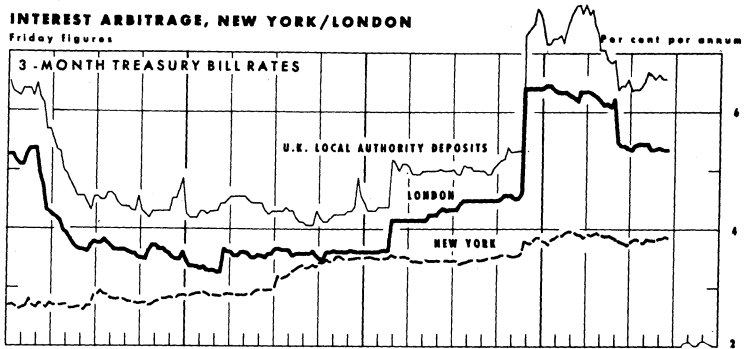


Thursday figures 1962, Friday thereafter

Chart 3

### INTEREST ARBITRAGE, NEW YORK/LONDON

Friday figures



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Chart 4

### INTEREST ARBITRAGE FOR GERMAN COMMERCIAL BANKS

Friday figures

Per cent per annum

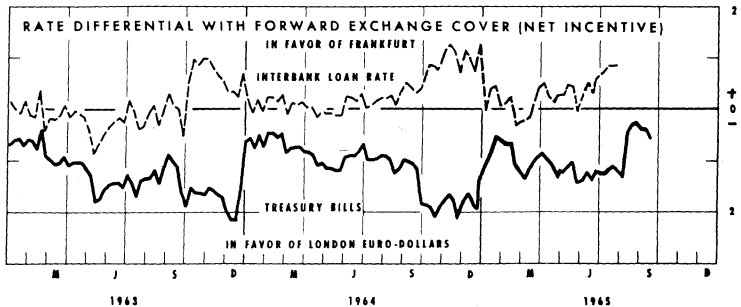
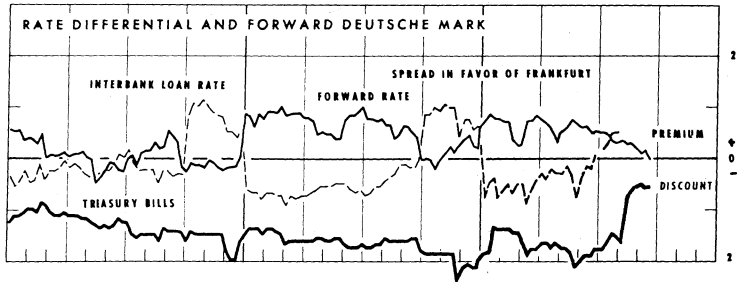
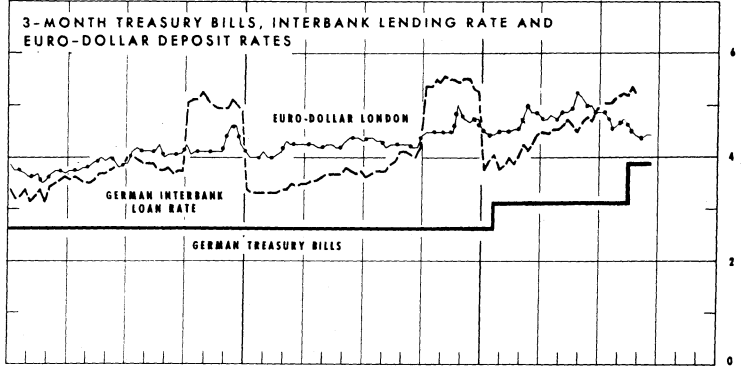
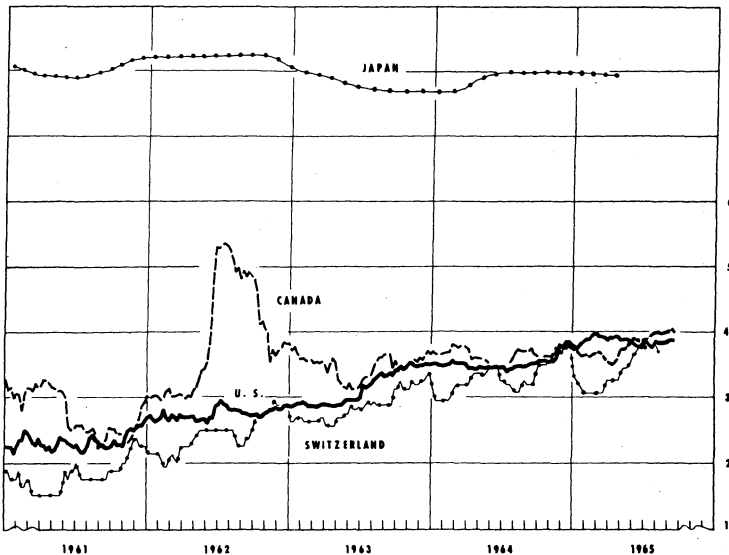
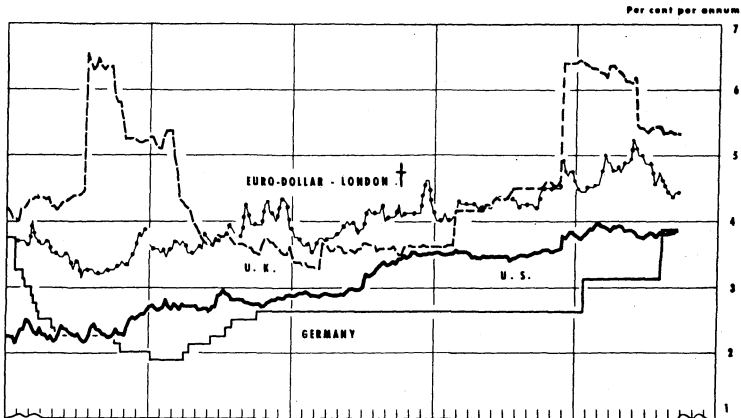


Chart 5  
SHORT-TERM INTEREST RATES\*



\* 3-month treasury bill rates for all countries except Japan (Average rate on bank loans and discounts) 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

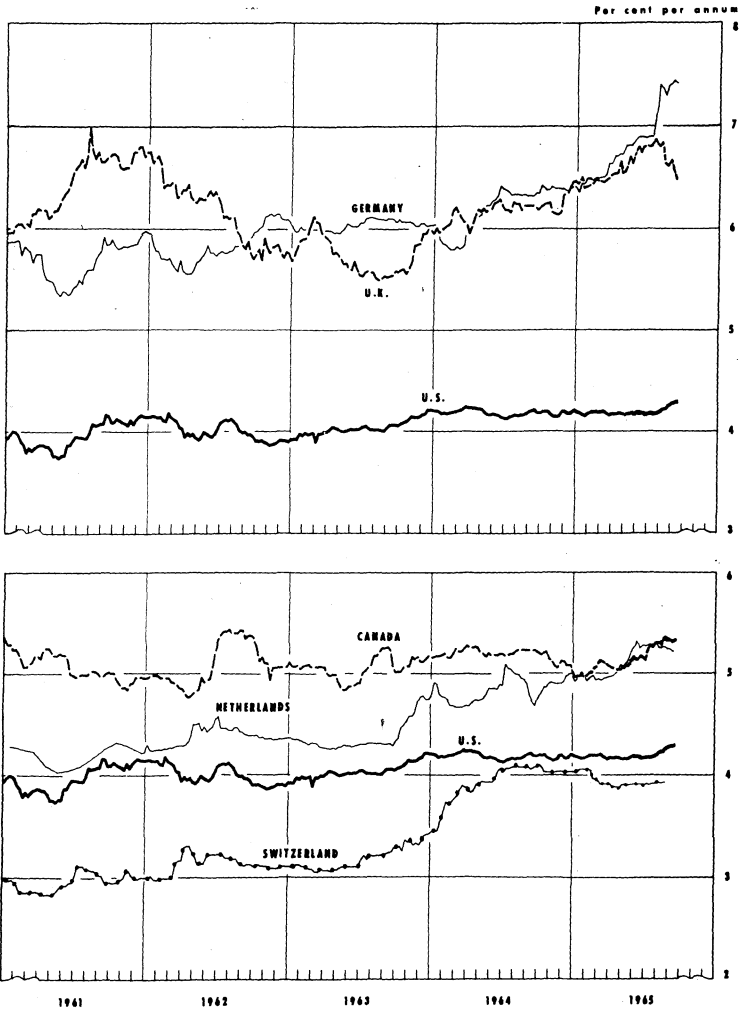
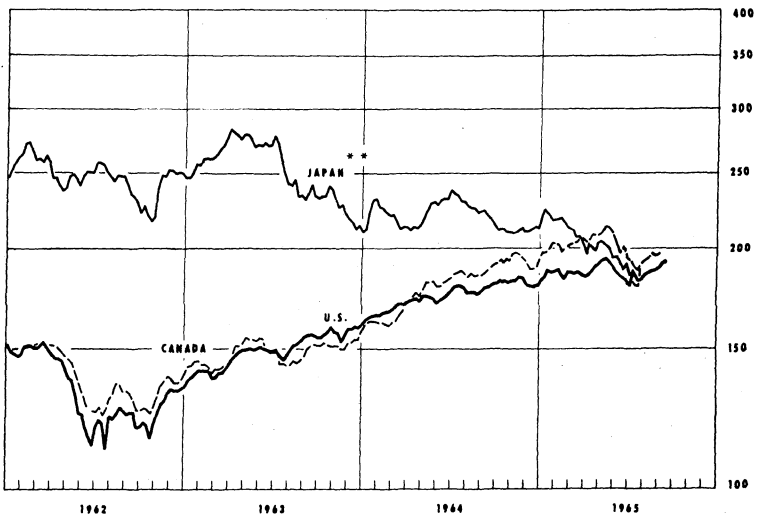
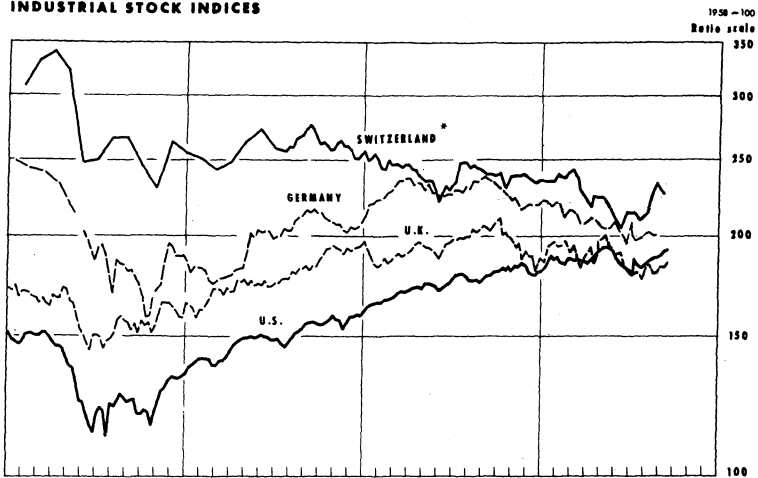


Chart 7  
INDUSTRIAL STOCK INDICES



\* Swiss Bank Corporation industrial stock.  
\*\* Japan: index of 225 industrial and other stocks traded on the Tokyo exchange.

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Chart 8

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

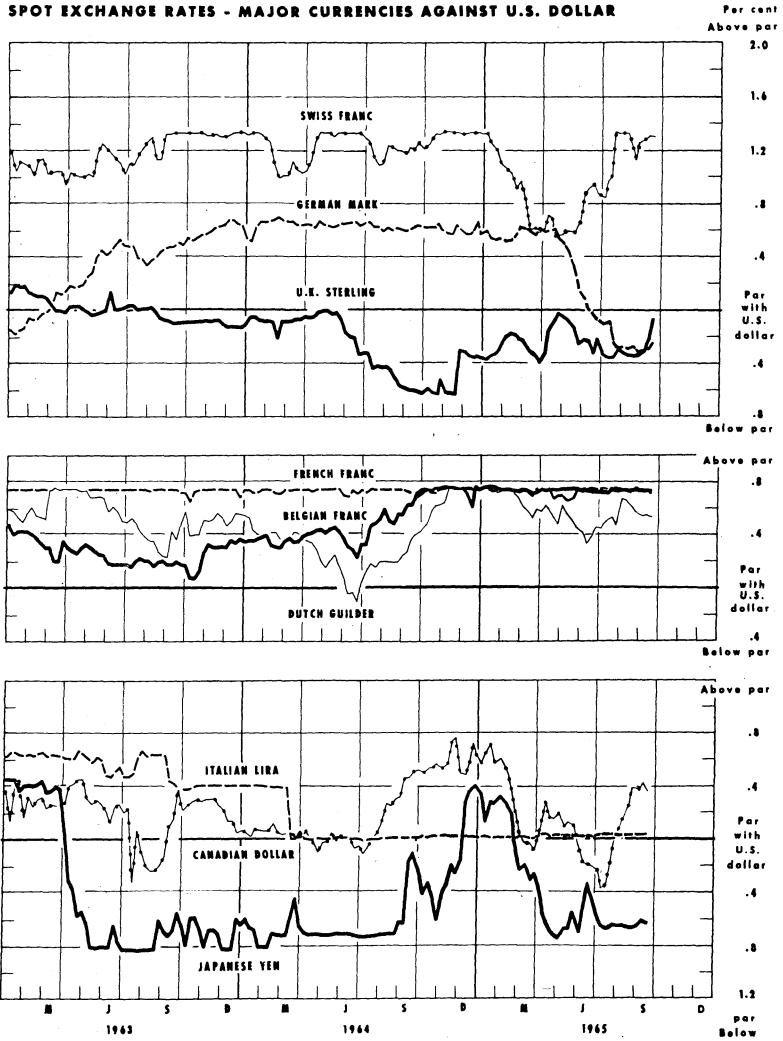
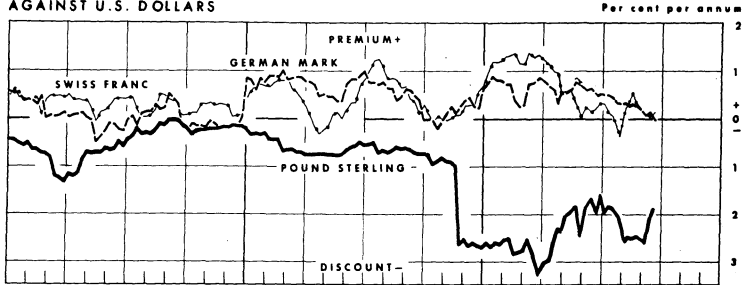
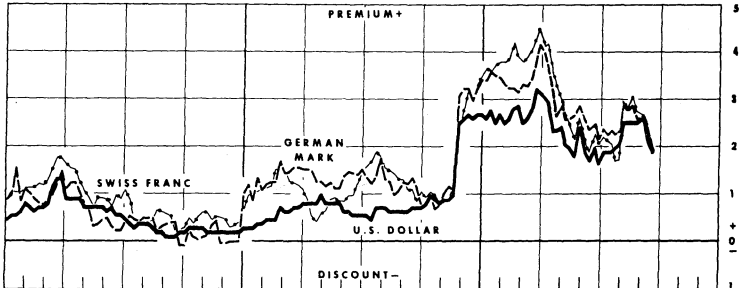




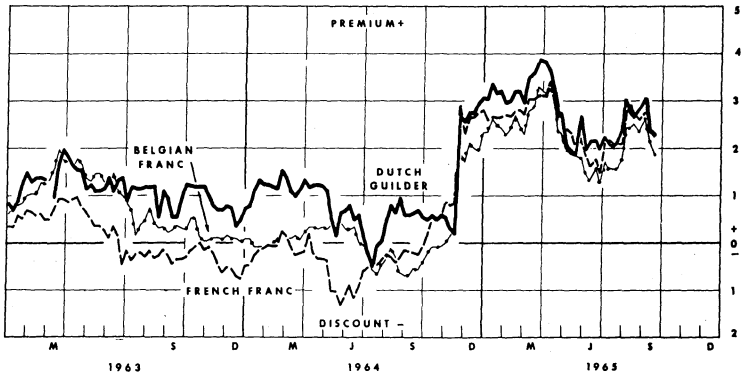
Chart 9  
**3-MONTH FORWARD EXCHANGE RATES**  
 Friday figures  
 AGAINST U.S. DOLLARS



AGAINST POUND STERLING - LONDON



AGAINST POUND STERLING - LONDON



III. Latest Figures Plotted In H.13 Chart Series, 1965

<u>Chart 1</u>	<u>Per cent per annum</u>	<u>Chart 5</u>	<u>Per cent per annum</u>
<u>Upper panel</u>		(Friday, <u>Sept. 17</u> , except as noted)	
(Wednesday, <u>Sept. 15</u> )		<u>Treasury bills:</u>	
Euro-\$ deposit	<u>4.44</u>	U.S.	<u>3.86</u>
U.S. certif. of deposit	<u>4.35</u>	U.K.	<u>5.36</u>
<u>Lower panels</u>		Germany	<u>3.88</u>
(Friday, <u>Sept. 17</u> )		Canada	<u>3.99</u>
Euro-dollar deposits: Call	<u>4.00</u>	Swiss 3-month deposits (Date: <u>Aug. 15</u> )	<u>3.69</u>
7-day	<u>4.12</u>	Euro-\$ deposit (London)	<u>4.44</u>
30-day	<u>4.31</u>	Japan: composite rate (Date: <u>Apr. 30</u> )	<u>7.921</u>
90-day	<u>4.44</u>	<u>Chart 6</u>	
180-day	<u>4.48</u>	<u>Bonds:</u>	
Finance Co. paper: U.S.	<u>4.25</u>	U.S. govt. (Wed., <u>Sept. 15</u> )	<u>4.29</u>
Canada	<u>4.66</u>	U.K. war loan (Thurs., <u>Sept. 16</u> )	<u>6.35</u>
Hire-purchase paper, U.K.	<u>4.80</u>	German Fed. Railway (Fri., <u>Sept. 10</u> )	<u>7.41</u>
<u>Chart 2</u>		Swiss Confederation (Fri., <u>Aug. 27</u> )	<u>3.93</u>
(Friday, <u>Sept. 17</u> )		Canadian govt. (Wed., <u>Sept. 15</u> )	<u>5.33</u>
Treasury bills: Canada	<u>3.99</u>	Netherlands government perpetual (Fri., <u>Sept. 10</u> )	<u>5.21</u>
U.S.	<u>3.86</u>		
Spread favor Canada	<u>+0.13</u>		
Forward Canadian dollar	<u>-0.40</u>		
Net incentive (Canada +)	<u>-0.27</u>		
<u>Chart 3</u>			
(Friday, <u>Sept. 17</u> )			
Treasury bills: U.K.	<u>5.36</u>		
U.S.	<u>3.86</u>		
Spread favor U.K.	<u>+1.50</u>		
Forward pound	<u>-1.88</u>		
Net incentive (U.K. +)	<u>-0.38</u>		